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

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

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

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

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

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

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

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

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

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

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

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

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

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