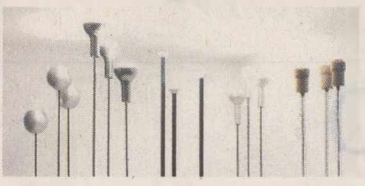

LIGHT OBSESSION
A COLLECTOR GOES FOR BROKE
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d Tribune

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Spanish bank aid won't end the pain

LONDON

Too many E.U. lenders remain dependent on day-to-day financing

BY LANDON THOMAS JR.

Europe may have sidestepped its latest catastrophe. But the intervention in Spain will do little to address the problem that continues to plague the Continent's increasingly vulnerable financial institutions.

Namely: Too many European banks remain addicted to the borrowed money

NEWS ANALYSIS

that provides the day-to-day financing that they need to survive.

It is a weakness that afflicts many euro zone banking systems — most notably that of Italy, whose fragile economy is even bigger than Spain's and whose banks also rely heavily on borrowed money to get by.

In Spain's case, the flight of foreign money for safer harbors, combined with a portfolio of real estate loans that had deteriorated along with the Spanish economy, led to the collapse of Bankia, the mortgage lender whose failure set off the country's current banking fiasco.

Europe hopes that this latest bailout — money that will be distributed to Spain's weakest banks via the government in the form of loans, adding to their long-term debt — can resolve the problem. But investors and analysts worry that highly indebted banks in other weak countries like Italy might face similar difficulties in the months ahead.

Last month, the ratings agency Moody's downgraded the credit standing of 26 Italian banks, including two of the largest ones, Unicredit and Intesa Sanpaolo. Moody's warned that Italy's most recent economic slump was creating more failed loans and making it very difficult for banks to replenish their coffers through short-term borrowing.

Because they have suffered no epic real estate bust, Italian banks have long been seen as healthier than their bailed-out counterparts in Ireland and Spain.

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MADRID

Prime minister says he wasn't pressured to take €100 billion rescue

BY RAPHAEL MINDER

The Spanish prime minister on Sunday called his country's banking rescue by Europe a victory for the euro zone but hastened to describe it as a deal that was drawn up on his country's own terms.

"Nobody pressured me, I was the one who pressured to get credit," Prime Minister Mariano Rajoy said at a news conference here. The aid, worth up to €100 billion, or $125 billion, for its cash-starved banks, is a deal, he said, that ensured "the credibility of the European project, the future of the euro, the solidity of our financial system and the possibility that credit will flow again."

Mr. Rajoy also insisted on Sunday that Spain was merely receiving "a line of credit" and not a full-fledged bailout. The money would be channeled to its bank restructuring fund in order to replenish the reserves of its weakest institutions, a loan structure different from the bailouts and tough conditions negotiated by international creditors to help the ailing economies of Greece, Portugal and Ireland.

Despite the sense of relief at avoiding a banking meltdown, Mr. Rajoy also warned of more pain as Madrid pushed ahead with austerity cuts to clean up public finances.

DANIEL OCHOA DE OLZA/AP

Mr. Rajoy said in Madrid on Sunday that the pact ensured "the future of the euro."

"This year is going to be a bad one," Mr. Rajoy said Sunday.

Alfredo Pérez Rubalcaba, leader of the main Socialist opposition party, suggested on Sunday that Mr. Rajoy was being disingenuous in his portrayal of the Spanish rescue.

"The government is trying to make us believe that we've won the lottery, that the Three Kings of the Orient have arrived, and that isn't so," Mr. Rubalcaba said at a separate news conference.

In any case, analysts say that Spain's economic problems will not vanish overnight as a result of the assistance, nor is the future of the euro guaranteed by the deal reached Saturday. While the agreement removes the threat of an immediate banking collapse in Spain, it was unclear whether financial markets would respond Monday with optimism.

"Market reaction is unlikely to be favorable, given that the bailout places even more strain on Spain's creditworthiness, sets a precedent that the euro

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vay, U.N. says

abled the Internet to flourish."

Vinton G. Cerf, the "chief Internet evangelist" at Google, warned during congressional hearings: "The open Internet has never been at higher risk than it is now. A new international battle is brewing — a battle that will determine the future of the Internet."

Time for a reality check. Documents prepared for the December meeting, which leaked out last week — yes, on the Internet — show that there are no proposals to hand governance of the Net to the I.T.U. The union insists that it has no desire to play such a role. And even if so[illegible] governments would like to give the ag[illegible]y increased regulatory powers, the United States and other like-minded countries could easily block them.

"It would be wrong, and a bit silly, to

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CONCERN HIGH AS GREEK ELECTION NEARS

The urgency of the Spanish bank bailout was driven by events at another edge of the euro zone: Greece. *PAGE 15*

Views

EDITORIAL OPINION

International Herald Tribune

THE GLOBAL EDITION OF THE NEW YORK TIMES

DENY THE MONEY

House Republicans propose gutting the agencies designed to prevent economic meltdowns like the recession in 2007.

If you wanted to reproduce the conditions that led to the Great Recession in 2007, the easiest way would be the plan unveiled last week by Republicans in the U.S. House of Representatives: Gut the regulators who are supposed to keep the worst business practices in check.

At a time when the economy is still reeling from the downturn, House Republicans released a spending bill that would severely cut the budget of the Commodity Futures Trading Commission, which would keep it from regulating potentially toxic swaps and other derivatives.

It refused to give the Securities and Exchange Commission the extra money it needs to carry out the Dodd-Frank financial reform bill.

And the bill would cripple the Internal Revenue Service, limiting its ability to detect tax avoidance, particularly by businesses and the wealthy.

The proposed cuts are the latest in a long series of efforts by Republicans to keep the government from tempering even the most economically dangerous desires of business.

Having failed to prevent the enactment of Dodd-Frank and the new Consumer Financial Protection Bureau, they are imposing their will with what may be their most effective weapon — choking off the air supply of regulators by limiting the money they can spend. These agencies had already been hesitant to impose a real crackdown; the cuts will make the situation worse.

With 710 employees, the C.F.T.C. staff is barely big enough for its current responsibilities, let alone its new mission under Dodd-Frank to oversee the huge over-the-counter swaps market. Its budget is $205 million, which President Obama proposed increasing to $308 million for 2013 to deal with swaps. The House Appropriations Committee has proposed slashing next year's budget to $180 million.

For the Securities and Exchange Commission, whose role protecting investors was also enhanced by the reform law, the House provided only an extra $50 million (far less than the $245 million increase requested by the president) but limited the money to technology expenses. None of it can pay for new watchdog employees.

The committee is clearly listening to Wall Street lobbyists who do not want the agency to enforce planned new regulations on money-market mutual funds.

The Internal Revenue Service said it needed $945 million more in 2013 to make sure people have health insurance beginning in 2014, and to keep up with tax cheats. (It already cut its staff by 5,000 last year.) The House provided none of that increase.

It is hard to believe that Republicans are serious about reducing the deficit if they will not let the government's revenue agency do its job.

A few weeks ago, JPMorgan Chase, a too-big-to-fail bank, lost at least $3 billion trading in derivatives. Regulators might have halted that if Dodd-Frank were fully in place.

The Republican response is to hobble the regulators even further — an invitation to another financial disaster.

Europe needs a German Marshall Plan

SAVING THE EURO I

It is time for Germany to design its policies with the same sense of urgency that America did after World War II.

Charles S. Maier

CAMBRIDGE, MASSACHUSETTS European leaders seemed to understand, at least until recently, that even a partial breakdown of the euro zone would have a devastating economic and political impact on departing countries and on the European Union as a whole.

But while they have repeatedly committed to providing emergency aid, they haven't yet accepted that saving the euro is more vital than clinging to the constraining rules that govern the European Central Bank. They should recall Secretary of State George C. Marshall's grave warning, upon returning from Germany in early 1947: "The patient is sinking while the doctors deliberate."

The former patient is now the principal doctor. The German chancellor, Angela Merkel, assures us that the answer to the crisis is "more Europe" — more coordination of policies and more common decision-making. But the question behind the immediate crisis posed by Greek and Spanish debt is how to bring about more Europe. It will not be created simply through the European Union's recent "fiscal compact" extracted by Berlin, which provides for automatic but unenforceable fines designed to encourage budget orthodoxy.

It is time for Germany, once the recipient of aid, to design its current policies with the same sense of urgency and vision that America did after World War II with the Marshall Plan. The Continent is vastly wealthier today than it was then, but the key issue remains how to overcome economic stagnation without imposing painful austerity that strengthens extremist parties and endangers democratic politics.

Unwinding a decade of profligate borrowing will not be easy. But no one should believe that if Greece and Spain abandon the euro, their economies will float buoyantly upward without wrenching interim misery. Their European neighbors will have to provide assistance whether they are in the euro zone or outside; after all, unemployed Greeks and Spaniards can and will migrate to northern Europe in search of jobs.

Many Germans have lost patience with the idea of pouring resources into a "bottomless barrel," as they often call Greece. They justifiably ask whether bailing out Greece won't make Spain even more vulnerable and they fret about rewarding irresponsible behavior and making it more likely to recur.

Yes, Spain and Greece indulged in irresponsible borrowing, but it's important to recall that they did so in partnership with French and German banks who were lenders. Moreover, Germany has benefited greatly from the euro and the E.U.: Two-thirds of German trade revenue, and about half of the trade surplus from which Germans derive so much pride, can be attributed to commerce with other members of the E.U.

Countries in a position of leadership must finance and support their distressed neighbors for systemic reasons, or they have no real claim to leadership. In the 1990s, West Germans committed roughly one trillion euros to give their newly reunited countrymen a common standard of welfare. Two decades later, Germans must extend the same sense of obligation to Europe more broadly.

The Marshall Plan is sometimes seen as an early triumph for "conditionality" — that is, grants dependent on the recipient's cutting domestic public expenses, raising revenues and, often, firing "redundant" workers. In fact, the Marshall Plan worked because it indefinitely suspended conditionality while nudging recipients toward eventual reforms. Postwar U.S. leaders repeatedly postponed austerity requirements when confronted with French and Italian tax evasion and budget deficits. They let Marshall Plan funds cover budgetary deficits, wagering correctly that growth would ultimately wipe out the deficits.

Today, rather than conditioning assistance on policies of immediate austerity that will only worsen depression, creditor countries like Germany would be wise to tie debt reduction and loan repayment to the resumption of economic growth.

The cautious leaders of the European Central Bank argue that the euro treaties prohibit the bank from buying the debts of member states; likewise, Berlin has resisted issuing any "Eurobonds" that the members of the European Union would have a collective duty to repay. But treaties can be loosened as well as tightened; they fit for a while, then must be revised.

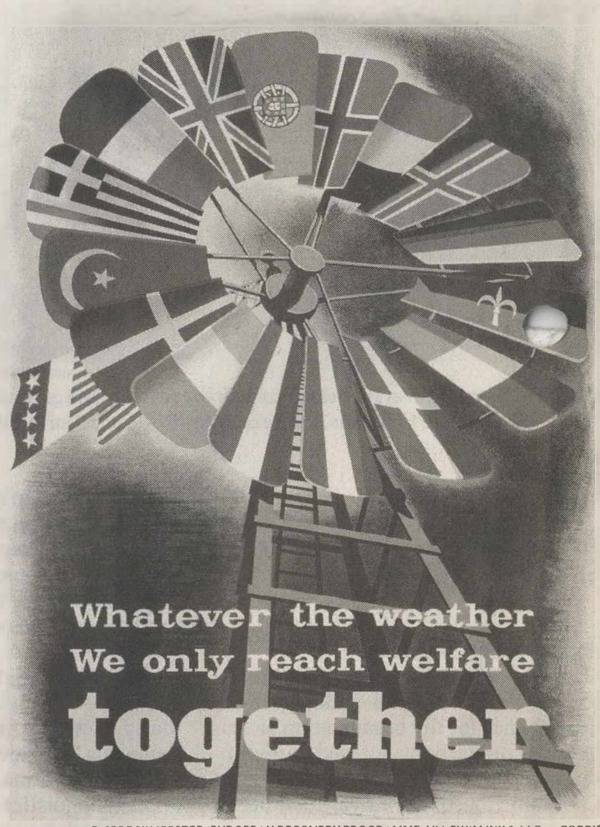
Sober minds among the German opposition understand this. Merkel seems to comprehend it, but, constrained in part by her own majority's reluctance, she has been moving too slowly to halt the unfolding crisis, hoping that lining up harsher fiscal discipline will stanch the ebbing of confidence. Promise the impossible and supposedly the bond markets should rally. But this is wishful thinking. Banks are fair-weather friends — anxious to lend in good times but in danger of imploding in crises.

Ultimately, the issue is not merely one of economic welfare. For over half a century the progress of the European Union has provided a civic vision comparable to earlier aspirations for national liberation from dictatorships — whether Nazi or Communist. It managed to move millions of excess farmers off the land into new jobs without their mass defection to xenophobic populist parties. It has led to a huge exchange of young students and workers, reintegrated formerly Communist nations of Eastern Europe and accommodated a united and wealthy Germany without a destructive revival of earlier anxieties. And in the future the European Union is needed for the Continent to remain a significant international actor in a world organized around powerful regional groupings.

Ultimately, the path to "more Europe" will require granting the European Parliament a far greater share of control over Europe's public expenditures, even if many E.U. experts might be scornful and the British would balk. Europe's Parliament should have the power to decide on the overall amounts to spend on welfare and pensions and support of the unemployed. Then European social preferences can be debated the way they are within every nation, through European-wide parties and parliamentary elections that will take on real significance. If German policies prevail, they will seem less coercive, and the national populist parties that have emerged with disturbing strength will be compelled to debate ordinary politics rather than demonize immigrants.

Merkel is right; Europe must press forward, and Germany is today the country on whose farsightedness the European project hinges. Chancellor Helmut Kohl proved an unlikely visionary in 1989-90 when he urged both German unification and an enhanced European Union. The need for decisive policies has come again.

CHARLES S. MAIER *is a professor of history at Harvard.*



E. SPRECKMEESTER/EUROPEAN RECOVERY PROGRAMME, VIA SWIM INK 2, LLC — CORBIS

A 1950 poster celebrating the economic recovery in Europe.

The euro's 11th hour

SAVING THE EURO II

European leaders have embraced ideas that simply won't do the job.

Steven Rattner

With each passing day, the noose around the neck of the euro zone grows tighter, with no indication that European leaders share any coherent vision for avoiding the hangman.

Instead of tackling structural problems, much of the endless chatter about the common currency centers on financial engineering: rescue funds, backstopping banks, printing money and the like.

At the heart of the European quandary is the conundrum that ideas that are economically sensible are not politically feasible, while ideas that are politically possible make little economic sense.

Topping the "must do" list is the need to fix the disastrous design flaw in which the 17 members agreed to a common monetary policy without coordinating their budgets and regulations.

A consequence was broadly divergent competitiveness. Since 2000, wages of German workers have increased barely more than efficiency has grown, an enormous advantage in global markets. Meanwhile, Greece's unit labor cost (the average cost of labor per unit of output) has increased by roughly 40 percent.

Greece is merely the most disobedient of a passel of problem children; by this all-important measure, the other 15 members are mostly sprinkled closer to Greece than to Germany.

Without the ability to adjust exchange rates, euro zone countries with rising labor costs can't compete against export powerhouses like Germany. But fully integrating 17 economies and undertaking the necessary restructuring remains, not surprisingly, politically absurd, with Europe's clock clicking down.

Frustrated, European leaders have descended into the five stages of grief: denial, anger, bargaining, depression and — by some — acceptance that the euro could fall apart. They have embraced ideas that simply won't do the job. Consider the simplistic headline-grabbing debate between growth (greater deficits) and austerity (smaller deficits).

In the near term, additional spending reductions or tax increases would only exacerbate high unemployment, now 24 percent in Spain. But pushing the larger deficits associated with a growth approach risks embedding inefficiencies and inciting a collapse of confidence in the bond markets on which Spain depends for its large borrowing needs.

Nor would "Eurobonds" — the fashionable solution embraced by the new French government — do anything to address the imbalances in competitiveness. Like giving spirits to an alcoholic, they could exacerbate the imbalances by reducing pressures on less-competitive countries to reform.

Weaker countries, fearful of forfeiting sovereignty, contend that they are acting forcefully and blame fickle financial markets for their rising interest costs.

To be fair, the new technocratic Italian government led by Mario Monti has trimmed its budget deficit and reformed pensions. But those measures fall short of the needed overhaul, particularly in regard to rigid labor laws.

Amid the cacophony, Mario Draghi, head of the European Central Bank, and Olli Rehn, the European economic commissioner, have spoken sensibly about the diagnosis, even if they have sometimes understated the need for surgery.

Meanwhile, all roads lead to Berlin. Ironically, a currency created in part to curb Germany's influence following reunification is now effectively under German control. Chancellor Angela Merkel has been caricatured as the leader of the austerity campaign, although the measures that she is demanding of others — like wage restraint and greater labor-market flexibility — mirror those Germany adopted over a decade ago.

In part, her tough stance reflects domestic politics; Merkel's Christian Democrats have suffered recent defeats in local elections and will face an electorate next year that opposes bailing out countries that have failed to match Germany's discipline. But recognizing the risks of euro disintegration — articulating the costs of a breakup is easier than explaining the benefits of remaining together — Merkel has recently been signaling that Germany's opposition to aiding the weaker countries could be relaxed. In essence, she (like the voters of Greece) is playing a huge game of chicken. She wants the weaker countries to clean house before loosening German purse strings.

If that happens, Germany would be well advised to back short-term financial rescue actions similar to those the United States undertook in 2008. And the stronger countries must also accept the need for fiscal transfers — subsidies to poorer euro zone members.

The euro zone may find another piece meal solution and escape the hangman for now, but unless it attacks its more fundamental problems, it is doomed to cascading series of crises that will ultimately destroy the common currency.

STEVEN RATTNER *is a longtime Wall Street executive and a former counselor to the U.S. Treasury secretary.*

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Worries grow as election nears in Greece

FRANKFURT

If voters renege on terms of bailout, euro zone as a whole is threatened

BY JACK EWING

KOSTAS TSIRONIS/BLOOMBERG NEWS

Discounted goods in Athens. The former interim prime minister of Greece said the nation's departure from the euro zone would be catastrophic, pushing inflation as high as 50 percent.

As European finance ministers labored on a plan to shore up Spanish banks in recent days, the urgency of that mission was driven by events in a country at the other edge of the euro zone: Greece.

The Spanish banking rescue agreed to on Saturday will be expensive — cost-

NEWS ANALYSIS

ing up to €100 billion — but well within the means of a European emergency fund already established for just such purposes.

Far harder to calculate are the costs if, after Greek elections Sunday, the new government there reneges on the terms of the bailout Athens negotiated with its European lenders only a few months ago. That could lead to an unprecedented withdrawal from the euro zone, threatening the structural integrity of a currency union that has largely benefited more prosperous members like Germany.

"The stakes are exceptionally high," Lucas Papademos, former interim prime minister of Greece, told a bankers' group in Copenhagen on Friday, "because the decisions to be made at, and immediately after, the forthcoming elections will determine the country's future for at least the next decade."

Mr. Papademos, who is also a former vice president of the European Central Bank, said Greece's departure from the euro zone would be catastrophic, pushing inflation in the country as high as 50 percent, putting extreme stress on Greek banks and reducing living standards.

And those problems would not be Greece's alone. The big fear in Europe is contagion — an infection of financial panic that could spread far beyond Greece. Indeed, Spanish leaders have long said that Greek problems were contributors to the general market uncertainties that helped undermine Spanish banks.

The next task of European leaders is to show the rest of the world that they are making a credible effort to repair the flaws in the edifice of the euro zone that allowed the problems in one small country, Greece, to become a threat to the world economy.

"The way the currency union has been functioning is not sustainable," Jens Weidmann, the president of the German Bundesbank, told the Welt am Sonntag newspaper. "A breakup of the currency union would bring extremely high costs and risks that no one can really predict," he said.

Even if Greece does end up with a government willing to try living up to the terms of its €130 billion, or $163 billion, bailout deal by meeting its payments and attempting to narrow its large budget gap, there are strong doubts whether any new leadership in Athens would be able to fulfill those obligations. A lot of

"The stakes are exceptionally high."

private money has already fled Greece, while its deeply depressed economy and dwindling tax revenues threaten to put the country ever deeper in the hole.

"Even in case of a new government, I doubt whether the institutional framework in Greece can guarantee the program," said Jürgen Stark, a former member of the European Central Bank's executive board. "Who has the competence to implement the program? That is the key point."

Mr. Stark is among those who believe that the euro zone is strong enough to withstand Greece's departure. "There will be contagion," he said in a telephone interview. "But I think it can be managed. It will be costly in the short term. There will be benefits in the long term."

Jitters about what Greek voters might do this Sunday may have helped soften the rhetoric coming from Germany, the euro zone's paymaster, in recent days. Although Berlin has been Greece's harshest economic critic, Germans awoke Thursday to see Angela Merkel, their chancellor, telling them on breakfast-time television that Europe needed a fiscal union — implying that some of their tax dollars might be needed to help the suffering Spaniards and Greeks.

"We need more Europe," Ms. Merkel said on ARD television. "We do not only need a monetary union, but we also need a so-called fiscal union. This means that we also need a common budgetary policy and we also need a political union."

Such a statement might have provoked an outcry a year ago, but Germans may be realizing that their own well-being is in imminent danger. That is why Germany has taken a lead role in stressing the urgency of addressing Spanish bank problems.

So far the German economy has come through the European economic crisis almost unscathed. Unemployment has continued to fall, and the country has even benefited from its status as a haven for investors, which has allowed the government to borrow at extraordinarily low interest rates. Spain's interest rate on its 10-year bonds was at 6.12 percent Friday; Germany's was 1.3 percent.

But if the German economy begins to slide toward recession, the political equation for Ms. Merkel could change significantly. Voters might be less opposed to the use of German financial resources to help countries like Spain, giving Ms. Merkel leeway to negotiate a more tightly knit Europe.

Already, there are warnings that the region's debt crisis is dragging on German growth. German industrial production fell 2.2 percent in April from March, according to data released last week. The drop was more than expected and comes after surveys of business sentiment also pointed to a slowdown in growth.

During this week official data will provide more clues about how the crisis is affecting the largest countries in Europe. Figures on industrial production in France and Italy are expected Monday and for the euro zone as a whole Wednesday.

Analysts expect declines, which would be bad for Germany because its biggest trading partners are other European countries. However, slower growth in Germany could also create a political backlash, making Germans more reluctant to help their fellow euro zone citizens.

"If people think they are poorer, maybe they become more reluctant to share the burden," said Clemens Fuest, an economics professor at Oxford. Mr. Fuest said he was skeptical that Europeans would ever agree to delegate control over their national budgets to a European authority as part of a fiscal union.

European leaders would be better off concentrating on measures that are more realistic, he said, like a common system for overseeing banks, guaranteeing deposits and dealing with ailing financial institutions. That could help avoid situations like those in Ireland, Cyprus and now Spain, where the cost of bank rescues raises doubts about the solvency of the national government.

Many proposals to push Europe closer together would take years to implement — too long to help ease current tensions. Mario Draghi, the president of the European Central Bank, said last week that it would help a lot if European leaders simply drew up a detailed plan for the future of the euro zone.

Mr. Draghi is on a panel with several other top European leaders that has been working to create a more perfect union. The other members are José Manuel Barroso, president of the European Commission; Herman Van Rompuy, president of the European Union; and Jean-Claude Juncker, head of the so-called Eurogroup of finance ministers in the euro zone.

One proposal they are working on would require euro zone nations to get approval from other finance ministers for deficit spending, the magazine Der Spiegel reported. This excess spending would be financed with common debt known as euro bonds.

But the problems facing Europe, including Spain and Greece, are immediate ones. And analysts are skeptical that political leaders can move quickly enough to devise longer-term solutions. Indeed, moments after Ms. Merkel made her televised remarks about a fiscal union, she began downplaying expectations that leaders were working on anything dramatic.

Asked by a reporter for ARD whether European leaders were working on a "master plan" for Europe, Ms. Merkel cautioned that a summit meeting of E.U. leaders at the end of June was unlikely to produce a "big bang."

Annual race for new jet orders starts in Beijing

BEIJING

REUTERS

A summer battle for new orders is gearing up in the global jet industry, which gathered in Beijing on Sunday to begin the first of two crucial events that pit the world's largest airplane makers against one another in a race for deals worth $50 billion.

The potential new sales span the globe and aircraft varieties, including airliners, warplanes and business jets. But analysts say the two largest makers of commercial jets, Airbus and Boeing, are sporadically having to offer hefty discounts to ride out economic uncertainty, especially for maturing models or for early shipments of new ones like the 787 Dreamliner from Boeing.

Boeing is expected to win the fiercely contested annual order race for the first time since 2006, as it catches up with a decision by Airbus to revamp medium-range jets. Advances by both companies will result in big fuel savings for airlines on the Airbus A320 and Boeing 737.

The dominant civil aircraft makers are positioning themselves early before the second major industry conclave, the Farnborough International Airshow in England next month, and deals valued at $14 billion have been announced in the past three days.

Airbus and Boeing have accused each other of waging a price war to win hundreds of orders for the revamped A320neo and 737 MAX and deny cutting corners themselves. Several industry analysts say pricing is under pressure this year. Although the made-over medium-range jets offer airlines a reduction of 15 percent in fuel — an airline's biggest expense — selling them is made more difficult by the financial pressure most carriers are under, and some are delaying deliveries to shore up their cash.

The industry body, the International Air Transport Association, or I.A.T.A., is expected to announce in Beijing that it has left its forecast for 2012 profit in the sector unchanged at $3 billion, but unease is growing.

The industry's archrivals, Airbus and Boeing, are also facing off indirectly in the global arms market with a competition to supply dozens of fighters to South Korea. Bids are due next Monday, and industry experts believe a decision may come as early as September in an $8 billion contest between Boeing's F-15; the Eurofighter, made by a group including Airbus's parent, E.A.D.S.; and the F-35, made by Lockheed Martin.

Asia, the Middle East and Latin America are rearming to replace aging equipment or in the face of regional threats.

Manufacturers are also seeing a steady rise in demand for top-line business jets from China, as the number of millionaires in that country rapidly expands.

Spanish prime minister warns of 'bad' year ahead

SPAIN, FROM PAGE 1

Europe's other bailed-out countries — in particular Ireland — are likely to object to and risks putting pressure on Italy," said Nicholas Spiro, managing director of Spiro Sovereign Strategy, a consulting firm in London that assesses sovereign debt risk.

In addition to Spain's banking woes, Mr. Rajoy is also having to fight the economic crisis on several other fronts. Madrid is struggling to meet budget targets and impose greater fiscal discipline upon regional governments. The country recently entered its second recession in three years, with unemployment at a record high of more than 24 percent.

Spain is set to receive the emergency loan via its Fund for Orderly Bank Restructuring, which was set up at the onset of the crisis but has been almost depleted after being used to wipe out the losses of some smaller collapsed banks.

While Madrid could have raised more money on the debt markets, its borrowing costs have been kept close to record highs since early May, when it was forced to seize control of Bankia, a giant mortgage lender in need of €19 billion in additional capital. That has basically made it impossible for Spain to auction bonds at an affordable cost, as well as threatening its ability to refinance existing debt.

Spain and its European partners still need to finalize in coming weeks the exact amount of the credit line, and any conditions attached to it. On Saturday, Luis de Guindos, the Spanish economy minister, said that Spain expected to receive "very favorable" terms for the European loan, at a below-market rate. He also suggested that Spain would not need the full €100 billion on offer, saying that this figure included "a safety margin" to cover any further difficulties that might emerge from ongoing audits of its banking sector

Two independent consulting firms are to deliver their assessments of Spanish banks on June 21. The International Monetary Fund estimated on Friday that Spanish banks would need an additional €40 billion of capital.

Despite the 11th-hour agreement in Spain, European leaders remained deeply divided about the way to carry out a more lasting solution to the euro debt crisis. Ahead of a summit meeting this month, members of the euro zone are debating a variety of fixes related to forming a tighter political and fiscal union. Still, "on the euro zone level, Spanish bank recapitalization will significantly facilitate the road to a banking union," said Erik F. Nielsen, chief economist of UniCredit in London.

The agreement reached Saturday also received endorsements beyond the boundaries of the euro zone. Christine Lagarde, the managing director of the I.M.F., said the scale of the financing offered to Spain "gives assurance that the financing needs of Spain's banking system will be fully met." And the U.S. Treasury secretary, Timothy F. Geithner, called the support European partners were showing Spain "important for the health of Spain's economy." He said that Spain's request for aid and Europe's agreement were "concrete steps on the path to financial union, which is vital to the resilience of the euro area."

Jens Boysen-Hogrefe, an economist at the Kiel Institute for the World Economy, called the deal "a calming signal at a time when calming signals are badly needed." But he added that "the uncertainty is still high and bad news can pop up anywhere in the euro area. This is not a final solution."

On Sunday, Mr. Rajoy said Spain should have intervened in its most troubled banks as long as three years ago, following the example of countries including Britain. Mr. Rajoy's Popular Party, however, only came to power after winning a general election last November. .

Whatever the final amount needed to clean Spain's banking sector, "I guess it all illustrates the cost of procrastination," Mr. Nielsen of UniCredit said.

Nicholas Kulish contributed reporting from Berlin, Paul Geitner from Brussels and Annie Lowrey from Washington.

On borrowed money — and time

EUROPE, FROM PAGE 1

EMILIO MORENATTI/THE ASSOCIATED PRESS

The agreement to help stabilize Spanish banks made headlines in Barcelona on Sunday.

And bankers in Italy have been quick to argue that Italian banks should not be compared to those in Spain.

But as economic activity throughout the region comes to a near halt, especially in perpetually growth-challenged Italy, the worry is that bad loans and a possible flight of deposits from the country will be a new threat to banks that already are barely getting by on thin cushions of capital.

Also hanging over European banks are the losses that would hit them if Greece were to leave the euro currency union, throwing most of their euro-denominated Greek loans into default. Banks in France and Germany would be hurt the most, as they have been long-standing lenders to Greece. In a recent analysis, Eric Dor, an expert on international finance at the Iéseg School of Management in Lille, France, calculates that French and German banks would be out €20 billion and €4.5 billion.

The French bank Crédit Agricole, for example, via its Greek subsidiary, has about €23 billion, or about $28.8 billion, in Greek loans on its books. If Greece were to leave the euro, the losses could exceed €6 billion, analysts estimate.

Because it was the financial excesses of banks in Ireland, and now Spain, that eventually forced those countries to seek bailouts, finding a Europewide solution to overseeing financial institutions has become a pressing priority for the euro zone's leadership. Otherwise, Europe will be able to address the weaknesses of member country banks only when the time comes to rescue them.

But as the president of the International Monetary Fund, Christine Lagarde, said in a speech in New York on Friday, there is little time to waste in this regard.

"European banks are at the epicenter of our current worries and naturally should be the priority for repair," she said.

Ms. Lagarde, who from her earliest days at the fund has focused on banking problems in Europe, left little doubt about how the issue should be addressed. "Let me be clear," she said in her speech. "The heart of European bank repair lies in Europe. That means more Europe, not less. Less Europe will be bad for the Continent and bad for the world. So, policy makers in Europe need to take further action now to put the monetary union on a sounder footing."

At the root of the issue is a simple fact: Just like the countries in which they operate, most European banks are highly leveraged entities. They depend heavily on borrowed money to operate day to day, whether making loans or paying interest to depositors.

For decades, the loans that European banks have made to individuals, corporations and their own governments have far exceeded the deposits they have been able to collect — the money that typically serves as a bank's main source of ready funds. To plug this funding gap, which analysts estimate to be about €1.3 trillion currently, European banks have borrowed heavily from foreign banks and money market funds. That is why European banks have an average loan-to-deposit ratio exceeding 110 percent — meaning that on any given day, they owe more money than they have on hand.

In Spain, this problem has been even more acute. Bankia, before it failed, had a loan-to-deposit ratio of 160 percent, one of the highest levels in Europe. Even the strongest banks in the country, like the global banking giant Santander, have a fairly risky ratio of 115 percent, while big Italian banks like UniCredit rely on bulk borrowing to a similar or higher degree.

In the United States, the comparable figure is about 78 percent, which means that the biggest American banks have a surplus of deposits and extra cash that they must put to work. (That can pose its own perils, as JPMorgan Chase recently demonstrated with its disastrous trading bets.)

Of late, Europe's bank financing gap has been filled largely by the European Central Bank's temporary program of low-cost, three-year loans.

Italian and Spanish institutions were the most aggressive in lining up at this lending window, and they used much of the low-cost financing to buy their own government's bonds. In the long run, that particular form of patriotism is likely to hurt those banks' finances, if the value of the bonds continues to decline.

China data dim hopes for recovery

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fine-tuning, rather than a serious stimulus, should be enough to generate" economic growth of 8 percent for the full year, said a research report from CLSA, an Asian brokerage firm.

Many economists are wary of Chinese economic statistics. Statistical studies over the years have suggested that local, provincial and national government agencies tend to smooth out the ups and downs of the business cycle by underreporting growth during booms and overstating it during downturns.

Some local Chinese officials, leery of informing provincial leaders about economic troubles in their jurisdictions, have been telling big companies to overstate their growth this spring, with an assurance that local taxes will continue to be levied on the true rate of growth, said two managers in China who insisted on anonymity to avoid legal difficulties with the authorities.

One of the most reliable proxies for economic growth over the years has been electricity generation, because a handful of big companies dominate the sector and report data directly to Beijing. Electricity generation grew only 3.2 percent in May compared with the same period a year earlier, the National Bureau of Statistics said Saturday.

However, that was still an improvement from April, when year-over-year growth was just 1.5 percent. Excluding effects from Lunar New Year, April and May this year have been the two slowest months for growth in electricity generation since the spring of 2009, when many export factories temporarily shut down during the global financial crisis.

Other data hint that the Chinese economy may still be slowing. The China Iron and Steel Association said Friday that the country's average daily tonnage of steel production from May 21 through May 31 had dropped 3.9 percent just compared with the middle of the month, May 11 through 20.

For Greece, euro is lesser of two evils

Hugo Dixon

POLITICAL ECONOMY

Odysseus would recognize the dilemma faced by Greeks today as they choose the pain of sticking with the euro or the chaos of bringing back the drachma. The Homeric hero had to steer his ship between the six-headed sea monster, Scylla, and the whirlpool, Charybdis. It was impossible to avoid both evils. So Odysseus chose the sea monster, each of whose heads gobbled up a member of his crew. He judged that was less bad than having the whole ship sucked into the whirlpool.

As Greece heads to the polls for the second time in little more than a month next Sunday, there is no good option. The economy has shrunk about 15 percent from its peak in 2008, unemployment is 22 percent, and further austerity and reform will be required as part of the euro zone/IMF bailout. But the lesser of two evils is staying the course.

Some of this misery was inevitable as Greece's current account and fiscal deficits each reached about 15 percent of gross domestic product in 2008 and 2009, and had to be cut. But much of it has also been self-inflicted.

When Odysseus had to pass by the sea monster, he told his crew to row as fast as possible and not stop. That way, each of Scylla's heads had time to munch only one man.

By contrast, Greeks today have dawdled. Confidence in the country and its political class is shot to bits, both at home and abroad. Capital is fleeing the country, investment has vanished and people have become even worse about paying their taxes. The government does not pay its bills, nor do many companies. As a result, Scylla keeps gobbling up more men.

Terrible as things are, the current situation is not hopeless. The budget deficit, before interest payments, declined in 2010-2011. The economy is also getting more competitive: unit labor costs, which shot up vis-à-vis Greece's euro zone partners in the first decade of the single currency, had by the end of last year recouped half the lost ground. They will have fallen further since the minimum wage was cut earlier this year.

What is now needed is a strong government. It would have three main tasks. First, complete the reform program, including cracking down on tax evasion. Second, negotiate with the euro zone/I.M.F. a longer period to eliminate the budget deficit and secure investment to increase short-term growth. Third, negotiate a further reduction in debts.

If such a government could be formed, confidence could gradually return and the economy could stop shrinking. The experience of the Baltic countries — Latvia, Lithuania and Estonia — shows such reforms can work. After the credit crunch crisis, G.D.P. in the three countries fell 15 percent to 21 percent but has since partly recovered.

But wouldn't going back to the drachma be better? Some commentators point to countries like Iceland, which restored its competitiveness by a steep devaluation following the credit crunch and suffered only an 11 percent fall in G.D.P. Wouldn't devaluation be a quicker and less painful way for Greece to get back in shape?

Dislocation caused by a new currency would be worse than devaluing one that exists.

The answer is no — for two reasons. First, the dislocation caused by bringing in a new currency would be much more severe than devaluing a currency that already exists. The banks would temporarily run out of cash and there would be multiple legal disputes over who owes what, which could gum up the economy for years.

Second, Greece is receiving an extraordinary amount of cheap money as part of its second bailout plan: €130 billion, or $162.7 billion, or 88 percent of G.D.P. This gives it time to cut its two deficits. If Athens left the euro, it would be lucky to receive even a fraction of that cash. The country would then have to balance its books immediately.

An even harsher fiscal squeeze would exacerbate the vicious spiral. The alternative would be to print drachmas to fill the hole in the budget.

PETROS GIANNAKOURIS/THE ASSOCIATED PRESS

Alexis Tsipras wav[illegible]o supporters [illegible]n Athens shipyard. Greece votes again Sunday.

But such monetary financing would lead to rapidly rising inflation, which would already have been given a lift by the devaluation. Lucas Papademos, the country's former technocratic prime minister, predicted last week that inflation could reach 30 percent to 50 percent.

Meanwhile, Greece is hugely dependent on imports, not just for final consumption but also to keep its economy going. It imports lots of oil, medicine and even food. If it had to cut imports suddenly, industry would grind to a halt. Even tourism, the mainstay of its economy accounting for 16.5 percent of G.D.P., could suffer if hotels that were promising a five-star experience could deliver only a three-star one. G.D.P. might fall another 20 percent, Mr. Papademos said.

In such a scenario, there could be huge social unrest: street battles, attacks on immigrants, vigilante law enforcement and strikes. That would further deter the tourists. It would also make it hard to put together a sensible government that continued with reforms. The field would be open for populists and extremists. This way leads to Charybdis.

To avoid this menace, the electorate will need to give a strong leader the mandate to pursue the current course more vigorously. Unfortunately, neither of the front-runners in the election next Sunday — the conservative Antonis Samaras and the radical leftist Alexis Tsipras — is a modern Odysseus. And neither looks as if he will secure a decisive victory. Unless a third election can produce a better outcome, the drachma will probably return and the Greeks will get sucked into the whirlpool.

Hugo Dixon is the founder and editor of Reuters Breakingviews.