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FORTUNE — There is so much turmoil in Europe right now, it's hard to know where to focus.

Greek voters will determine the fate of their currency on Sunday, and Spanish 10-year bond yields just hit a euro record high of 7%, the ominous level that prompted Greece, Portugal and Ireland to seek costly and humiliating sovereign bailouts.

But amid all of this, Europe's biggest problem may actually be Italy.

The country is simply too big to bail.

European Union leaders must finally get serious about creating a true fiscal and political union if they want to head off an all-out Italian financial and banking crisis.

At the same time, the Italians need to do their part by showing the market that they are serious about growing and modernizing the country's anemic economy and fractured political system.

Without a quicker response from both sides, the bond vigilantes will end up forcing the issue, which could bring a chaotic end to the euro and plunge the continent into an even deeper recession.

The 100 billion euro Spanish banking bailout announced in Madrid last weekend was supposed to bring calm to the markets and help lower borrowing rates across the continent.

But the poorly constructed plan did not fool the markets — borrowing rates in Spain and in other eurozone countries went up instead of down.

Now there is growing concern that the unelected technocrat government in Italy led by Mario Monti isn't moving fast enough to implement economic reforms that would help put that cracked economy back together again.

There is also concern that any positive reforms Monti ends up making will simply be reversed once he returns control of the government back to Italy's notoriously corrupt political parties, which could occur as early as the spring of next year.

It has certainly been a tough week for Italy.

First there was the gloomy economic data release showing that Italy's economy shrank 0.8% in the first quarter of the year, marking the third consecutive quarter of negative growth for Italy.

Later in the week, the Italian Treasury watched in horror as it had to pay a whopping 4% yield on its one-year sovereign bonds to attract investors, up from 2.3% last month.

At the same time, Italian 10-year bond rates rose to 6.2% on the open market, up from just 4.8% in March.

Then yesterday, Maria Fekter, the outspoken Austrian finance minister, shocked the markets when she said that Italy may be in need of a bailout.

This caused Italian yields to shoot up again with investors demanding a high 5.3% yield to buy Italian 3-year bonds, up sharply from the 3.9% they garnered just last month.

The jumps in yields were partially related to the troubles going on in Spain, but the bulk of the concern was centered squarely on Italy's own internal problems.

With a debt-to GDP ratio of 123% (and rising) and a total debt load quickly approaching two trillion euros, Italy is in some serious trouble.

Investors are demanding the extra yield because if Italy experiences problems there is no way the European bailout fund can come to its rescue.

Both the EFSF and ESA have a combined firepower that is half that of Italy's total debt load — and that's before counting bailout commitments already made to Ireland, Greece, Portugal and a possible future bailout of Spain.

If borrowing rates continue to rise, Italy would need extraordinary help from the European Central Bank to keep its debt market from collapsing.

The ECB has already bought up around 269 billion euros worth of Italian debt since launching its bond-buying program last year in an effort to blunt the rise in bond yields.

It seems reluctant to just continue buying Italian paper in such large quantities in perpetuity.

Italy has major funding needs and will need to issue around 120 billion more euros in debt this year to cover its budget shortfall and make its interest payments on existing debt.

Italy's large and once active debt market needs private investors who believe that the country is doing all it can to dig itself out of debt while remaining relatively solvent.

It needs to quickly regain investor trust before its bond yields hit critical levels.

A good start would be to attach a guarantee on Italian debt that forces the government to pay off its bond investors before paying for anything else, like education or health care.

Italy should also get more aggressive in selling off state-owned assets.

This will not only help to pay down its growing debt load but it would also show that the government still runs the show.

Monti hinted that the government was considering such a sell-off, but was vague as to what assets might be up for sale or when they would hit the block.

It is critical that Monti starts his big garage sale quickly and before investors start to doubt if it will ever happen.

The payoff could be huge, with some estimates of around 570 billion euros potentially up for sale.

That money will go a long way in helping to pay down Italy's debt load, which will push its credit rating much higher and hopefully lower borrowing rates.

The market also wants to see Italy getting serious on growth.

The Italian economy will continue to putter along unless there are significant changes to the way companies are run and structured.

Liberalizing hiring and firing laws was a good first step Monti helped push forward, but it should extend to all industries, especially government positions.

There also needs to be a lot more money earmarked for research and development schemes, especially those in the high tech sector.

Italy's economy is very old school with car manufacturing and textiles anchoring its GDP.

Italy's economy will continue to experience anemic growth if steps aren't taken to build an economy for the 21st century.

But this is just part of what needs to occur if Italy wants to avoid a trip to the bailout court.

EU leaders need to finally get real when talking about solving the eurozone crisis by offering up real solutions that address the tangible problems facing the common currency, like the lack of a fiscal union.

Creating a fiscal and political union is the only way Germany will agree to share more of its balance sheet and credit with its eurozone partners.

The creation of Eurobonds and the pooling of the eurozone's existing debt will help to rebalance the market so that it isn't so lopsided with the periphery debt-ridden and the core humming along.

The clock is now ticking on the eurozone crisis.

The next few days will prove critical with the Greeks heading to the voting booth to elect a new government while eurozone leaders meet in Brussels to discuss forming a closer fiscal union.

A negative outcome from either event could spook the Italian debt markets, sending bond yields critically higher.

Bond market investors will be looking for a hint of optimism so they can jump back in the European markets.

Hopefully the Europeans can finally deliver.