NORWAY'S BAD BOY
AN AUTHOR WHO REALLY PUTS IT ALL OUT THERE

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Hollande confronts a German puzzle

PARIS

Merkel likely to counter pro-growth proposals with call for integration

BY STEVEN ERLANGER

Armed with a new mandate and a solid legislative majority, France's François Hollande is off to do battle with the Huns in the name of growth, prosperity and human decency. Or that's the popular image, at least, of what in fact is a more delicate and nuanced relationship between the new French president and the German chancellor, Angela Merkel.

The co-partnership between Europe's two largest economies — the fourth- and fifth-largest in the world — has been vital to the functioning of the European Union and the 17-nation euro zone. And it has thrived under leaders from similar parties or different ones; the euro itself is a French-German confection.

But that marriage is under considerable strain at present, and France is very much on the defensive, not just because of the endless euro crisis, which is now undermining its southern European allies Spain and Italy, but from the growing weakness of the French economy as well, which makes the French-German couple less than equal.

Pascal Malville, 49, selling pastries at a Paris market, said he thought the Germans had it essentially right. "Hollande will be obliged to yield to German power," he said, "because it's Germany that's on the good path."

On Friday, Mr. Hollande will go to Rome to meet with Ms. Merkel and the Italian and Spanish prime ministers, Mario Monti and Mariano Rajoy, to discuss the euro zone crisis ahead of next week's E.U. summit meeting. On the agenda are plans to develop cross-border banking supervision and a proposal from Mr. Monti to use the E.U.'s bailout funds to buy sovereign debt to help hold down interest rates for countries like Italy and Spain.

It's not a new idea —there aren't many of those — and Ms. Merkel has been reluctant to accept it, since it could be another form of blank check signed by German taxpayers.

But Mr. Hollande is determined to show the French that he is willing to stand up to Berlin, to push Ms. Merkel to contribute even more than before toward a lasting solution of the euro mess, which is both financial and institutional. He believes that the German prescription — heavy on fiscal discipline, light on new spending — does not fit the euro disease in a recession. He casts himself as leader of what he hopes will be a new wave of left-leaning social democratic governments in Europe after long years of more conservative rule.

The problem for Mr. Hollande is that Ms. Merkel, while expressing support for some of his milder growth initiatives, is pushing back in a way that challenges France to the core.

Mr. Hollande brings to the table an argument for collectivized debt, or so-called euro bonds, and for the European Central Bank to be able to loan directly to banks and to the European bailout funds. In general, he wants the E.C.B. to operate more like the U.S. Federal Reserve, able to act as a lender of last resort to guarantee the debts of euro zone countries.

In response, Ms. Merkel contends that these steps must be a result of more political and economic union, not a precursor to it. Shared debt can only work if

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JOHN GRESS/GETTY IMAGES-AFP

François Hollande and Angela Merkel will discuss the euro crisis on Friday in Rome.

BUY BONDS WITH BAILOUT FUNDS?

Italy wants Europe's money used to reduce the borrowing costs of countries under siege by investors. *PAGE 17*

AUDITS OF SPAIN'S BANKING HOLE

The Spanish government planned to release two independent reports on the state of its banks Thursday. *PAGE 19*

Greece's new leader takes over, already fighting for survival

ATHENS

BY RACHEL DONADIO

To those who know him, Antonis Samaras has worked his entire life to become prime minister of Greece. But now that he has the job, it remains to be seen how long he will stay in power. With Greece's economy at a standstill and European leaders still uncertain about the country's fate, Mr. Samaras, a pro-European nationalist known for his stubbornness and his tactical approach, comes into power fighting for his political life.

His new role requires some political contortion. As opposition leader, Mr. Samaras opposed the terms of Greece's first loan agreement signed by the Socialist government in May 2010, saying it would destroy the economy and limit Greece's sovereignty. Although his predictions largely came true, he supported Greece's second bailout in February only after European leaders strong-armed him into signing.

His center-right party, New Democracy, placed first in elections on May 6 and on Sunday pledging to honor the loan

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AT LAST, A NEW GOVERNMENT INSTALLED

Greece ushered in a new government on Wednesday that will put it back at Europe's bargaining table. *PAGE 4*

Greece fills destabilizing leadership void

ATHENS

BY LIZ ALDERMAN
AND NIKI KITSANTONIS

Greece ushered in a new government on Wednesday that will put it back at Europe's bargaining table, ending a seven-week leadership vacuum that had destabilized this already fragile nation and cast a shadow over the euro zone's future.

Antonis Samaras, the leader of New Democracy, was sworn in Wednesday afternoon as prime minister in a televised ceremony conducted by Archbishop Ieronymos of the Greek Orthodox Church. Mr. Samaras is preparing to work with two other parties that agreed to form a coalition.

But whether his government will last more than a few months, or succeed in renegotiating some of the tough austerity terms of Greece's multibillion-euro bailouts with its European partners, remained an open question.

Together with the Socialist party, Pasok, and a moderate party that won 6.2 percent of the vote, the Democratic Left, Mr. Samaras is maneuvering to form an airtight majority coalition in Parliament. He hopes this will suffice to resist Syriza, the popular far-left party that has said it will fight if Mr. Samaras does not repudiate the most onerous terms of Greece's loan deals with its creditors.

Analysts noted that, with the economy in a downward spiral and the government bleeding cash, Mr. Samaras has little room for maneuver and scant chance of comforting Greeks.

The new government can "incrementally develop a certain sense of stability and certainty, but it will always be vulnerable to any shock — whether political or economic," said Marco Vicenzino, director of the Global Strategy Project, a geopolitical risk analysis firm based in London.

After he was sworn in by the archbishop — an inclusion of a religious figure customary in Greece, but unusual in much of Europe — Mr. Samaras emphasized the need for "patriotism, national unity and trust that with the help of God we can ensure that the Greek people emerge from the crisis as soon as possible." He said he would press his new cabinet to work hard, with the aim of giving Greeks "tangible hope."

"I am fully aware of the critical moments we face as a country," Mr. Samaras said during the handover with the outgoing caretaker prime minister, Panagiotis Pikrammenos, adding that the Greek people were "injured" and needed "healing."

Syriza signaled immediate tough opposition, bluntly stating that the new government would not be able to renegotiate the country's loan deal. The new administration has been "built on the basis of continuing the policies of the memorandum," it said, referring to the debt deal.

The president of the National Bank of Greece, Vassilis Rapanos, was expected to be named Greece's new finance minister. But in a sign of the challenges the new government will face, Evangelos Venizelos, the Pasok leader and a former finance minister who negotiated Greece's second debt deal with foreign creditors, said his party would not contribute politicians to the new cabinet — clearly an effort to avoid being associated with any additional austerity measures. Leaders of the Democratic Left had made similar statements.

The new Greek government came together just the day before European finance ministers gather in Luxembourg on Thursday to discuss Greece's troubles, which have exacerbated Europe's debt crisis by sowing doubts about the financial viability of two big euro zone economies, Spain and Italy.

The political turmoil in Athens has also been a thorn in the side of Chancellor Angela Merkel of Germany, who is facing a bailout-weary public as Germany foots a growing bill for the euro crisis. Greece is expected to need even more financial assistance from European taxpayers as its economy continues to stumble.

The troubles are being watched closely in Washington, where President Barack Obama does not want to see the European crisis that began in Greece ricochet back to the American economy before presidential elections in November.

"If something else happens in Greece, the chain reaction in Europe will impact the U.S. economy, and Obama's own presidency could be at stake if the situation cannot be stabilized," Mr. Vicenzino said.

George Zannias, the departing finance minister, is expected to represent Greece at Thursday's meeting. He will face representatives of Germany, France and other nations that have been exasperated with the slow progress Greece has made in implementing reforms that the nearly bankrupt country agreed to over the last three years in exchange for hundreds of billions of euros in financial support.

ALKIS KONSTANTINIDIS/EUROPEAN PRESSPHOTO AGENCY

Greeks receiving free vegetables Wednesday at a market in Athens set up by farmers from the island of Crete for the unemployed and poor.

"We have to prepare very well for the European summit; it will be the first battle to change the program and return to growth," said Mr. Venizelos, referring to Greece's debt deal with creditors.

The new government will face a daunting double mandate: to enforce the loan agreement with foreign creditors — the European Central Bank, the International Monetary Fund and the nations of the European Union — while renegotiating enough of the bailout to keep the government in power despite mounting social unrest.

Greece has repeatedly missed targets and dragged its feet on painful structural reforms like reducing its vast public sector, improving haphazard tax collection and raising billions of euros through privatizations.

But given the distress the austerity package has wrought, the troika of creditors has signaled willingness to discuss bailout terms more adapted to a rapidly unraveling economy.

Elizabeth Prodromou, a professor of international relations at Boston University who closely follows Greece and the East Mediterranean countries, said the strength and duration of Mr. Samaras's government would rest on its ability to quickly broker a renegotiation before the country runs out of money and faces potential shortages of basic goods like medicine.

That could undermine the larger challenge of undertaking unpalatable structural reforms seen as a basic minimum to put Greece on a long-term path to growth.

"This is a make or break moment for New Democracy and Pasok," Ms. Prodromou said. "For the last 38 years, these two governments have alternated power. Now is the time for them to demonstrate they are doing something positive for the Greek economy and for society."

Rachel Donadio contributed reporting.

Greek premier will govern unruly group

GREECE, FROM PAGE 1

agreement but to renegotiate the terms, a stance that won him enough votes to edge out Syriza, the leftist party that placed a close second with its pledge to tear up the deal.

Now, Mr. Samaras, a youthful 61, must wrest enough concessions from Brussels to satisfy his constituents and push through enough changes to the economy to satisfy foreign lenders. He must also govern an unruly coalition that includes his party's longtime Socialist rival, Pasok, and a smaller leftist party who have little common ground besides a desire to prevent collapse.

Although European leaders had hoped for a victory by New Democracy over Syriza, some European officials say privately that Mr. Samaras will have to work hard to gain trust and good will, given his strident opposition to the first bailout deal and his weeks of foot-dragging last autumn on the second.

Many Greek voters switched parties to support Mr. Samaras as their last best hope to save the country from immediate exit from the euro. Mr. Samaras ran on a platform promising to change the policy mix in the loan agreement with lower taxes and restoring cuts to pensions, although he did not convincingly spell out where the money would come from in a country whose coffers are expected to run dry as soon as mid-July.

Even in opposing the first loan deal, his party has supported the privatizations of state assets required by it and criticized the Socialists for not carrying them out.

Mr. Samaras has steadfastly insisted that Greece needed more growth, saying tax cuts would be more helpful than tax increases and that the austerity medicine prescribed by international creditors was making problems worse. Despite that, Mr. Samaras has been vilified from the far left and the far right as a traitor for signing the deal.

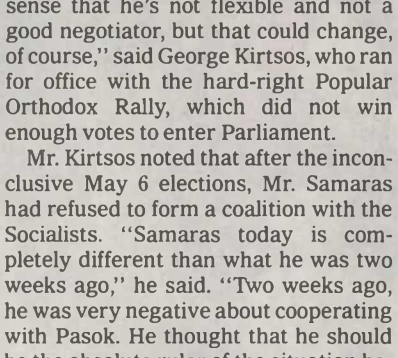
"Although he comes from the conservative background of New Democracy, he has an open mind on both sides of the spectrum regarding problems of social cohesion and social justice," said Chrysanthos Lazaridis, a member of Parliament from New Democracy who is one of Mr. Samaras's close advisers. As a trained economist, "he has an open mind to allowing market forces to do their job without letting social cohesion unravel," he added.

Critics say that Mr. Samaras destabilized Greece with his insistence on calling elections to replace the technocratic government of Prime Minister Lucas Papademos, whose mandate was to sign Greece's second loan agreement. "He just wanted to be prime minister," said Thanos Veremis, a political historian who said he voted for New Democracy as a last resort. "It was pure ambition, pure and simple. Even in this state of collapse, he wanted to be Nero, playing his harp."

Others questioned whether Mr. Samaras could manage a coalition government. "He's kind of stubborn in the sense that he's not flexible and not a good negotiator, but that could change, of course," said George Kirtsos, who ran for office with the hard-right Popular Orthodox Rally, which did not win enough votes to enter Parliament.

Mr. Kirtsos noted that after the inconclusive May 6 elections, Mr. Samaras had refused to form a coalition with the Socialists. "Samaras today is completely different than what he was two weeks ago," he said. "Two weeks ago, he was very negative about cooperating with Pasok. He thought that he should be the absolute ruler of the situation because otherwise he wouldn't be able to implement his own economic policy."

Educated at Athens College, an elite high school founded by his ancestors, Mr. Samaras, like many politicians, has spent his entire career in office. He was first elected to Parliament at age 26 in 1976, after receiving an M.B.A. from Harvard Business School and an undergraduate degree in economics from Amherst College. There, he lived in the same dormitory as George A. Papandreou, who later became prime minister as a member of Pasok and whose efforts to convince Mr. Samaras to join a coalition government in June 2011 failed, setting off an acute phase of the euro crisis.



PETROS GIANNAKOURIS/AP

Antonis Samaras was sworn in as Greece's prime minister on Wednesday in Athens.

Since the fall of the military dictatorship in 1974, Greek politics has been dominated by three families: the Papandreou family for the Socialists and the Mitsotakis and Karamanlis families with New Democracy. So Mr. Samaras has long played the role of the ambitious outsider.

As Greece's foreign minister in 1992, he signed the Maastricht Treaty, which set out the criteria for the single currency. But that year, he was fired from the government of Constantinos Mitsotakis when he objected to allowing the Former Yugoslav Republic of Macedonia to call itself simply Macedonia. After leaving the government, he set up his own party, Political Spring, triggering the collapse of the Mitsotakis government in 1993.

Mr. Samaras then stayed on the sideline of Greek politics for more than a decade, returning to New Democracy in 2004 and becoming a member of the European Parliament. In 2009, he defeated Dora Bakogiannis, the daughter of Mr. Mitsotakis, to become party leader. Last year, he kicked her out of the party for supporting the loan agreement, only to reconcile with her after the May 6 elections.

Although his campaign oratory has often been fiery, in person, Mr. Samaras is soft spoken, reflective and a bit introverted. In Greek politics, he is known for his patience as much as his ambition.

Mr. Samaras is a descendant of two of Greece's most well-established families. His father was a cardiology professor and his mother was the granddaughter of Penelope Delta, a beloved Greek writer who committed suicide on April 27, 1941, when the Nazis invaded Athens.

Mr. Samaras recounted that grim episode in a campaign speech on April 27, sounding a nationalist note that resonated with Greeks who believe the loan deal is a loss of sovereignty to Germany. In an election in which Golden Dawn, a neo-Nazi party known for its violent scuffles with immigrants, won 18 seats in Parliament, Mr. Samaras also tacked hard to the right on immigration issues.

Now, Mr. Samaras must score points at home by criticizing Germany while working closely with the Germans to try to negotiate a better deal for Greece.

Martin Schulz of Germany, president of the European Parliament, captured Europe's wariness toward the new Greek prime minister. "Mr. Samaras has not made himself known for his reliable comments," Mr. Schulz told German public television, ARD. "In the past, he was one of those who rejected all reform measures proposed by George Papandreou."

But Mr. Schulz said he believed Mr. Samaras was capable of forming a government that could work together with Europe. "I trust him to become a responsible partner," Mr. Schulz said.

In large part, the success of Mr. Samaras's government could also determine the fate of both New Democracy and Pasok, which have alternated power for nearly four decades and which critics see as having helped bring Greece to the point where it required a bailout.

"I think the future of both parties lies in this merger," said Mr. Veremis, the historian. "If they fail to pull it off, they will both go down the drain under the Syriza onslaught, which is bound to come soon."

Niki Kitsantonis in Athens, David Jolly in Paris, Paul Geitner in Brussels and Melissa Eddy in Berlin contributed reporting.

Confusion grows as lawyer denies report on Mubarak

EGYPT, FROM PAGE 1

that declared him "clinically dead," just as the military council was trying to extend its hold on state power indefinitely in the face of growing street protests demanding that it cede authority to a newly elected president and reinstate the dissolved Parliament. Egyptian officials, the state news agency and official media said he had been removed from the prison to a hospital after a stroke and heart attack had left him in a coma, near death and dependent on artificial life support.

Mr. Abdel Razeq denied that on Wednesday. What really happened, the lawyer said, was that Mr. Mubarak had suffered a fall in the prison bathroom, resulting in a blood clot on his neck, and that he had been removed from the prison at 5 p.m. — long before the reports of his near-death experience began to appear.

"We were surprised at what we can call a media mania in Egypt last night," the lawyer said.

He said that doctors had quickly given Mr. Mubarak medicine to remove the blood clot, and that Mr. Mubarak underwent a medical scan and was in stable condition. Mr. Abdel Razeq said Mr. Mubarak's legal team had filed a request with an administrative court seeking Mr. Mubarak's full release on medical grounds. And he said that they were open to sending Mr. Mubarak abroad for medical care out of the country as well, just as he had traveled to Germany two years ago for intestinal surgery. "If the doctors recommend that, of course," Mr. Abdel Razeq said.

Earlier Wednesday, security officials said that Mr. Mubarak was breathing on his own and that his condition was nearly stable.

The former president's health has been a source of constant speculation and suspicion since his imprisonment. Mr. Mubarak has had health problems for years, but the flood of reports and scares in recent weeks led many Egyptians to believe that the military rulers, determined to move Mr. Mubarak from prison, were using those accounts to prepare the public for such a move.

Low-ranking security officers, speaking on condition of anonymity for fear of reprisals, speculated Wednesday that the previous night's reports that Mr. Mubarak was on the edge of death were part of a scheme to transport him out of Egypt for care. Indeed, many Egyptians wondered whether the state news agency reports of his near death were all a morbid hoax.

Security outside the hospital where Mr. Mubarak was said to be staying was light for a facility housing the former head of state. Civilians came and went freely through a side door of the hospital Wednesday, and two people leaving the grounds said they noticed no change in the hospital's operations or security.

The news accounts of his failing health late Tuesday spread quickly through Tahrir Square, the birthplace of the uprising, where tens of thousands of people were protesting the military council that is governing Egypt. In recent days, the generals had moved to seize the kind of uncontested authority that the former president wielded during his nearly three decades in power.

The confusion over Mr. Mubarak's health injected new volatility into the country's growing political and constitutional crisis, even as the two candidates to replace Mr. Mubarak as president both declared themselves the winners of the election over the weekend. The result is scheduled to be announced Thursday, although Egypt's election committee said Wednesday that it might not be ready to declare the winner by then because it was still reviewing appeals from the two candidates.

On Monday, Mohamed Morsi, a Brotherhood leader, said he had won Egypt's first competitive presidential election, beating Ahmed Shafik, Mr. Mubarak's last prime minister, with 52 percent of the vote.

The votes were counted publicly at the polling stations, and Egyptian state news media reported the same count as the Brotherhood. Official vote results are expected to be announced this week, but on Tuesday, Mr. Shafik disputed several of the tallies, including those reported in the state news media, that forecast Mr. Morsi as the winner.

A spokesman for Mr. Shafik, Ahmad Sarhan, said without explanation that he had won with 51.5 percent of the vote. But that announcement seemed another tactic in a battle that began before voters went to the polls.

Jimmy Carter, the former U.S. president, whose Carter Center monitored the election, said in a statement on Tuesday that he was "deeply troubled by the undemocratic turn that Egypt has taken." The center expressed its "grave concern about the broader political and constitutional context, which calls into question the meaning and purpose of the elections."

Mr. Carter said that in contrast to the first round of voting last month, some international observers had been subjected to "heightened scrutiny and intimidation from military personnel" during voting.

Mayy El Sheikh, Dina Salah Amer and Liam Stack contributed reporting.

A discount shop in Athens, where the debt crisis first emerged. European leaders are scrambling to contain further contagion after bailouts in Ireland, Portugal and Spain.

Focus shifts to Italian debt plan

LONDON

Germany's chancellor, whose support is crucial, leaves door slightly open

BY STEPHEN CASTLE

An Italian proposal to use Europe's money to reduce the borrowing costs of Italy, Spain and other countries under siege by investors has become the new hot topic on the euro zone's agenda.

Prime Minister Mario Monti of Italy has started urging that the euro zone's bailout funds, along with money from the European Central bank, be used to buy Spanish and Italian bonds, whose yields have been dangerously high lately. Those yields, or interest rates, did slip lower Wednesday, on hopes that Europe might intervene.

It remains far from clear, though, whether Germany would countenance such proposals. German support would be crucial for any such shift in policy, but the question would hinge on what kind of conditions would be required in return.

That could become clearer on Friday, when Angela Merkel, the German chancellor, meets with her Italian, Spanish and French counterparts in Rome.

Ms. Merkel left an opening Wednesday, saying in Berlin that Europe's bailout funds could buy state debt on the secondary market. Although she said that subject had not been raised with her, and underscored the fact that it was "theoretical," she said it remained "one of the options" for bringing down yields on Spanish and Italian bonds.

Mr. Monti's proposal would aim to create a mechanism to keep the interest-rate gap between German bunds and other euro zone bonds within a certain range, according to one euro zone official not authorized to speak publicly. To benefit from the arrangement, countries would have to abide by the European Union's tight fiscal rules but would not face additional conditions.

The euro zone's temporary bailout fund, the European Financial Stability Facility, and its permanent replacement, the European Stability Mechanism, which is scheduled to start operating next month, already have the power to buy bonds in the primary and secondary markets. This capacity has not yet been tapped, however.

Ms. Merkel, appearing with Prime Minister Mark Rutte of the Netherlands, said there was "no concrete planning that I'm aware of" for the bailout funds to begin buying bonds. "But it is

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Audits add to pressure on Spain to fill its banking hole

MADRID

Estimates of bad loans may not reflect depth of problems, analysts warn

BY RAPHAEL MINDER

Spain's government plans Thursday to release two independent reports on the state of the country's banks, which Madrid has said it is waiting for to determine how much of the €100 billion European bailout offer it actually needs.

A ballpark figure of around €60 billion, or $76 billion, is already widely assumed. And any subsequent, deeper audit of the murky loan portfolios of the most troubled Spanish banks is likely to take time that Madrid simply does not have.

NEWS ANALYSIS

Spain, in fact, is being accused of dithering over the details of the bailout process at a time when the financial markets are anxious to know what steps the government intends to take to fix the underlying problems of its banking system.

"I don't think Mariano Rajoy's government will be capable of restoring investor confidence because too much has been lost already, and constant standoffs with Angela Merkel over timing and conditions are only making things worse," said Edward Hugh, an economist based in Barcelona, referring to the German chancellor. Eventually, he predicted, "Spain will need a full bailout and very strict conditions and monitoring."

The latest test of market sentiment will come Thursday, when the Spanish Treasury plans to sell as much as €2 billion of bonds, even as its borrowing costs reach record levels.

However fragile the euro zone is looking, such European interdependency is one reason Spain's borrowing costs fell back somewhat Wednesday. The decline came amid reports that the Italian prime minister, Mario Monti, and other European leaders were scrambling to come up with a new and larger financial solution to the euro debt crisis, before the situation worsened for Italy and other fragile economies.

In such a context, "a strong statement from the Spanish government detailing how it intends to reform its banks is what is needed now," said Tony Anderson, a partner in London at the law firm Pinsent Masons. "Otherwise we have another leaking bucket to refill, and no one able to agree on the size of the bucket or the size of the holes."

DANIEL OCHOA DE OLZA/THE ASSOCIATED PRESS

A woman begging in Madrid. The credibility of stress tests has suffered from flawed attempts to use them earlier in the euro crisis, most notably by the European Banking Authority.

Whatever the findings are Thursday, the Spanish government has insisted that it will not shut down crippled institutions. That stance has already prompted a dispute with Brussels, where Joaquín Almunia, Spain's representative in the European Commission, suggested this month that Spain should close at least one of its failed banks.

Even though the audit reports, or stress tests, due Thursday will do little to shed light on how Madrid plans to overhaul its most troubled banks, "the stress tests are not a pointless exercise," Mr. Hugh said. "They will give markets a number to work around, and that in itself has a value."

That number is widely believed to be around €60 billion, as reflected in a separate analysis published Wednesday by Fitch Ratings, the credit agency. Fitch estimated a capital shortfall for the domestic loan portfolio of Spanish banks of €50 billion to €60 billion under a favorable simulation, but that figure could rise to €90 billion to €100 billion under worse conditions — along the lines, say, of the banking collapse in Ireland.

The reports are being put together by Oliver Wyman and Roland Berger, two consulting firms retained by the Spanish economy ministry in May, giving them just a month to work out how much extra capital the banking sector would need to stay afloat.

They were hired after the demise of Bankia, a giant mortgage lender nationalized in early May that is in line to receive €19 billion of the rescue capital offered by Europe. The hiring process was also clouded by a last-minute decision to appoint Roland Berger, a leading German firm but one with little previous experience in Spanish banking, instead of the investment firm BlackRock, because of concerns about a possible conflict of interest with BlackRock's fund management activities.

In addition to working under a tight deadline, the two firms have also had to rely on data from the Bank of Spain rather than go through the banking portfolios themselves. The risks such a second-hand approach presents were demonstrated last month by Bankia, when it restated its 2011 accounts. A profit of €309 million reported in February suddenly became a loss of €3 billion, the largest in Spanish banking history.

The credibility of stress tests has also suffered considerably from flawed attempts to use them earlier in the euro debt crisis, most notably by the European Banking Authority. The authority gave clean bills of health to Irish and Spanish banks, whose losses subsequently turned out to be significant enough to require bailouts.

"Unfortunately there is no easy solution — stress tests have become a key part of the toolkit in dealing with the reshaping of banks," said Nils Melngailis, the managing director for the financial services team in London at Alvarez & Marsal, a consulting firm that was involved in assessing Greek and Irish banks. But such stress tests, he added, "need to be carefully calibrated to be credible."

The reports issued Thursday are expected to divide Spanish groups into different categories, one of which will indicate institutions that cannot survive without further rescue financing.

Armed with the new estimates of capital requirements, the Madrid government is expected to move swiftly to negotiate the final terms of the European rescue package.

Mr. Rajoy has remained defiant as bond investors push up Spain's borrowing costs. "The fundamentals of the Spanish economy remain well above the risk premium and the debt cost that is being paid at this moment," he said at a news conference Wednesday after the conclusion of the meeting of leaders of the Group of 20 in Mexico.

"A strong statement from the Spanish government detailing how it intends to reform its banks is what is needed now."

Spanish debt has become even less attractive lately because investors wishing to trade Spanish government bonds through LCH.Clearnet, the largest clearing house in Europe, will have to put up additional money to buffer trades, or margin requirements. Investors trading Spanish 10- to 15-year debt, for example, must now put up 14.7 percent of the value of the securities in a margin account, compared with 13.6 percent previously, the clearing house said Tuesday.

Higher margin requirements mean investors must commit more capital to a transaction, reducing their overall funds for investment.

The Spanish government also separately hired four firms to audit the accounts of the 14 largest Spanish banks, encouraging them this time to actually examine the banks' books to pick up on the kind of auditing failures that surfaced at Bankia. Those audits, though, are not expected to be completed until the end of July. On Tuesday, the economy ministry denied rumors that those audits might not be presented until September.

David Jolly contributed reporting from Paris.

With Germany, Hollande must tread carefully

FRANCE, FROM PAGE 1

there is shared decision-making over budgets, taxes and pensions, she says.

That's why Ms. Merkel is pushing to move ahead with the long-stalled process of European integration. As the former foreign minister and Green party stalwart Joschka Fischer said, "you can't mutualize the debt without mutualizing sovereignty; you can't have the financial benefits of a state without having one."

But "more Europe" would mean a considerable loss of French sovereignty over its budget and financial system, an extraordinarily sensitive issue for Mr. Hollande and the Socialist Party, which split badly on a similar issue in 2005.

"Merkel's call for fuller political, fiscal and budgetary union in the euro zone, though without details, creates problems for Hollande," said Thomas Klau of the European Council on Foreign Relations. "Hollande will have to accept or reject a course to euro zone integration sooner rather than later, and that will revive the French debate over how much sovereignty to transfer to Brussels."

In his delicate dance with Ms. Merkel, Mr. Hollande is seeking support not just in Rome and Madrid but even in Ms. Merkel's backyard: just last week, he invited leaders of Germany's Social Democrats, her opposition, to Paris.

The invitation was judged a barbed message to the chancellor, who openly supported former President Nicolas Sarkozy and refused to meet Mr. Hollande when he was campaigning.

There are dangers to too much antagonism. "Without a partner in Paris ready to cooperate, overcoming the crisis is not conceivable," the Frankfurter Allgemeine Zeitung said in a front-page editorial this week.

So at the same time, Mr. Hollande has sent softer signals, wanting to modify, but not destroy, the French-German equation. His first visit, within hours of taking office, was to Berlin. He has named German speakers to key posts, including the prime minister, Jean-Marc Ayrault, and spoken often of the need to work with Berlin. His actual proposals for a "growth pact" to go alongside the German-inspired fiscal treaty are modest, making it easy for Ms. Merkel to accept most of them.

Mr. Hollande's majority in Parliament gives him some breathing space, said Mr. Klau. "Domestically, his powers are almost unparalleled, but for Europe, they are much more restricted."

Any moves toward further union within Europe will require constitutional change, and because Mr. Hollande does not have the three-fourths majority necessary in Parliament, he would face almost irresistible demand for a referendum. "That's the one scenario where the French president loses his power to French politics and the voters," Mr. Klau said. The Gaullist center-right would attack, and the process would reopen the political arena to anti-European voices on the far right and far left.

The issue of sovereignty is real for France, in part because it is so much weaker economically than Germany, which has emerged bigger and stronger than ever after the costly, problematic process of reunification.

France has always wanted what Charles de Gaulle called "l'Europe des patries," or the Europe of homelands or nations, with key decisions firmly in the hands of national leaders. But "more Europe means more centralized institutions with more power, and that means more Germany," said a senior diplomat, who spoke on condition of anonymity. "To agree to a more supranational Europe is also to agree to more German leadership in Europe."

Ms. Merkel is pushing back in a way that challenges France.

Mr. Hollande's proposal for a "growth pact" at the European Union summit meeting later this month is actually modest; Ms. Merkel has already signaled her acceptance of its key elements.

The total spending in the program is about €120 billion, and it involves very little new money. The French package retargets €55 billion in existing E.U. funds for job creation, calls on the European Investment Bank to make an additional €60 billion in loans to private businesses and creates €5 billion in "project bonds" for infrastructure. At best, the sum represents less than 1 percent of annual E.U. economic activity.

More important are proposals pushed by the European Central Bank and the European Commission for Europe-wide banking regulation and deposit insurance. But like the Italian plan to allow Europe's bailout fund to buy sovereign debt directly, it is not clear whether Germany will accept either one.

At their first news conference in Berlin, Mr. Hollande and Ms. Merkel said that they would come forward with joint proposals before the June 28-29 summit meeting. So far, they haven't.

But there is still time. On Monday, Ms. Merkel's deputy, Georg Streiter, said that "she does not associate France with concern, but with hope." Germany has long enjoyed "very close, trusting and friendly relations" with France, Mr. Streiter said. "That is not going to change."

Melissa Eddy and Nicholas Kulish in Berlin and Palko Karasz in Paris contributed reporting.

Fed worries about recovery

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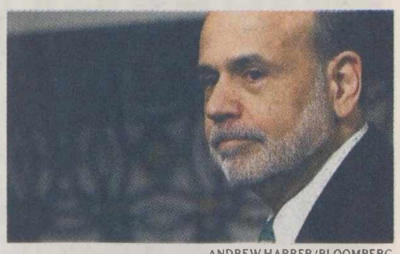
appears to be growing at a moderate pace that would attract little comment in normal times, but that is far too slow to make up for the vast loss of wealth and jobs during the recession. Mr. Bernanke and his allies have shown little desire to drive growth much above this modest pace.

After falling rapidly in the closing months of 2011, the unemployment rate has stalled above 8 percent during the first half of this year. But Fed growth projections released in April suggested that the economy would expand fast enough to modestly reduce the rate during the rest of the year.

Mr. Bernanke told Congress in testimony this month that the Fed would consider additional action if it concluded that the economy would not grow fast enough to reduce unemployment, as inflation was under control.

The decision is further complicated by a pair of looming risks: that events in Europe will freeze global financial markets and that political dysfunction in Washington will undermine the domestic recovery. Some influential members of the Fed's policy committee argued in recent weeks that the Fed should consider increasing its efforts to stimulate the economy as an insurance policy against potential disruptions.



ANDREW HARRER/BLOOMBERG

Ben S. Bernanke, the Fed chief, had promised action if unemployment stayed high.

China to regulate rare earths

HONG KONG

BY KEITH BRADSHER

The Chinese cabinet issued its first white paper on rare-earth industry policies Wednesday, acknowledging that poorly regulated mining of rare-earth metals had caused widespread environmental damage and promising an extensive cleanup and a crackdown on illegal mines.

The document warned that inefficient mining and refining practices had squandered scarce mineral reserves and produced extensive emissions of radioactive residues, heavy metals and other contaminants.

"Excessive rare earth mining has resulted in landslides, clogged rivers, environmental pollution emergencies and even major accidents and disasters, causing great damage to people's safety and health and the ecological environment," the white paper said.

China produces more than 90 percent of the world's rare earth metals, which are essential to high-technology applications including smartphones and smart bombs and are also used in oil refining, glass polishing, batteries, electric car motors and many other industrial applications.

The document comes after the United States, the European Union and Japan jointly filed a case in March at the World Trade Organization that challenged China's restrictions on rare earth exports, which were imposed in 2006 and have been repeatedly tightened since then. The W.T.O. case alleges that the export quotas and tariffs violate free trade rules by putting pressure on companies to move their factories to China if they want to tap China's vast supply of rare earths.

Chinese officials have previously signaled that their defense in that cas[e] will be to use a provision of W.T.O. rules that allows export restrictions for environmental protection and the conservation of scarce natural resources. But they were quick to deny Wednesday that this had been their motive for releasing the white paper.

"The protection of the environment is never a pretext for gaining advantage or increasing economic returns," Su Bo, a deputy minister of industry, said at a news conference in Beijing.

The white paper says China has only 23 percent of the world's rare earth reserves and has already depleted the most accessible reserves. But the U.S. Geological Survey a year ago raised its estimate of Chinese rare earth reserves, to half the world's supply, compared with a third of the world's reserves.

Various local and provincial governments across China have announced numerous discoveries of large rare earth deposits in recent years, yet Beijing officials have scarcely changed official estimates for nationwide reserves, rare earth industry experts point out.

Merkel leaves door open for shift in euro crisis response

BONDS, FROM PAGE 17

possible to buy state bonds on the secondary market through the E.F.S.F. and the E.S.M. — naturally always bound together with conditionality," Ms. Merkel said. "But that is an entirely theoretical statement with regard to the situation according to treaties."

The bailout funds are not limitless. The temporary fund, the E.F.S.F., will have €248 billion, or $315 billion, left after Greek, Irish and Portuguese bailouts have been accounted for.

The permanent fund is supposed to have reserves of €500 billion. But not all of that money will be available this year. And even that would not go very far if it is tapped for part of the €100 billion being promised to Spain for its banks — or if the Spanish government itself should eventually need a bailout.

So far, it has been left to the European Central Bank to intervene to buy bonds of euro zone countries in the context of its mission to maintain price stability. But the E.C.B. appears to have become reluctant to intervene in bond markets, possibly because the market benefits of such moves seemed to be fading. The bank said Monday that it did not buy any government bonds last week, the ninth week in a row with no purchases.

Recently, Spain and Italy's bond yields rose to levels that analysts said would make those countries' borrowing costs unsustainably high. As recently as Monday, Spain's 10-year bonds surpassed the 7 percent level, the highest rate for those bonds since the advent of the euro currency union. But since Monday, both countries' bond rates have fallen back a bit. Spain's 10-year bonds traded Wednesday to yield 6.66 percent, while Italy's were at 5.74 percent. Spain plans to sell additional bonds Thursday.

Mr. Monti, speaking Tuesday in Mexico at the meeting of leaders of the Group of 20 biggest economies, said talks were under way to ensure bond market support for South European nations.

"The idea is to stabilize borrowing costs, especially for countries who are complying with their reform goals, and this should be clearly separated from the idea of a bailout," Mr. Monti said.

France's new president, François Hollande, said that no decisions had been made, but that the idea was worth exploring and would be discussed at Friday's meeting in Rome with Mr. Monti, Ms. Merkel, and the Spanish prime minister, Mariano Rajoy.

"Italy has launched an idea which is worth looking at," Mr. Hollande said.

Under E.U. rules, were the E.F.S.F. to buy a country's bonds, it would first require a formal request from that country. Purchases would only be made under previously agreed conditions that would have to be spelled out in a formal accord, or memorandum of understanding.

"If those countries want help and if they cannot withstand the current borrowing rates, they have to say it and then the euro zone would look at it," said one euro zone official not authorized to speak publicly.

A spokesman for the European Commission, Amadeu Altafaj, said Wednesday that there had been no formal request for the E.U. bailout funds to be used to relieve tension in bond markets.

Another idea making the rounds of European policy makers is changing the rules for the euro zone bailout fund to allow it to inject cash directly into banks, without channeling resources through national governments and thus increasing debt burdens. Spain has been a leading advocate of such changes.

Finance ministers from the euro zone countries will meet Thursday in Luxembourg to prepare the way for a summit meeting of E.U. leaders at the end of next week.

The Italian proposal is seen by most euro zone officials as unworkable unless the unlimited resources of the E.C.B. were deployed. The central bank has not commented on either proposal.

Nicholas Kulish in Berlin, Jack Ewing in Frankfurt and Paul Geitner in Brussels contributed reporting.

Is lying to investors as bad as stealing?

Window on Wall Street

STEVEN M. DAVIDOFF

After the financial crisis and the recent insider trading convictions of Raj Rajaratnam and Rajat K. Gupta, perhaps it is time to reconsider the plight of Jeffrey K. Skilling.

The former chief executive is serving a 24-year sentence arising from his conviction on 19 counts after the stunning 2001 collapse of Enron. Until the financial crisis, Enron's bankruptcy was viewed as Exhibit A for corporate crime and executives run amok. After a trial in U.S. District Court in Houston that lasted months, Mr. Skilling was convicted of securities fraud, among other crimes.

Judge Sim Lake imposed a term at the low end of the recommended sentencing range. The sentence was still viewed as harsh by a few commentators at the time, but for those who had been victims of Enron's collapse and lost their jobs or life savings, Mr. Skilling got what he deserved.

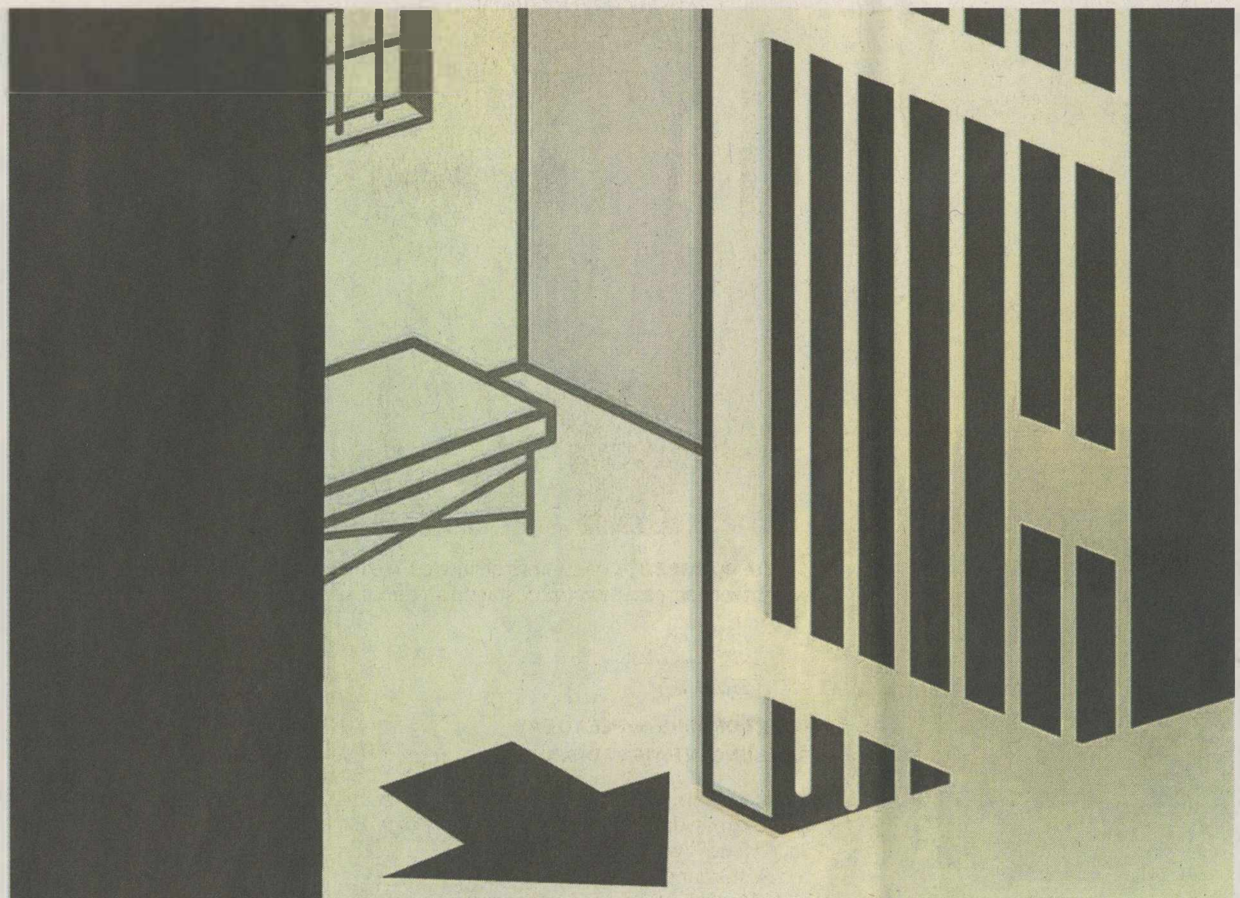
The problem is that the case against the Enron executive was always an iffy one, and in light of recent events, Mr. Skilling's sentence appears increasingly unjustified.

The case against Mr. Skilling was so amorphous that prosecutors found it difficult at first to weave the various threads into a cogent narrative. In a 2007 article in The American Criminal Law Review, John C. Hueston, the lead trial lawyer for the U.S. government in the Skilling prosecution, wrote that the case against the Enron executive had had "fundamental weaknesses."

It was complicated, difficult to explain and, perhaps most important, there was no smoking gun. Mr. Hueston wrote that he had found his trial strategy after watching the Enron documentary "The Smartest Guys in the Room."

It was all about creating a "simple but powerful trial narrative of lies and choices," he wrote. The narrative — that Mr. Skilling lied and therefore deserved his punishment — is a powerful one.

In a 2007 article in The New Yorker, Malcolm Gladwell argued that much of the information that constituted the lie had already been in the public domain, so that the problems of Enron could



HARRY CAMPBELL

Recent cases suggest it is time to reconsider Jeffrey K. Skilling's prison sentence.

have been discovered had someone only looked hard enough. Joe Nocera of The New York Times disputed Mr. Gladwell's thesis, arguing that Mr. Skilling had "lied to the investing public about the true condition of the company." He added, "And no matter how you slice it, that's against the law."

In this light, the charges against Mr. Skilling are both serious and curious. The significant ones concern hiding losses through reserve accounts and other accounting tricks, like shifting reserves to meet earnings targets. Those are the big lies. But Mr. Skilling was also convicted of falsely describing the wholesale energy business as a "logistics" company rather than a "trading" company. Does anyone think that during the Internet bubble and its haze, people would have noticed the difference between those labels?

As for the serious charges, the question is whether lying to your investors merits 24 years in prison — nearly a life sentence for a man who is now 58.

We will never know the real truth of what Mr. Skilling did, though clearly he played fast and loose at Enron. But Mr. Hueston also acknowledged that Mr. Skilling had not behaved like a criminal. He offered to invest millions in Enron as it struggled with a lack of funding and returned as chief executive to try to help.

This supports the counternarrative that Mr. Skilling was simply reckless. His conviction was largely a result of the actions of people at Enron, like the chief financial officer, Andrew S. Fastow, who did indeed steal from the company and then testified against Mr. Skilling for more lenient treatment.

If Mr. Skilling did lie, as the jury found, that does not make his sentence right. It all boils down to whether there is a difference between lying and stealing. Some may argue that they are equally bad, but the difference comes out in comparing Mr. Skilling to other financial criminals.

His crimes could be seen as different from the kinds committed by Bernard L. Madoff and Mr. Rajaratnam.

Mr. Madoff deliberately stole to benefit himself. He received a 150-year sentence for taking billions of dollars. Mr. Madoff's was sentenced under guidelines that specify terms that increase rapidly with the size of the loss. In a multibillion-dollar public company, the numbers can quickly grow to life terms.

In Enron's case, the loss was so great that the guidelines recommended a minimum sentence of 24 years. Mr. Skilling was placed on the same footing as Mr. Madoff, even though it can be argued that Mr. Skilling's lies were not as egregious as Mr. Madoff's outright theft.

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It's time to turn tables on Germany

Anatole Kaletsky

INSIDE THE MARKETS

LONDON As Europe absorbs the "success" of the Greek election or the deal to recapitalize Spanish banks, the euro project is finally revealing its fatal flaw. If there is one country that poses an existential threat to the currency zone, it is not Greece, Italy or Spain. It seems to be Germany.

Every serious proposal to resolve the crisis since 2009 — losses for bank bondholders, more realistic fiscal consolidation targets, jointly guaranteed euro bonds, a pan-European bailout fund, asset purchases by the European Central Bank — has been vetoed by Germany, and this pattern is likely to be repeated next week.

Nobody should be surprised by Germany's role, given its unusual geopolitical situation. The country is too big and powerful to coexist comfortably with its European neighbors in any political structure ruled purely by national interests. Yet it is not big and powerful enough to dominate its neighbors decisively, as the United States does North America or China will the Far East.

Wise German politicians recognized this inherent instability after 1945 and abandoned the realpolitik of national interest in favor of the idealism of European unification. Instead of trying to create a "German Europe," the new national goal was to build a "European Germany." Unfortunately, this lesson sometimes seems to have been forgotten by Angela Merkel.

Whatever the intellectual arguments for or against German-imposed financial discipline, there can be no dispute about their political import. As a result, when Ms. Merkel talks about "more Europe," it can end up seeming like a more German Europe, with every country running its economy according to German rules.

Ms. Merkel doubtless believes she is helping Europe when she instructs the Greeks, Italians and Spaniards to "do their homework." But efforts to impose German hegemony have not solved the problem. As European leaders prepare for their summit meeting in Brussels next week, the question is not whether Europe will agree to live under German leadership, but whether Germany will agree to live with E.U. leadership — or whether the other countries must form a united front against Germany.

To be specific, the euro's only chance of survival depends on a decisive move toward political and fiscal union. Ms. Merkel often nods to such political union, even saying democratic accountability is her main condition for financial rescues.

But she must also be accountable to German voters, German newspapers and German constitutional judges. Even as she promises to "do whatever it takes to save the euro," she is constrained by the realities of German public opinion and national interests.

At the summit meeting next week, France, Italy and Spain could choose to make a united stand. Led by President François Hollande of France, who has apparently abandoned President Nicolas Sarkozy's aspirations for parity with Germany, the big three Mediterranean countries could agree on a program that really might save the euro.

Ms. Merkel has vetoed every serious proposal to resolve the euro crisis.

The elements might include a banking union, followed by jointly issued euro bonds and backed by quantitative easing — the creation of money to buy assets and keep interest rates low — by the E.C.B.

The Germans on the E.C.B.'s governing council would doubtless oppose this, but even with support from Finland, Slovakia and perhaps Austria and the Netherlands, Germany could command no more than seven votes out of 23. Germany would then face the very same existential choice about its relations with Europe that Ms. Merkel has suggested for Greece and other debtor countries: Live by euro zone rules or leave the euro union.

Germans would almost certainly support the political concessions that might give the euro a chance of survival, including fiscal transfers and some mutualization of debts, if their leaders pointed out to them that their only alternative would be isolation from the rest of Europe.