



A Chinese school is no fan of cheering for Japan

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Wal-Mart's U.S. chief is ringing up a rebound

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What's News —

Business & Finance

World-Wide

Spain's banking system may be next in line to take a hit from the global financial crunch, having so far held up well. The outlook, particularly for local savings banks, is dimming amid a deepening domestic housing bust. **Page 1**

■ **Some initial signs** of moderating U.K. inflation were reported alongside a sharp decline in retail sales. **Page 11**

■ **Germany's cabinet** is to vote on a bill that would allow the government to block foreign takeovers of companies. **Page 11**

■ **The Georgian conflict** is casting doubt on the country's reliability as a key energy corridor for Caspian crude. **Page 19**

■ **U.S. shares extended** their rally as oil prices continued to fall despite the conflict in Georgia. Auto and aerospace companies led Europe's gains. **Page 20**

■ **Five of the U.S.'s largest** credit unions are reporting big paper losses on mortgage-related securities. **Page 16**

■ **Waste Management raised** its unsolicited cash offer for rival Republic Services by nearly 10% to \$6.73 billion. **Page 8**

■ **Power shortages in China** could undermine manufacturing growth and fuel the already worrisome inflation rate. **Page 10**

■ **iPhone users have** downloaded over 60 million programs from an online software clearinghouse, Apple's Jobs said. **Page 32**

■ **U.S. natural-gas production** is up 8% this year and growing faster than demand, raising concerns for producers. **Page 7**

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11782.35	+48.03	+0.41
Nasdaq	2439.95	+25.85	+1.07
DJ Stoxx 600	293.06	+3.78	+1.31
FTSE 100	5541.8	+52.6	+0.96
DAX	6609.63	+47.98	+0.73
CAC 40	4538.49	+46.64	+1.04
Euro	\$1.5000	-0.0035	-0.23
Nymex crude	\$114.45	-0.75	-0.65

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Russian troops seized towns outside Georgia's disputed territories, prompting fears of a full invasion and threatening a decisive split between Russia and the West. The conflict is Europe's biggest diplomatic test since the U.S.-led invasion of Iraq. The crisis highlights Vladimir Putin's continuing dominance of Russia's foreign policy. **Pages 1, 2, 3, 4**

■ **Taliban insurgents** are stepping up a campaign to seize and destroy supplies for NATO troops in Afghanistan. **Page 9**

■ **A car bomber hit** a NATO convoy in Kabul, killing three civilians. Clashes and an airstrike in southern Afghanistan killed 25 militants and eight held hostage.

■ **Pakistani forces dropped** bombs on Islamic militants in a tribal region next to the Afghan border, killing at least 13 people.

■ **Zimbabwean President** Robert Mugabe said only "little hurdles" are left to clear in talks on a power-sharing deal with opposition leader Tsvangirai. **Page 10**

■ **Iraq said** military operations in Diyala province have been halted for a week. Jordan's King Abdullah II became the first Arab head of state to visit Iraq since the 2003 U.S.-led invasion.

■ **Thailand's high court issued** an arrest warrant for ousted Prime Minister Thaksin and his wife after they skipped bail and fled to exile in London. **Page 10**

■ **Bolivian President Morales** and some of his rivals among provincial governors kept their jobs in a national recall vote.

■ **Mauritania's coup leaders** released the prime minister and three other high-ranking officials held since last week.

■ **Padraig Harrington won** golf's U.S. PGA title Sunday, only the fourth player to win the British Open and PGA in the same year.

EDITORIAL & OPINION

Russian imperialism

The bear is on the prowl and the West better push back. **Pages 13-15**

Georgia appeals for help as Russia occupies towns

Troops capture Gori and a military base; fears of full invasion

BY MARC CHAMPION

TBILISI, Georgia—Russian troops for the first time occupied towns outside Georgia's disputed territories Monday, prompting fears in the Caucasus nation of a full invasion and threatening a decisive split between Russia and the West.

Thousands of Georgian troops, as well as tanks and other vehicles, fled the town of Gori, just below the disputed territory of South Ossetia late Monday afternoon in response to the Russian advance. By evening, Georgian officials said Russian infantry had taken the town, about 60 kilometers from the capital of Tbilisi.

In the west of Georgia near the Black Sea, Russia acknowledged that its troops moved out of the Russian-backed separatist territory of Abkhazia, seizing Georgia's most modern military base, Senaki. *Russian troops captured Gori, a town about 60 kilometers from the capital of Tbilisi, Monday.*

Spanish banks see resilience start to fade

BY SARA SCHAEFER MUÑOZ AND JONATHAN HOUSE

The Spanish banking system may be next in line to get hit by the global financial crunch.

As their counterparts throughout the U.S. have suffered mounting write-downs and gone hats in hand for capital injections, Spanish banks so far have held up remarkably well, a fact many analysts attribute to a regulatory system that forced them to set aside more reserves during the good times. But with a deepening local housing bust taking its toll on builders, homeowners and the broader economy, the outlook is dimming—particularly for the country's system of local savings banks.

In recent weeks, warning signs have multiplied. When British banking giant Barclays PLC reported half-year earnings last week, it included impairment charges of £103 million (\$197.7 million) in its Western European retail and commercial business to help cover losses tied to

Please turn to page 35



Russian military vehicles head for Gal, in Georgia's separatist region of Abkhazia.

EU's familiar rifts arise in addressing conflict

The war between Russia and Georgia is Europe's biggest diplomatic test since the U.S.-led invasion of Iraq five years ago.

The European Union—with its aspirations to a common foreign policy—is trying hard to show a united

By Marcus Walker in Berlin, John W. Miller in Brussels and Stacy Meichtry in Paris

front. But beyond the EU's call for an immediate cease-fire by Russian forces in Georgia, familiar fault lines are emerging over the conflict's true culprit and its broader implications.

Some established EU and NATO members, such as Germany, France and Italy, are expressing only limited criticism of Russia, a major energy supplier that many Western European governments view as a partner they can't do without. The U.K., however, which has had several diplomatic spats with Moscow this year over energy giant BP PLC's investments in Russia, went further, with Prime Minister Gordon Brown warning that Russia's military actions would damage its relations with other countries.

Some European officials are warning that Georgia has set back its hopes of joining the North Atlantic Treaty Organization through its attempt to seize control of its breakaway province of South Ossetia Thursday night. Russia vehemently opposes NATO membership for

Georgia and Ukraine, which also wants to join.

"This is clearly part of a bigger game, which is the expansion of NATO," Italian Foreign Minister Franco Frattini said in an interview. "Today Georgia's entry [into NATO] is more complicated," he said. "It doesn't behoove us to pit ourselves against Russia. Russia is a strategic partner."

But in Central and Eastern Europe, where former Soviet satellites such as Poland and Estonia have joined the EU and NATO, governments are seeking a robust condemnation of Russian actions in Georgia, amid rising fear that Russia could assert itself through military force against other neighbors in future.

The Russian offensive in Georgia "is a clear warning to Ukraine and Moldova," Estonian Foreign Minister Urmas Paet said in an interview. In the Baltic countries, the notion of Russian tanks rolling in is not that far fetched, he said.

"Indications are not so good" for a united EU stance in the present crisis, said Estonian President Toomas Hendrik Ilves. He said West European countries which oppose NATO's opening to Georgia were partly to blame for the conflict, because they "sent a green light to Moscow to go ahead and move. I think that was a serious miscalculation."

Europe was split down the same lines at the last summit of NATO lead-

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LEADING THE NEWS

Kremlin casts maneuver as form of defense

Putin argues rights of ethnic Russians have been abused

BY JEANNE WHALEN AND ALAN CULLISON

For the West, the war in Georgia is Russia's most aggressive foreign-policy maneuver in decades.

Russia's handling of the crisis highlights the continuing dominance of Vladimir Putin over Russia's foreign policy, even after he formally ceded the presidency to his longtime confidant Dmitry Medvedev.

Since Mr. Putin came to power in 2000, he has worked to reassert Russia's dominance in and around the borders of the former Soviet Union.

Mr. Putin also has sought to defend the rights of ethnic Russians and Russian passport holders living abroad, who he says have been abused and neglected by the newly independent states that arose from the former Soviet Union.

It is a cause, Russia argues, that the West should understand. Earlier this year, with the backing of the

West, Kosovo was effectively granted independence—an ethnic group within a sovereign country, just like South Ossetia.

The desire of South Ossetia and Abkhazia for independence is "historically and actually much more legitimate than Kosovo's," Mikhail Margelov, chairman of the foreign-affairs committee in the upper house of Parliament, said in a letter to U.S. senators Monday.

The Kremlin continued to insist that it was merely responding to an attack by Georgia on innocent South Ossetians, calling it "genocide." In a televised meeting with his cabinet Monday, Mr. Putin expressed irritation with the West's response to the situation.

"The scale of their cynicism causes surprise," he said. "It's the ability to cast white as black, and black as white which is surprising, the ability to cast the aggressor as the victim and blame the victims for the consequences."

Mr. Putin particularly criticized the U.S. for transporting Georgian troops from Iraq back to Georgia. "It's a pity that some of our partners, instead of helping, are in fact trying to get in the way," he said.

Russia's tough handling of the situation is disturbing the country's neighbors. "It's worrisome," Estonian President Toomas Hendrik Ilves said in a telephone interview, adding that he phoned Georgian

President Mikheil Saakashvili on the first day of the conflict to express his support. "That's why we wanted to be in NATO. That's why Georgia wanted to be in NATO. And still does."

Mr. Ilves said Russia's argument that it is merely responding to a Georgian attack on South Ossetia is hard to believe. "This required a long-term, massive buildup with planning, so it's difficult to say this is a reaction to anything. This was fairly well coordinated, with ships coming from Sevastopol and 10,000 troops moved in in a matter of a day."

Highlighting the different perceptions of the conflict in the West and inside Russia, many Russians believe that the White House is behind the conflict.

Mr. Saakashvili "was forced to start this war by [U.S. Vice President] Dick Cheney to support the campaign of John McCain," the presumptive Republican nominee for U.S. president, said Sergei Markov, a member of Parliament and director of the Institute of Political Studies. "The only possibility for John McCain to win is to have some kind of war," Mr. Markov said in a phone interview Monday.

Russian state-controlled television also hinted that Washington had encouraged Georgia to strike South Ossetia.

The gulf in understanding between the West and Russia over the

occupation of South Ossetia isn't likely to be closed any time soon. Russia's European neighbors, most of them former Soviet republics, have long accused Moscow of using the defense of ethnic Russians living abroad as an issue to manipulate internal politics.

In recent years, Russia has effectively bypassed Latvia as a route for its oil exports amid allegations that Riga is mistreating ethnic Russians living there.

Russia sharply curtailed oil exports through Estonia last year, after the government there moved a monument to Soviet war dead from the capital of Tallinn.

Sympathy for Georgia should run especially high in Ukraine, a country of 46 million people whose

political leadership has accused Moscow of manipulating its large ethnic Russian population, concentrated in the east near the border with Russia.

Ukraine's president, Viktor Yushchenko, suffered a near-fatal poisoning of dioxin in 2004 while running against a pro-Russian presidential candidate. Mr. Yushchenko says he knows who masterminded the crime but refuses to name names. He accuses Russia of refusing to extradite key figures in the case or provide Russian-made dioxin samples for tests. Russia is one of the few countries that produces the dioxin of the formula found in Mr. Yushchenko's body.

Over the years Messrs. Yushchenko and Saakashvili have become close personal confidants.

CORRECTIONS & AMPLIFICATIONS

Emirates Airline isn't the only carrier affected by delays completing Boeing Co.'s 777 aircraft. A page-one article Friday incorrectly said the three planes were all for Emirates.

Common shares in Fresenius Medical Care were up 1% this year through Friday. Monday's European Markets article incorrectly gave the performance of the company's less-liquid preferred shares.

The Parc Landon Agency works on behalf of David Beckham's soccer team, the Los Angeles Galaxy. The On Style column in Friday's Weekend Journal incorrectly said Mr. Beckham himself has been a client.

Writer Branwell Brontë's sisters were Maria, Elizabeth, Charlotte, Emily and Anne. A Weekend Journal article Friday about author Daphne du Maurier incorrectly said one of Mr. Brontë's sisters was named Jane.

INDEX TO BUSINESSES

This index of businesses mentioned in today's issue of The Wall Street Journal Europe is intended to include all significant references to companies. First reference to these companies appear in boldface type in all articles except those on page one and the editorial pages.

Table listing various companies and their page numbers, such as Advance Publications, Alitalia, Allianz SE, etc.

INDEX TO PEOPLE

This index lists the names of businesspeople and government regulators who receive significant mention in today's Journal.

For more people in the news, visit CareerJournal.com/WhosNews

Table listing names of people and their page numbers, such as Arkin, Stanley, Astorina, Joseph, etc.

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LEADING THE NEWS

Georgia crisis challenges McCain, Obama

As '3 a.m. moment' hits the candidates, their responses differ

BY LAURA MECKLER

WASHINGTON—The violence between Russia and Georgia quickly thrust foreign policy into the U.S. presidential election, with John McCain standing to benefit and Barack Obama facing a more perilous situation.

The conflict was soon cast as “a 3 a.m. moment”—a reference to Sen. Hillary Clinton’s argument during the Democratic primary that Sen. Obama was unprepared for a middle-of-the-night phone call on a foreign-policy crisis.

As such, the conflict gave Sen. Obama the opportunity to show that he is indeed prepared, but it also gave prominence to foreign policy, one of the few areas where polling shows that Sen. McCain has a clear advantage with voters.

“It’s a chance for both candi-

dates to really seem presidential—big P ‘Presidential’—for the first time,” said Jay Campbell, a Democratic pollster who helps conduct the Wall Street Journal/NBC News poll. “The challenge is probably a little bit more pointed for Obama than McCain.”

It wasn’t clear whether the conflict will expand, or whether it will come to the fore in the minds of voters typically more concerned with close-to-home issues such as the price of gasoline.

“The truth is it probably won’t have much impact at all—the sad truth, perhaps,” said Democratic consultant Mark Mellman. But he said that if the issue does affect voters, “it gives McCain a slight advantage.”

That is because voters already see him as more prepared to handle this kind of crisis, a problem that Sen. Obama tried to rectify with a trip last month to the Middle East and Europe. While Sen. Obama has little foreign-policy experience, Sen. McCain was in the Navy, was a prisoner of war for 5½ years and has long sat on the Sen-

ate Armed Services Committee.

“It is a real national-security crisis,” said Nicolle Wallace, an adviser to Sen. McCain. She added that while much of the foreign-policy debate has centered on the war in Iraq, this is a reminder that other parts of the world hold peril.

Still, the crisis gives Sen. Obama an opportunity to prove himself by saying “the right

The issue could give Sen. McCain ‘a slight advantage,’ said a Democratic adviser.

things” and striking the “right stance and tone,” said Mr. Campbell, the pollster.

The candidates’ responses to the crisis were initially very different in tone. Sen. McCain forcefully blamed Russia, a country he has taken a hard stand on in the past. He has called for ejecting Russia

from the Group of Eight leading nations and has mocked U.S. President George W. Bush’s statement that he saw goodness in former Russian President Vladimir Putin. Sen. McCain said that when he looked into Mr. Putin’s eyes, he “saw three letters: K-G-B.”

“Russia should immediately and unconditionally cease its military operations and withdraw all forces from sovereign Georgian territory,” Sen. McCain said Friday morning. He credited Georgia for having called for a cease-fire.

Sen. Obama’s initial response was more measured, not blaming either side. “Now is the time for Georgia and Russia to show restraint, and to avoid an escalation to full-scale war,” he said. Later Friday, Sen. Obama toughened his position, calling for restraint on both sides but blaming Russia for invading its neighbor. Saturday, he went further, saying, “Russia has escalated the crisis in Georgia through its clear and continued violation of Georgia’s sovereignty and territorial integrity.”

Obama foreign-policy adviser

Michael McFaul, an expert on the region at Stanford University, said that at first it wasn’t clear that Russia was entirely at fault. “I just don’t think at that point it was useful to start assigning blame. The first thing you need to do is stop the violence,” he said.

But the McCain campaign is pointing to the Arizona senator’s initial statement as evidence that he got it right from the start. Sen. Obama’s “first statement was very weak and did not distinguish between the aggressor and the victim,” said Randy Scheunemann, Sen. McCain’s top foreign-policy adviser.

Meanwhile, the Obama campaign pointed to statements in April and July on the gravity of the conflict, while the McCain campaign highlighted the Arizona senator’s past engagement on the issue.

The conflict, said McCain spokesman Tucker Bounds, “is an opportunity for American voters to get a sense of the way both candidates will perform in a very serious international situation.”

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THE RUSSIA-GEORGIA CONFLICT

Georgia appeals for help as Russian troops occupy towns

Continued from first page
sian troops also moved into Zugdidi, the main Georgian town outside the Abkhaz border, according to Shota Utiashvili, the spokesman for Georgia's interior ministry. The Zugdidi and Gori occupations couldn't be confirmed independently.

"We are in the process of the invasion, occupation and annihilation of an independent, democratic country," said Georgia's president, Mikheil Saakashvili, appealing in English for international help at a news conference. He said Moscow's goal was regime change, accusing his powerful northern neighbor of "ethnic cleansing" in Abkhazia.

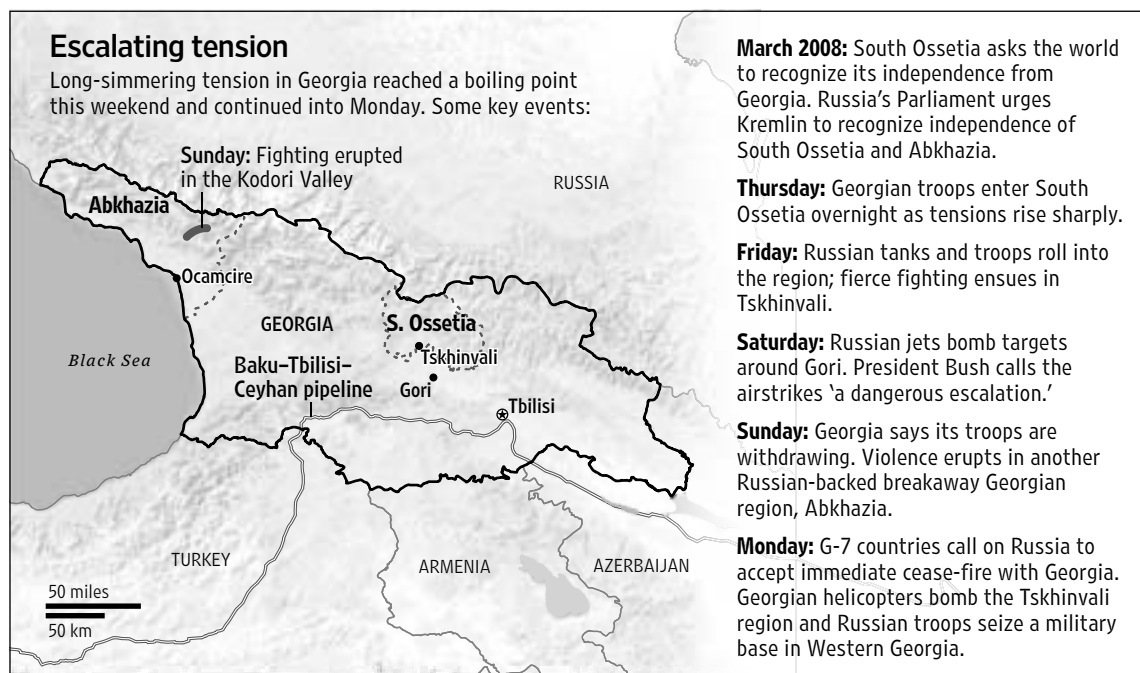
Russia's foreign ministry and other officials insisted Moscow's goal wasn't to move on Tbilisi or to occupy the whole country but to create a buffer zone that would prevent Georgian troops from firing into the country's two separatist territories.

Gori and Senaki lie on the main highway that runs east-west across the country, from Tbilisi in the east to the Black Sea coast in the west, giving Russian troops the ability to control movement across the nation. Late Monday, Mr. Saakashvili said his country had effectively been cut in half.

"We no longer know the limits of the invading Russian army," said Kakha Lomaya, secretary of Georgia's National Security Council. The government said Georgian troops were pulling back to protect the capital.

Russian Prime Minister Vladimir Putin confirmed a desire for regime change in televised comments Monday. "To quote Ronald Reagan: Somoza is a scoundrel, but he's our scoundrel, and we'll protect him," Mr. Putin said, referring to Nicaragua's former U.S.-backed president, Anastasio Somoza.

"The world has changed since



the Cold War," Mr. Putin added, implying that the U.S. wouldn't be able to protect its new "scoundrel," Mr. Saakashvili. Mr. Putin also accused the U.S. of extreme cynicism for agreeing to help Georgia ship home 2,000 troops from Iraq.

In a further sign Russia's military intervention in Georgia is proving a watershed in relations between Russia and the West, in particular the U.S., the Group of Seven leading industrialized nations issued a statement after a conference call urging Russia to accept an immediate cease-fire. The G-7 is often expanded into the Group of Eight, which includes Russia, but Russia's foreign minister wasn't included in the call.

Earlier Monday morning, Mr. Saakashvili signed a draft ceasefire agreement submitted to him by French Foreign Minister

Bernard Kouchner. Mr. Saakashvili said the draft calls on both sides to stop shooting, withdraw to their positions before the conflict, and then patrol the areas with a joint Russia-Georgia force of peacekeepers. Georgia declared a unilateral ceasefire at dawn on Sunday, but Russia continues to say it is not being observed and has refused to follow suit.

"We are in an extreme situation," said Georgia's Foreign Minister, Eka Tkeshalashvili, speaking by phone from the government's emergency-situation room. Earlier, she said she believed Russia was using the ceasefire situation as a delaying tactic, giving it time to achieve its military goals.

Russian officials showed increasing anger at the way the conflict and Russia's actions are being portrayed in the West.

"The Russian army is trying to enforce peace, and to do that, we have to attack the Georgian military," which is shelling South Ossetian villages and towns from outside the region's nominal border, Sergei Ivanov, Deputy Russian Foreign Minister said on CNN. "We have to stop the genocide." He also indicated that Mr. Kouchner's ceasefire proposal falls short: Moscow is demanding that Georgia first sign agreements with leaders of the pro-Russian breakaway republics of South Ossetia and Abkhazia.

Both Mr. Ivanov and Konstantin Kosachev, chairman of the Foreign Affairs Committee of the Russian Duma, justified the Russian action with a comparison to NATO actions in Kosovo in 1999, when NATO aircraft bombed targets in Serbia proper, as far from the Kosovo battlefield as Belgrade.

"We're doing the same as the British did in Serbia," Mr. Kosachev told Britain's BBC World TV. In 1999, against fierce Russian opposition, NATO mounted a major air campaign against Serb forces in Kosovo. NATO aircraft also targeted infrastructure around Serbia in an effort to halt what it described as genocide against Kosovo Albanians, hundreds of thousands of whom fled the country.

Russian officials say between 1,000 and 2,000 civilians were killed in South Ossetia when Georgian forces launched an offensive Thursday night. They also alleged that civilians were deliberately burned, run over by tanks, or killed with hand grenades as they hid in their basements. None of those claims have been independently confirmed.

The United Nations High Commission for Refugees said Monday it was organizing an airlift of supplies for some 30,000 refugees from South Ossetia who have fled North into Russia. It also said it was concerned that about 56,000 Georgians had now been displaced from Gori. Thousands more have fled Zugdidi, and on Monday the U.N.'s refugee agency said civilians from the Georgia-held valley of Upper Abkhazia, where an estimated 2,000 people live, fled in buses as Russian-backed Abkhaz forces moved on the valley.

The high commission said it still didn't know exactly how many people have been displaced in the conflict and was relying on Russian and Georgian figures. The refugee agency has a permanent mission in Georgia, where it helps 275,000 displaced people, the vast majority of whom are Georgians who fled Abkhazia in the early 1990s, when Russian-backed Abkhaz forces drove Georgian troops out of the region in a conflict that included atrocities on both sides.

As European Union seeks united front, familiar divisions emerge

Continued from first page
ers in April, when Germany, France and some other Western European countries blocked a push by the U.S., with support from East European leaders, to give Georgia and Ukraine a so-called membership action plan, which would have been a significant step towards joining NATO.

NATO foreign ministers are due to review the alliance's stance in December. Diplomats and analysts say the war in Georgia will probably make skeptical European governments even less inviting towards Georgia and Ukraine than before, for fear of being sucked into a dangerous confrontation with Russia by unpredictable allies.

"In the minds of the Western European countries, Georgia has been rash" in trying to take control of South Ossetia through military force, said Sergio Romano, a former Italian ambassador to NATO and Moscow. "This will harden attitudes" in France, Germany and Italy.

Georgia's military move last week was "not terribly wise," said one U.K. official, who declined to be named. Still, the U.K. put the onus on Russia on Monday to end the fighting.

"There is no justification for continued Russian military action in Georgia, which threatens the stability of the entire region and risks a humanitarian catastrophe," Mr. Brown said.

A spokesman for German Chancellor Angela Merkel, Thomas Steg, said it was too early to say what NATO foreign ministers will decide

in December, but that Georgia's "conflict potential and internal tensions," as highlighted in recent days, had shaped Ms. Merkel's opposition to membership action plans in April.

The EU's short-term aim is to stop the conflict from escalating into a war in which Russia seeks to occupy Georgia and overthrow the government of President Mikheil Saakash-

The EU's short-term aim is to stop the conflict from turning into all-out war.

vili, which some European officials fear the Kremlin would like to do.

European countries voiced their support on Monday for French-led diplomatic efforts to stop the fighting and get Russia and Georgia to the negotiating table. French President Nicolas Sarkozy, who holds the EU's rotating presidency, was due to visit Moscow and Tbilisi Tuesday to mediate between the two sides.

French foreign minister Bernard Kouchner met Mr. Saakashvili to discuss an EU plan that calls for an immediate cease-fire, medical access to victims and the withdrawal of both Russian and Georgian troops from the disputed region.

But analysts say the EU has little leverage to secure a quick cease-

fire if Moscow prefers to press its military advantage. "We have very limited tools to convince Russia to stop the use of force," says Thomas Gomart, Russia analyst at the French Institute of International Relations.

Europe has also sacrificed influence by effectively telling Georgia it can't join NATO until its territorial disputes are resolved, analysts say, because Moscow has every incentive to keep Georgia's conflict with its Russian-backed separatist regions simmering.

Since the end of the Cold War, Western Europe has held out the dual offer of joining the EU and NATO as a carrot for former Communist countries looking to become Western-style democracies with market economies. That policy is increasingly running up against hard-nosed rejection from Russia, which has long resented Western encroachment in its former sphere of influence, and whose assertiveness is growing in parallel with its oil-fueled economy.

The Georgian crisis is "a big game-changer," says Tomas Valasek, an analyst at the Centre for European Reform, a London think tank. "EU foreign policy has worked on the basis that if we hold out the prospect of membership, the world around the EU will eventually change in the EU's image. That vision is under threat," he said.

The West's response to the war exposes its division into three camps on how to handle Russia,

NATO Alliance

European membership landscape in addition to U.S. and Canada

NATO member	Candidate countries	In talks to join
1 Belgium	25 Slovenia	28 Ukraine
2 Bulgaria	26 Albania	29 Georgia
3 Czech Rep.	27 Macedonia	30 Bosnia-Herzegovina
4 Denmark	24 U.K.	31 Montenegro
5 Estonia		
6 France		
7 Germany		
8 Greece		
9 Hungary		
10 Iceland		
11 Italy		
12 Latvia		
13 Lithuania		
14 Luxembourg		
15 Netherlands		
16 Norway		
17 Poland		
18 Portugal		
19 Romania		
20 Slovakia		

Source: North Atlantic Treaty Organization

says Markus Kaim, head of security policy research at the German Institute for International and Security Affairs. The U.S. sees Russia as a strategic rival, Western Europe sees it as a strategic partner and Eastern Europe sees it as a threat, he says.

Germany, which gets more than a third of its natural gas from Russia, has long been a key supporter of strategic partnership with Moscow.

That hasn't changed under Ms. Merkel, despite her sometimes blunt criticisms of Russia's record on human rights and democracy.

Italy is also heavily dependent on Russian energy imports and is one of the most pro-Russian EU members.

—Alessandra Galloni in Paris, Jeanne Whalen in Moscow and Alistair MacDonald in London contributed to this article.

CORPORATE NEWS

AIRLINES

Cathay Pacific to reduce flights to North America



CATHAY PACIFIC Airways Ltd. said it plans to cut more flights to North America and re-deploy aircraft on shorter routes to Australia and Europe as it copes with record fuel prices.

The Hong Kong-based carrier said it will suspend one of three daily flights to Los Angeles beginning Oct. 26, when it plans to add weekly flights to Australia. It also will stop three weekly flights to Vancouver, in addition to earlier-announced plans to reduce seven weekly flights to Canada.

The airline said last week that its average fuel price jumped 60% from a year earlier to US\$132 a barrel in the first half. —Jeffrey Ng

MINING

Kazakhmys raises stake in ENRC to just over 25%



LONDON-LISTED miner Kazakhmys PLC said it increased its stake in Eurasian Natural Resources Corp. to just more than 25%, but it said it had no plans "at the moment" to further increase that

stake or launch a full bid for the larger rival.

The company bought an additional 35.73 million shares in ENRC, which produces alloys, iron ore and aluminum, for about £402.4 million (\$772.5 million), bringing its stake in the company to 25.02%, up from 22.24%, and making it the single biggest shareholder in ENRC. ENRC declined to comment.

In May, ENRC proposed a £7.05 billion takeover of Kazakhmys, which was rejected. —Erica Herrero-Martinez

AVIATION

Lagardère, Daimler are dropped from lawsuit



LAGARDÈRE SCA said a U.S. lawsuit alleging insider trading in European Aeronautic Defence & Space Co. by the French media company and Daimler AG has been dropped.

European shareholder Danielle Bobin decided to terminate the action Aug. 4, Lagardère said. She is represented by New York law firm Dreier LLP.

Lagardère and Daimler both sold large blocks of EADS shares in April 2006, weeks before EADS announced delays in its A380 superjumbo-jet project.

French prosecutors and regulators are still investigating alleged insider trading at EADS. —Jethro Mullen

Wal-Mart's U.S. chief lays out his strategy

Castro-Wright gets struggling division to hit sales targets

BY ANN ZIMMERMAN

EDUARDO Castro-Wright took over as chief executive of Wal-Mart Stores Inc.'s U.S. division three years ago, just as growth of the \$240 billion unit appeared to have hit a wall.

The U.S. economy was relatively robust in 2005, but Wal-Mart posted slowing sales growth while rivals surged forward. One solution the Bentonville, Ark., discounter tried—luring higher-income shoppers with trendier fashions—flopped, eroding profits. Mr. Castro-Wright, a Texas A&M University-trained engineer who is 53 years old, devised a three-year plan to overhaul stores marred by cluttered aisles, unattractive merchandising displays and slow checkout lines.

As Wal-Mart prepares to report fiscal second-quarter earnings on Thursday, the changes appear to be paying off. Its U.S. stores have beat or hit sales targets for the last six months, besting most of its rivals. Sales slowed somewhat in July as the last of the U.S. government stimulus checks were spent, and Mr. Castro-Wright noted that consumers were getting increasingly cautious.

Wal-Mart's return to its low-price roots has been seen as a boon to consumers amid the swooning economy. But recent efforts to warn its work force about proposed legislation that could make it easier to unionize companies have given its opponents new ammunition.

In an interview, Mr. Castro-Wright talked about how his strategy is progressing. Excerpts:

WSJ: How much of the credit for recently improved sales goes to bargain hunters turning to Wal-Mart

in a weak economy, and how much to your overhaul plan?

Mr. Castro-Wright: I wouldn't say a significant part of the current results is related to the economic environment. The changes in merchandising, marketing and improved service in the stores, aligned around the purpose of saving money so people can live better, have vastly improved the shopping experience, and that will continue to drive sales after the economy rebounds.

WSJ: Costco Wholesale Corp. recently issued a profit warning it blamed on rising merchandise costs. Is Wal-Mart facing the same pressure to accept price increases from suppliers that it will have to pass on to consumers?

Mr. Castro-Wright: As you know, Wal-Mart is the price leader and we will do whatever it takes to retain price leadership.

WSJ: What were your marching orders from Chief Executive H. Lee Scott Jr. when he put you in charge of the Wal-Mart Stores division?

Mr. Castro-Wright: The marching orders would have been something like "We need to fix the customer experience in the stores." Now that does not mean that the orders were "Clean up the stores." That's easy. Providing a good customer experience starts with providing customers with the product choices they deserve, maintaining clean environments, and having friendly associates [employees] so that the customers would want to come back.

WSJ: Wal-Mart's senior leaders traditionally grew up in the company. You worked at RJR Nabisco and Honeywell before heading Wal-Mart's Mexico-based stores. And your senior leaders cut their teeth at Target, PepsiCo's Frito-Lay and Diageo. How important was that outside experience to devising and implementing changes?

Mr. Castro-Wright: I think that the power of a leadership team is in diversity, especially diversity of



Wal-Mart's Eduardo Castro-Wright discusses changes he has implemented in stores across the U.S. during a tour of a Wal-Mart Supercenter in Rogers, Ark., last week.

thought. You want people that have different backgrounds, that think differently and have different experiences, so they can contribute in ways that are always additive.

WSJ: What did the three-year plan entail?

Mr. Castro-Wright: First, we had to reinforce our price leadership. We needed to ask ourselves what we stood for and it was more than just low prices, but [rather] saving people money to make their lives better. That gave us a unifying marketing message and gave 1.3 million associates a powerful sense of purpose.

Then it included everything from improving navigational signs in the stores so people could find things more easily to investing in technology to allow for a faster checkout. We took down high shelves to reduce clutter and improve sight lines throughout the store.

We learned that providing customer choice wasn't about more products, but carefully selected products that customers cared about. We made big bets in growth categories such as consumer electronics, providing brands that gave

us authority.

It's still not finished yet.

WSJ: Did you make any mistakes along the way?

Mr. Castro-Wright: Many. The one thing I would do differently is I would have done things faster, which is counterintuitive. When you think about changing a big organization rooted in its history, you think the changes should be gradual. I think that the faster you move, the faster you make the tough calls and the better off you're going to be. You don't want to have organizations in what some people think of as a liquid state. I'm an engineer by training so my physics comes back. An organization is something very solid and when you apply a lot of heat to change it, it becomes fluid. You want to make sure that you don't keep it fluid too long, because liquids move in many directions that you might not have intended.

WSJ: Wal-Mart's culture was Bentonville-based, with divisional and regional presidents fanning out across the U.S. every Monday, visiting stores, then reporting back by the end of the week. You moved all

of those executives into the markets they managed. How hard was it to make that change?

Mr. Castro-Wright: The idea of having people out there day in and day out where they are part of the community, where they live the same issues and opportunities, root for the same local football team, that all creates ownership. And in business, results are directly linked to how much you believe that you own the results that you're accountable for. Because of that, while very difficult and culturally challenging, I believe that from a customer point of view it was the right thing to do.

WSJ: When you ran Wal-Mex, you opened smaller stores that proved very successful. Do you think the smaller-format stores you are testing in Arizona will play a big part in Wal-Mart's future?

Mr. Castro-Wright: We are a multi-format retailer in most of our foreign markets and there's no reason why being a multi-format retailer in the U.S. wouldn't allow us to serve our customers better.

WSJ: Your grandfather built what became one of the largest supermarket chains in Ecuador. Did you ever think about staying in the family business?

Mr. Castro-Wright: I never worked for the family business except when I was probably 10 years old and I used to go on the weekends with my mother and I helped in stocking shelves. ... I come from a very large family [one of eight children] and I figured early on that probably there was going to be a lot of competition.

WSJ: You have been mentioned as a possible successor to Lee Scott as chief executive. What do you think is next for you?

Mr. Castro-Wright: I enjoy what I do today. I think that we haven't completed what we set out to do, so I'm focused on how do I help my team achieve the objectives that they have.

CORPORATE NEWS

Food giants shift their costs to consumers

Soaring grain prices are changing the way many do business

BY SCOTT KILMAN

Companies throughout the food chain are changing the way they do business in response to soaring grain costs, and consumers are likely to bear the brunt in the form of rising food prices.

Farmers are making the broadest cuts to their livestock herds in decades, meaning meat at the supermarket will likely cost more in coming years. Middlemen are trying to shorten the duration of supply contracts to 90 days from one year so they can pass on higher costs more quickly. And food brands are shrinking the contents of their packages, from ice-cream cartons to beverage containers.

"Everyone's adjusting," Brenda C. Barnes, chief executive of Sara Lee Corp., said Thursday after the company reported a \$695 million loss for the quarter ended June 28. That included an \$850 million after-tax charge, mostly for writing down the value of bakery businesses hit by soaring wheat costs.

The Downers Grove, Ill., food giant, whose stable includes bread, cheesecake and hot dogs, is winnowing its product lineup and reducing the amount of meat in its Hillshire Farm deli packages, among other steps. Sara Lee expects its commodity and energy costs to climb an additional \$500 million in its fiscal year ending June 2009, following a \$350 million increase in fiscal 2008.

Nestlé SA, which on Thursday reported a strong profit for the first half of the year, has raised its prices on thousands of products in recent months, passing at least some of its higher costs on to consumers.

Before the grain markets stirred in the summer of 2006, the price of corn had stayed below \$3 a bushel for a decade. In the space of two years it surged as high as \$7 a bushel. Soybean and wheat made similar moves.

Global grain demand has outstripped production for much of this decade, draining supplies to unusually low levels. Strong economic growth in the developing world is giving hundreds of millions of people the means to afford richer diets, such as grain-fed meat. High oil prices on top of aggressive government mandates, meanwhile, are stoking production of corn-derived ethanol fuel. U.S. ethanol makers, while still struggling for profitability, are forecast to consume one-third of the corn now growing across the Midwest—double their appetite of just two years ago.

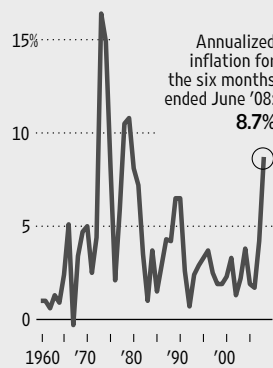
In the past month, the speculative fever has eased. Still, the efforts by ranchers, bakers and meatpackers to shift the burden of higher grain prices show they think their raw-material costs aren't returning to their old levels soon.

"They know prices aren't going backward," says David A. Schawk, chief executive of Schawk Inc., a Des Plaines, Ill., firm that designs packaging for companies. He figures that up to 5% of grocery products are shrinking, a level he calls unprecedented.

Higher prices hit the table

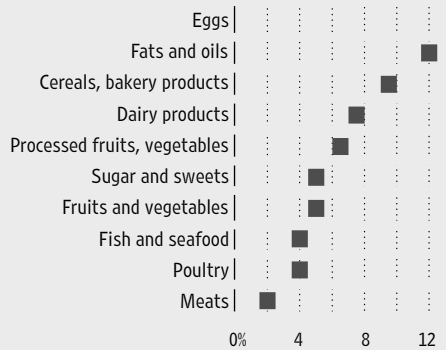
U.S. food prices are rising faster and are expected to keep climbing

Annual change in the prices of food consumed at home

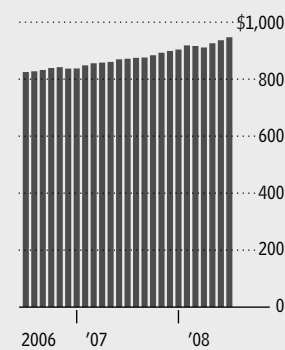


Forecast change in U.S. consumer prices in 2008

Minimum ■ Maximum

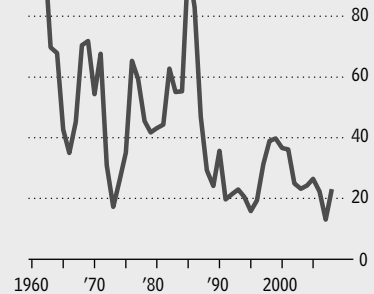
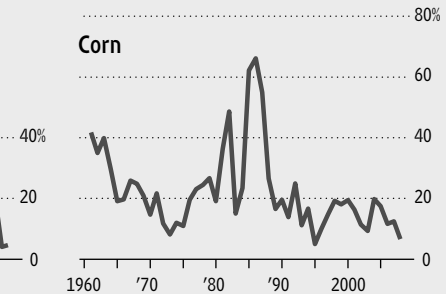
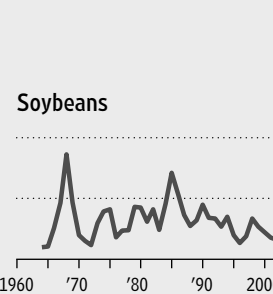


Monthly cost for a family of four* to eat a healthy diet on a moderate budget in the U.S.



Inventories of key crops have fallen to unusually low levels in the U.S.

Stocks-to-use ratios, or inventories at the end of each year measured in terms of that year's demand



*Couple with one child, 6 to 8 years, and one child, 9 to 11 years

Sources: U.S. Labor Department (food-at-home inflation); U.S. Department of Agriculture's Economic Research Service (food-price forecasts and family food costs); AgResource (stocks-to-use ratios)

The grain-price rally is adding billions of dollars to the U.S. food industry's annual costs, creating new winners and losers. Many companies that help farmers grow crops are riding high. The stock price of fertilizer maker Mosaic Co. has climbed about sevenfold since the grain boom began two years ago. Monsanto Co. stock is up about 140% on rising sales of its genetically modified seed. Deere & Co. stock is about 90% higher on strong demand for the company's farm equipment.

Many food processors, meanwhile, are slumping because they are having a hard time passing along their costs. Pork giant Smith-

Grain is adding billions of dollars to costs, creating new winners and losers.

field Foods Inc.'s stock has slipped 10% since August 2006, while the stock of meat rival Tyson Foods Inc. has lost 24% of its value over the past year. The stock of dairy-products giant Dean Foods Co. dropped 5.7% one day last week despite reporting stronger second-quarter earnings because it warned of "continued volatility and inflationary pressure."

Food companies with strong brands are having the most success passing higher costs to consumers. The stock price of cereal maker Kellogg Co. is up 11% since the grain-price rally began.

"I think we are in the early stages of this," said Paul D. Ridder, chief financial officer of Tasty Baking Co., a Philadelphia maker of snack cakes,

which raised prices of its single-serving items by 8% during its second quarter ended June 28.

During the first six months of 2008, the consumer-price index for food compiled by the U.S. Bureau of Labor Statistics rose at a seasonally adjusted annualized rate of 6.8%, with retail prices of breakfast cereal, bakery products and cooking oil among the fastest climbers. That six-month inflation rate is far higher than anything U.S. consumers have had to stomach in 18 years.

In another measure, the cost of the groceries that the federal government suggests middle-class families buy to have healthy diets rose 8.6% in June compared with the same month a year earlier.

Michael Swanson, an economist at Wells Fargo & Co., thinks the food-inflation rate could rise as high as 6% next year. Paul Prentice, president of Farm Sector Economics, Colorado Springs, Colo., said he expects retail food prices to rise about 7.5% in 2009.

The U.S. Department of Agriculture sees food prices climbing 4.5% to 5.5% this year and 4% to 5% in 2009. Even under this more conservative forecast, the average family of four would see its annual food costs hit \$9,800 in 2009, up about \$1,200 since 2006.

Meat is a big reason economists think food inflation has legs.

Grain is such a big part of the cost of raising livestock that many farmers big and small are losing money on every chicken, steer and hog they sell this summer. As a result, the livestock industry is beginning what could be its biggest contraction since 1982. By next year, the supply of beef, pork and poultry available to U.S. consumers is expected to shrink by five pounds per person, according to the Live-

stock Marketing Information Center in Denver.

Joe Jennings, who raises cattle with his brother near Lazbuddie, Texas, is shrinking his family's feedlot operation to 2,000 cattle—half last year's level and their smallest herd since the 1970s. The brothers have lost roughly \$100 on some steers because the cost of fattening them on grain has climbed nearly 60% in two years.

"It is getting pretty precarious," said Mr. Jennings, 60 years old.

Feedlots are buying fewer cattle from ranchers, who in turn are selling their breeding cows for slaughter, which means fewer calves in the future. James Mintert, a Kansas State University economist, expects the number of U.S. cattle to sink as low as 90 million by January 2010, down 6.7 million from January 2008.

Smithfield, which reported a 94% drop in its earnings for the fourth quarter ended April 27, is shrinking the size of its breeding herd by 5%, or about 50,000 sows.

Poultry processor Pilgrim's Pride Corp., which saw its poultry-feeding costs leap \$266 million, or 41%, during its fiscal third quarter ended June 28, figures the wholesale price of chicken breasts needs to climb roughly 60% for the company to cover its costs. The company is cutting chicken production during the current quarter by 8.7%.

"American consumers should brace themselves for sticker shock in the meat case over the next 12 months," Pilgrim's Pride Chief Executive Clint Rivers said last week during a conference call with analysts.

Chris Hurt, a Purdue University agriculture economist, said retail pork prices will probably jump by more than 10% late this year. Retail

beef prices will probably begin to accelerate in 2009, jumping by more than 10% in some months, then continue to climb through 2011, he said.

Food executives also are trying to find ways to pass along costs more quickly. Meat companies have long sold much of their meat to food-service customers under contracts that fix the price for a year or longer. Executives of Pilgrim's Pride and Tyson Foods said recently they are trying to modify their contracts so they can adjust prices every 90 days or so.

"We're in a new era of ratcheting up food costs," says Larry Marcucci, president of Alpha Baking Co., which is paying twice as much for wheat flour as a year ago to make the bread and buns it sells to restaurants and supermarkets.

Before the grain boom, the family-owned Chicago firm adjusted its prices annually. Now its customers know prices might change quarterly. "Things are so hectic now, it's hard to get a handle on things," said Mr. Marcucci.

Many food manufacturers are retooling assembly lines to produce smaller versions of everything from cereal boxes and ice-cream cartons to mayonnaise jars, margarine tubs and cheese packages. By giving consumers less for roughly the same price, food executives hope to keep consumers from moving to cheaper brands.

Consider General Mills Inc.'s Cheerios cereal. When the American Farm Bureau Federation sent members into supermarkets to conduct its second-quarter food-price survey, the 10-ounce box of Cheerios had vanished. So the volunteer shoppers turned to the box nearest in size, 8.9 ounces.

The smaller box cost \$2.98 on average, up from \$2.86 charged by the stores for the bigger box a year earlier. On a per-ounce basis, the retail price of Cheerios jumped 17% to 33.5 cents in the second quarter from 28.6 cents a year earlier.

General Mills spokesman Tom Forsythe said moves by the Minneapolis company can't alone explain the big retail-price jump. It is possible that supermarkets, which set the retail price, are taking advantage of an opportunity to add some margin of their own.

David Mackay, Kellogg's chief executive officer, said in an interview last week that his company has shrunk about 10% of its U.S. breakfast-cereal boxes by an average of 2.4 ounces. With the company's input costs climbing 9% this year, Mr. Mackay said he doubts grain prices will ever drop back to where they were just a few years ago.

—Julie Jargon
contributed to this article.

Marketplace

Making the upgrade

New technology helps companies better detect travel offenders > Page 29



CORPORATE NEWS

U.S. natural-gas firms face supply surplus

Industry takes steps to increase demand, keep output strong

BY BEN CASSELMAN

As major oil companies search for more oil to meet growing global demand, U.S. natural-gas companies face the opposite problem: what to do with all the gas they will soon be producing.

U.S. natural-gas production is soaring, thanks to high energy prices and new technologies that have unlocked reserves considered too difficult or expensive to tap in earlier eras. Production is up 8% this year, according to government data, and the growth is expected to continue as companies drill thousands of wells in Texas, Louisiana and Oklahoma and look at massive new reserves in Appalachia and Canada.

Demand is growing too, but more slowly. Total U.S. natural-gas consumption is up 5.5% this year through May, spurred largely by a gradual shift from coal power plants to cleaner-burning gas-fired ones. Consumption actually fell slightly between 2003 and 2006.

As some analysts have begun to toss around terms like "gas glut," natural-gas futures have tumbled 9.2% in the past two weeks, and they have brought producers' stocks down with them. Shares of large natural-gas producers Chesapeake Energy Corp., XTO Energy Inc. and EOG Resources Inc. are down 30% or more from highs in late June and early July. By comparison, oil-focused Exxon Mobil Corp. is down 17% from its high May 20.

"I think that supply growth has become the 800-pound gorilla in the North American gas-investing equation," said Dan Pickering of Tudor Pickering Holt & Co., an energy-focused investment bank.

For consumers, increased supplies of natural gas could mean lower heating and cooling bills, as the fuel generates a fifth of the nation's electricity and heats half of U.S. homes. But any relief is likely to be limited. Analysts say that if natural-gas prices settle below \$8 per million British thermal units, producers will cut back production—tightening supplies and driving prices up again.

"It'll be essentially a self-correcting mechanism," EOG Chief Executive Mark Papa said.

Cutbacks in production could spell trouble for producers and their investors. Unlike Big Oil, most independent producers aren't using their cash to buy back stock or pay big dividends. They have been plowing it back into drilling, because

Wall Street values the companies on their growth potential. If lower prices force producers to slow their drilling, their growth will slow too.

To prevent that, the industry in recent months has cranked up its lobbying to increase long-term demand for natural gas. In television ads and congressional testimony, the industry has been touting natural gas as cheaper than oil, cleaner than coal and domestically produced.

"Find me the congressman or find me the policy maker who's against cleaner energy, cheaper energy and American energy," Chesapeake Chief Executive Aubrey McClendon said in an interview.

Mr. McClendon, whose company expects to become the nation's top natural-gas producer by the end of the year, has been especially aggressive. Late last month he lobbied Washington lawmakers to promote compressed natural gas as an alternative to gasoline.

Mr. McClendon said he wants to make lawmakers and the public aware of the potential for natural gas. But he added: "You can only produce what the market wants.... We're not going to expand if the market for that expansion isn't there."

Other producers acknowledge they are concerned about supply outstripping demand. EOG's Mr. Papa said that if recent discoveries prove as successful as companies expect, the industry will need to promote natural gas for both power generation and transportation.

"It's going to change the dynamics of the gas markets," Mr. Papa said.

The new supplies could pose problems for importers of liquefied natural gas. LNG imports to the U.S. are down two-thirds from last year because higher prices in Asia and Europe have attracted shipments to those markets. If new U.S. production keeps prices comparatively low, LNG imports are unlikely to rise.

The U.S. natural-gas industry has a history of booms and busts. Last fall, producers cut back production when predictions of a warm winter drove prices to below \$6 per million BTUs.

But experts say the current situation is different. Instead of a single big discovery or a weather-related demand slump leading to a temporary rise in supplies, the industry has found a new resource—shale—that could last decades.

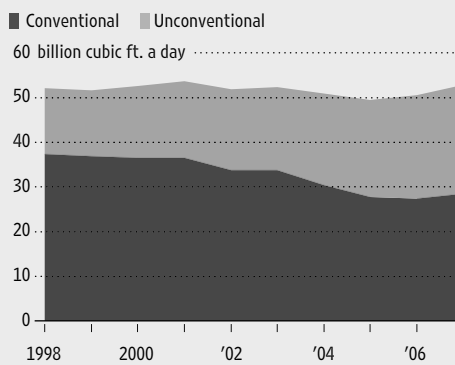
Shale—dense rock formations common in many parts of the country and around the world—has long been known to hold natural gas. But production was impractical because the rock isn't porous enough for the gas to flow.

In the 1990s, however, companies figured out how to crack the

Well endowed

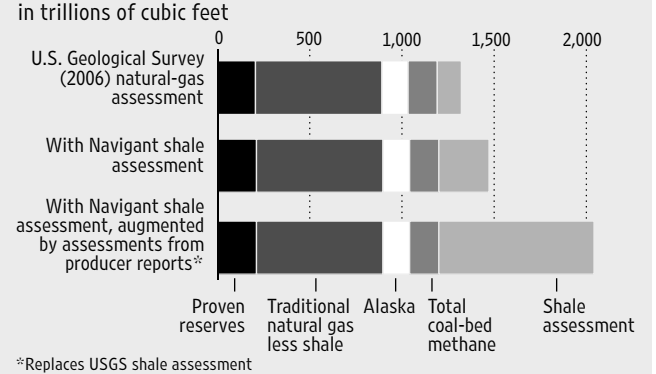
An industry-backed study by Navigant Consulting estimates that unconventional natural-gas shale resources could boost U.S. total natural-gas resources to levels far beyond earlier estimates.

Production



Resources

Natural-gas resources judged likely to be recovered, in trillions of cubic feet



*Replaces USGS shale assessment

shale using pressurized water, releasing the gas. They perfected the technique in the Barnett Shale, a massive shale-gas field around Fort Worth, Texas, that now produces about four billion cubic feet of natural gas a day, 6.5% of total U.S. production and quadruple what it produced in 2004.

The success of the Barnett set off a frantic search for new shale fields, some of them staggeringly large. The recently discovered Haynesville Shale in northwest Louisiana and East Texas has by some estimates 250 trillion cubic feet of recoverable gas, five times as much gas as the Barnett. The massive Mar-

cellus Shale formation in Appalachia could be bigger still. Together, U.S. shale plays could hold as much as 840 trillion cubic feet of gas, by one industry estimate—the equivalent of more than 140 billion barrels of oil, more than half the proven reserves of Saudi Arabia.

It is still early, and the amounts produced could be lower. All that gas won't be available right away. Producing it will require drilling tens of thousands of wells at a cost of billions of dollars. Limited availability of drilling rigs, oil-field workers and pipeline capacity, as well as environmental and regulatory constraints, will restrict how fast pro-

duction can increase.

But the recent discoveries have put natural-gas producers in a fundamentally different position from their oil-producing peers. Many gas producers are promising double-digit production growth next year. Meanwhile, Chevron Corp. saw production decline 3.4%, and Exxon's oil production fell 2% in the second quarter from a year earlier, excluding unusual disruptions.

"There's very little doubt that you can bring this much gas supply on. The reserves are there," Credit Suisse analyst Jon Wolff said. "The issue is, does that amount of gas push the price down?"

Tokio Marine defends big deal

TOKYO—Shares of Tokio Marine Holdings Inc. have fallen 10% since July 23, when the insurer announced the biggest acquisition of a foreign financial-services firm by a Japanese company. Analysts say the \$4.7 billion offer for Philadelphia Consolidated Holding Corp., a mid-size U.S. nonlife insurance company, was too generous.

But Shuzo Sumi, Tokio Marine's president, in an interview said his team assessed the fundamental value of the group using discounted cash-flow analysis, and couldn't be

distracted by the daily volatility of the U.S. company's share price. "Analysts who say we overpaid are analysts who don't understand Philadelphia's business model," he said.

Mr. Sumi also stressed that Tokio Marine needs to be involved in the \$493 billion U.S. property and casualty-insurance market.

"We knew that the European and U.S. markets were very mature and competitive, but we also realized that true global expansion meant a steady position in those markets," Mr. Sumi said.

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CORPORATE NEWS

Refuse handler raises bid

Waste Management offers \$6.73 billion for Republic Services

BY MATTHEW KARNITSCHNIG

Waste Management Inc. raised its unsolicited cash offer for rival Republic Services Inc. by nearly 10% to \$6.73 billion, the latest salvo in an increasingly heated turf war among the biggest U.S. trash haulers.

Waste Management, of Houston, the largest American waste company by revenue, delivered a letter to Republic Services, of Fort Lauderdale, Fla., the No. 3 player, offering to pay \$37 a share, up from its original \$34 a share bid. The offer represents a 33% premium to Republic's share price prior to Waste's first bid.

The new offer could upend Republic's own plan to challenge Waste's dominance by acquiring the industry's No. 2 player, Allied Waste Industries Inc., of Phoenix. Republic agreed in late June to acquire Allied for \$6.24 billion in stock. Waste responded July 14 with its unsolicited bid for Republic.

If successful, Waste's acquisition of Republic would create a trash juggernaut with annual sales of more than \$16 billion, or about \$10 billion more revenue than the nearest competitor. The company would control nearly half of all permitted landfill capacity in the U.S.

Waste has received initial prom-



Waste Management hopes to negotiate a friendly deal with Republic after raising its unsolicited bid.

ises of financing from its banks though it hasn't executed commitment letters. Waste is hoping that it will be able to negotiate a friendly deal with Republic. Banks generally offer better terms for transactions carried out on a friendly basis. Waste believes it will be able to maintain its investment-grade credit rating after the transaction.

Some analysts have speculated that regulators might block or place severe conditions on such a combination. After recent meetings with U.S. Justice Department officials, however, Waste executives believe the transaction would pass regulatory muster, people familiar with the matter said. Waste believes a deal could be concluded by early

2009 if not before.

In an effort to erase doubts about its commitment to a deal, Waste offered Republic a \$250 million breakup fee and to agree to penalty payments if the deal isn't concluded by a negotiated deadline.

Though smaller than Waste or Allied, Republic is generally regarded as the best-run trash hauler in the U.S., and its stock has outperformed its rivals.

Waste has concluded that a combination of the two companies could create annual synergies of more than \$200 million, the people said. That compares with the \$150 million in annual savings Republic and Allied have said their deal would create.

GLOBAL BUSINESS BRIEFS

Deutsche Lufthansa AG

Passenger numbers fell 1.4% in July as strikes took toll

Deutsche Lufthansa AG, feeling the weight of strikes by ground staff and other employees, said passenger numbers at its core Lufthansa airline fell 1.4% in July from a year earlier to 5.2 million. The carrier's load factor—the measure of how full its airplanes are—fell by 1.3 percentage points to 82.2%. However, Lufthansa said passenger numbers for the entire group were up 0.8% to 6.4 million. The group includes Swiss International Airlines, which has increased its capacity in recent months. The group's overall load factor declined by 0.9 percentage point to 82.9%. Lufthansa earlier this month settled a dispute over pay for ground staff with the ver.di service-workers union. A weeklong strike resulted in service disruptions in late July, mainly in Germany and Europe.

BG Group PLC

Just days after it told of a "material" discovery in Brazil, BG Group PLC found new oil in Norway's North Sea, according to the government's Norwegian Petroleum Directorate. Oil was discovered during drilling at Jordbaer prospect, which is northeast of the Snorre field in the northern North Sea, the directorate said. Norwegian exploration company Revus Energy ASA, which holds 20% in Jordbaer, said the discovery is "significant" and has tested at a rate of about 7,500 barrels a day. "In Revus opinion, the Jordbaer discovery significantly increases the likelihood of additional discoveries in the area," the smaller company added. BG operates the prospect with a 45% stake. Norway's Idemitsu Petroleum Norge AS, a subsidiary of Idemitsu Kosan Co., owns 25%, and Germany's RWE AG owns 10%.

Cie Financière Richemont SA

Cie Financière Richemont SA said it acquired a 60% stake in Geneva-based watch maker Manufacture Roger Dubuis SA for an undisclosed sum, which analysts estimated at about €100 million to €200 million (\$150 million to \$300 million). Richemont said it will have neither a substantial impact on its earnings nor its balance sheet this year. The transaction is another sign that the consolidation in the luxury industry, especially in the high-end watch segment, is continuing, analysts said. With the deal, Roger Dubuis's high-end mechanical-watches business, which was launched in 1995, will be marketed internationally through Richemont's network. Richemont already owns watchmakers such as IWC and Vacheron Constantin.

Babcock & Brown Ltd.

Investment and asset management firm Babcock & Brown Ltd. said its first-half profit likely tumbled by as much as 40% due to write-downs, and it no longer expects annual earnings to rise this year. It said it will incur non-cash impairment provisions in a range of investments, including real-estate holdings and its stake in satellite fund Everest Babcock & Brown Ltd. "The volatile global capital market conditions have made and continue to make business conditions uncertain and forecasting in the short term difficult," Chief Executive Phil Green said. The company is scheduled to announce first-half results Aug. 21. It said profit for the six months ended June 30 is expected to be 25% to 40% below the year-earlier first-half results of 250 million Australian dollars (US\$222 million).

Alitalia SpA

Prosecutors in Rome opened a probe Monday into alleged fraud and mismanagement at state-controlled airline Alitalia SpA, a person familiar with the matter said. The probe, from which no formal accusations have been made, follows a complaint filed by consumer-rights association Codacons. The complaint is leveled at the high salaries paid to Alitalia's chief executives in recent years despite the airline's dismal performance, and the state funds used to keep the carrier afloat. Rome prosecutors weren't immediately available for comment, while Alitalia declined to comment. Rome has pumped more than €5 billion (\$7.5 billion) into Alitalia in the past decade. The Italian government, which owns a 49.9% stake in the carrier, has been unsuccessfully looking to sell Alitalia for 18 months.

Diebold Inc.

Diebold Inc., which hasn't released complete results for more than a year amid accounting issues, estimated second-quarter net income fell 4.8% on an 11% increase in revenue. The U.S.-based maker of automated-teller machines and electronic-security products, which has rebuffed a takeover bid by United Technologies Corp., also boosted its 2008 outlook, with earnings expectations topping Wall Street's estimates. The company expects to file restated financial results in September. Diebold put net income at \$25.6 million, compared with preliminary net last year of \$26.9 million. Revenue is estimated to have risen to \$771 million from \$694.6 million.

Bouygues SA

French conglomerate Bouygues SA said revenue rose 15% in the second quarter amid growth in its construction and real-estate activities. Revenue rose to €8.5 billion (\$12.8 billion) from €7.38 billion a year earlier. Revenue increased 19% to €2.3 billion in the construction division and 64% to €735 million in the real-estate division. Revenue at Bouygues Telecom grew 7.5% to €1.26 billion. Bouygues's share price rose 2.5% to €45.65 Monday, but remains down about 20% since the beginning of the year, broadly in line with France's benchmark CAC 40 index, as concerns remain over the impact of the economic slowdown on its construction and real-estate activities. The company will report first-half earnings Aug. 28.

Bertelsmann AG

Three Rivers Press, a paperback imprint of Crown Publishing, will publish U.S. Sen. Barack Obama's latest book, "Change We Can Believe In: Barack Obama's Plan to Renew America's Promise." Crown, a division of Random House Inc., itself a unit of Bertelsmann AG, also published Mr. Obama's "Dreams From My Father" and "The Audacity of Hope." According to the presidential candidate's literary representative, Washington attorney Robert Barnett, the contract is between Crown and the senator's campaign, not Mr. Obama himself. The book will include a foreword by Mr. Obama and feature sections, written by members of his presidential campaign, on such issues as health care, energy and national security.

—Compiled from staff and wire service reports.

Beauty magazines lose ad weight

BY SHIRA OVIDE

Last year, the all-important September issues of American fashion and beauty magazines such as Condé Nast's Vogue and Hearst's Marie Claire were thick enough to throw out the backs of mail carriers across the U.S. The champ, Vogue, weighed in at a hefty 2.2 kilograms, thanks to 725 pages of glossy ads.

It is a different story this year. As September issues begin hitting the newsstands, two-thirds of the 16 top fashion and beauty magazines by number of ad pages are smaller than a year ago. W magazine, also published by Condé Nast Publications, a unit of Advance Publications, has 18% fewer advertising pages. Vogue has 674 pages of ads this year, down 7%, while Hearst's Cosmopolitan is six pages, or 3.2%, lighter.

Until recently, fashion and beauty magazines had been something of an oasis amid the steady stream of red ink being reported by print-media properties. Last year was a record year for many titles in the category, and a number of publications were still selling ad pages at that pace into the first quarter of 2008.

The magazines' core marketers in luxury goods, clothing, jewelry and beauty products have been slower than advertisers in other categories



Sergio Capursi/The Wall Street Journal

Getting thinner

With a few exceptions, the number of ad pages in the September issues of fashion and style magazines fell, compared with a year ago.

Change in September ad pages from a year earlier	
Elle	6.60%
Cosmopolitan	-3.17
Vanity Fair	-5.38
Vogue	-7.10
W	-17.67

Sources: Publishers' estimates; Media Industry Newsletter; Publishers Information Bureau

September 2008 issue

to shift spending to the Internet. At the same time, the magazines have a rich history of readers who flip pages as much to see ads for the latest fall fashions as to read the stories, a factor that help keeps advertisers loyal.

But now things are starting to get ugly for the beauty magazines. Ad pages for the top fashion and beauty titles were down about 8% in the second quarter, and publishers acknowledge the downturn largely has held or grown steeper since then.

While luxury advertisers mostly are hanging in, many middle-market clothing and cosmetics companies are paring back ad pages or pulling out completely as a cooling economy quiets their cash registers. Other categories that traditionally advertise in these publications are also bumpy. At prices that can climb to \$120,000 for a full-page ad, every missing page hits the magazines hard.

Of course, the appeal of fashion and beauty magazines' September

issues hasn't suddenly vanished. Those pages are still considered a must-buy for many advertisers wanting to pitch new car models, back-to-school shopping and fall fashions. And a number of tony brands are still ubiquitous.

"We have definitely the biggest fall budget we've ever had for advertising," says Alex Bolen, chief executive of Oscar de la Renta. Mr. Bolen says the designer increased its U.S. print media budget by 15% this year.

But in most cases, increased spending by advertisers such as Oscar de la Renta isn't covering the cuts by midtier marketers. Apparel retailer bebe stores took out four pages with In Style—a magazine published by Time Warner's Time Inc.—last September and none this September. Nordstrom's had a six-page spread in Elle last year to promote its "via C" clothing line but has nothing this year.

—Jennifer Saranow contributed to this article.

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ECONOMY & POLITICS

FRANCE

Dalai Lama won't meet Sarkozy on 12-day visit

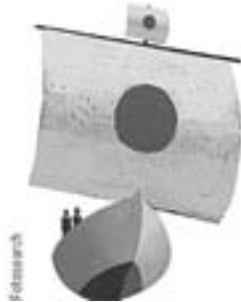


THE DALAI LAMA arrived in Paris Monday for a 12-day visit to France, treading softly to avoid controversy over Tibet and devoting his stay to religion. It will likely be difficult to skirt the subject of Tibet entirely while the Beijing Olympics are in progress.

President Nicolas Sarkozy's decision not to meet with the Tibetan spiritual leader while the Olympics are in progress has stirred criticism. The president's office has said the Dalai Lama, above, didn't seek a visit with Mr. Sarkozy. The Dalai Lama is scheduled to hold one political meeting: a session Wednesday with lawmakers in the group overseeing Tibetan issues. —Associated Press

JAPAN

Government outlines plan to stimulate the economy



FACING a rapidly decelerating economy, the Japanese government unveiled an outline for an economic-stimulus package designed to help companies and people hit hard by soaring oil and food prices.

The outline was put together amid rising concerns that the world's second-largest economy is losing steam at a much faster pace than a few months ago. Politicians and government officials will put together a final package at the end of August. On the agenda are measures aimed at easing worries about accelerating domestic inflation, and old staples like reducing burdens on small companies and farmers. —Yuka Hayashi

DENMARK

Alleged Islamic militants go on trial in bomb case



TWO ALLEGED Islamic militants accused of preparing a bomb attack went on trial in Denmark, with prosecutors showing secret video footage of them testing a highly explosive material in an apartment building in Copenhagen.

The prosecution said the two men conducted the small test blast with the same explosive that was used by suicide bombers who killed 52 commuters in London in 2005.

Both defendants have pleaded not guilty but admitted making triacetone triperoxide, or TATP, saying it was to be used for fireworks. —Associated Press

Militants step up attacks on NATO convoys

Same strategy used by Afghan insurgents against Soviet troops

TALIBAN INSURGENTS have stepped up a campaign to seize and destroy supplies destined for North Atlantic Treaty Organization troops in Afghanistan, driving up the cost of the war and signaling a new setback in the nearly seven-year-old campaign.

The attacks in Afghanistan and Pakistan are part of the militants'

By Alan Cullison in Kabul, Afghanistan, and Peter Wonacott in Peshawar, Pakistan

campaign to isolate the fragile U.S.-backed government in Kabul, led by President Hamid Karzai. In addition to targeting supply convoys, insurgents in Afghanistan have blown up roads and bridges that were the centerpiece of U.S. efforts to rebuild the nation after NATO troops helped drive the Taliban from power in 2001.

"There's been a pretty clear trend in the past couple of weeks to interdict our supply routes," says Brig. Gen. Mark Milley, deputy commander for U.S. forces at Bagram Air Base in Afghanistan.

Across the border in Pakistan, the deepening political crisis in Islamabad also is emboldening militants to attack convoys hauling supplies for NATO troops.

The latest attack came Friday at the Torkham border crossing between Pakistan and Afghanistan, when unidentified gunmen opened fire on a convoy of trucks carrying supplies for NATO forces. Three truck cleaners sustained injuries, according to Gul Jan, an official in the local security force in the Khyber Tribal Agency in Pakistan reached by telephone. The gunmen escaped, and no group claimed responsibility for the attack, Mr. Jan says.

About 90% of U.S. goods destined for Bagram, the main U.S. military base in Afghanistan, pass through Torkham from Pakistan's Karachi port, an eight-day journey,

according to U.S. officials. Weapons and ammunition are flown into Afghanistan.

The majority of NATO supplies transported through Pakistan continue to reach their destinations, say Western diplomats and army officials. The U.S. government estimates it has lost only about 1% of its cargo going from Karachi to Afghanistan.

Still, the targeting of supply chains marks a new and troubling development. The militants' tactics appear designed to bog down foreign forces and wait them out, the same strategy adopted successfully by Afghan insurgents against the Soviet Union in the 1980s.

In response, NATO forces are adopting some of the Soviets' tactics. They are paying more money to local warlords to guarantee safe passage over roads and importing more fuel from central Asia, across Afghanistan's northern borders with Uzbekistan and Tajikistan, where roads are still safe. That presents logistical challenges and drives up the cost of the war.

"We saw this situation developing a while ago, so the northern route looked a lot safer," says an official close to the situation. "And it's clear security is not improving."

Standard security precautions, such as armed gunmen accompanying large convoys, are no longer sufficient. In June, Taliban fighters in Afghanistan ambushed a convoy of more than 50 trucks carrying supplies to troops in the south, setting fire to them about 40 miles south of Kabul.

"We had plenty of guards, but we never expected an attack so strong," says Haji Ajmal Rahmani, whose company, Afghan International Transportation & Logistics, lost 40 trucks in the June attack. Mr. Rahmani says 40 of his employees, mostly drivers, were killed and 20 went missing, probably burned beyond recognition or blown up when the trucks exploded.

One of the hardest-hit stretches in Afghanistan has been the U.S.-built Highway 1, a 500-kilometer road connecting the capital with Afghanistan's second-largest city, Kandahar, in the south.

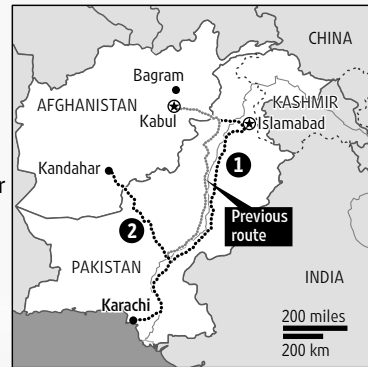
Access to Afghanistan

1 Northern route: Karachi to Bagram
Total 1,948 kilometers
Transit time: eight days
Used to transport 90% of supplies

2 Southern route: Karachi to Kandahar
Total 1,120 kilometers
Transit time: five days

Previous route: Bagram to Karachi

Source: U.S. military via U.S. Embassy in Islamabad
Photo: Reuters



▶ A British soldier keeps watch at the scene of an attack in Kabul on Monday. A suicide car bomber killed three civilians and wounded 12 more as he targeted a convoy of foreign troops.

Insurgents blew holes in a major bridge on the road in late April and have been blowing up bridges and culverts with increasing frequency since. On Saturday, in the southern province of Ghazni, officials say insurgents blew up a 25-meter bridge, halting traffic for hours.

Gen. Milley surveyed Highway 1 from a helicopter last week. He says the road was broken and buckled in parts, and several bridges were impassable because large holes had been blown in them. Insurgents haven't yet demolished a bridge entirely, he says, but they placed explosive charges near structural beams, making the bridges impossible to use.

Other parts of the road are scarred by attacks from bombs set off along the road and the carcasses of burned-out trucks. Gen. Milley says there were a half-dozen attacks on convoys along the road in the past few days.

He says the attacks haven't put a serious crimp in supply lines to fuel-hungry armored units in the south.

But he says the expertise of some attackers was a surprise. "They show a degree of skill and training that we have not seen before."

Western embassies and private aid groups in Afghanistan advise their staffers to avoid the Kabul-Kandahar road because it is too dangerous.

NATO says the road remains open because engineers have bulldozed routes around the blown bridges. But the bypasses often run through dry creek beds that will fill with the autumn rains. More permanent repairs will be a challenge since insurgents have been kidnapping and killing road workers.

Gen. Milley says the insurgents had evidently recognized that attacking the highway would undermine confidence in the government.

"One of our main goals is to connect the people to the government," he says. "The enemy is trying its best to stop us."

Insurgents also are taking aim at "soft targets," such as govern-

ment offices, employees and aid organizations, U.S. officials say.

Earlier this month an umbrella group of nongovernmental organizations issued a report noting that NGO workers are "subject to increasing attacks, threats and intimidation, by insurgent and criminal groups."

Across the border, Pakistan's security forces face a resurgent militancy as political infighting has dogged a new civilian-led government. In an effort to unite the two main political parties—the Pakistan People's Party and the Pakistan Muslim League-Nawaz—the government last week said it intends to impeach President Pervez Musharraf. He is an unpopular former army chief but a staunch supporter of the U.S.-led war on terrorism.

Pakistan's army spokesman, Maj. Gen. Athar Abbas, says recent militant attacks on convoys represent just a sliver of the total truck traffic. "Three thousand trucks cross daily into Afghanistan," he said in an interview in late July. "Is this a serious disruption?"

But Nawab Sher Afridi, general secretary of the All Pakistan Oil Tankers Owners Association, says ambushes are rising against trucks carrying ordinary fuel and highly flammable jet fuel to NATO forces. Over the past 18 months, as many as 250 tankers have been damaged and 40 drivers have been killed, according to Mr. Afridi. "There is no security in Pakistan. No security in Afghanistan," he says. "We are losing our business."

Imtiaz Alam, a 29-year-old Pakistani truck owner whose vehicles have been delivering cargo to NATO troops in Afghanistan for five years, says he has had to devise his own security measures, partly because poorly paid Pakistani police have provided little cover for his fleet. Mr. Alam makes sure his armed guards hail from the same tribal areas his trucks plan to pass through.

"Even militants and criminals will think twice about shooting tribesmen," he says, standing beside a flatbed truck with an armored personal carrier under a blue tarp.

ECONOMY & POLITICS

Deal nears in Zimbabwe

International voices pressure Mugabe to share power

BY SARAH CHILDRESS

A combination of international pressure and economic woes seems to have pushed Zimbabwean President Robert Mugabe to the brink of a power-sharing deal with opposition leader Morgan Tsvangirai, a dramatic step toward resolving the nation's months-long political stalemate.

While the rival camps remain locked in negotiations, Mr. Mugabe said in a televised address Monday that there are only "little hurdles" left to clear.

The structure of any deal is still unknown, and Mr. Tsvangirai isn't commenting. But an agreement that allocates executive power to Mr. Tsvangirai would represent a significant softening of the government's position. Mr. Mugabe, who has ruled Zimbabwe for 28 years, had vowed to go to "war" rather than cede power to Mr. Tsvangirai, and has insisted throughout the ne-

gotiations that he remain president.

However, Mr. Mugabe has been under tremendous pressure from regional leaders to strike a deal with the opposition since he declared victory in a one-man runoff election in June. Mr. Tsvangirai won the first round of presidential elections by a narrow margin in March but withdrew from the second round, citing fears for his supporters' safety after weeks of attacks by security forces.

The most influential voice likely has been that of South African President Thabo Mbeki, who has worked quietly with Mr. Mugabe to encourage him to negotiate. A deal would be a major coup for Mr. Mbeki, who has been reviled at home and abroad for not taking a harsher line on Mr. Mugabe, particularly if he can bring about an agreement by an Aug. 16 meeting of the regional powers that have given him the task of trying to resolve the crisis.

News of the potential breakthrough caused guarded optimism in Harare and elsewhere. Many

found it difficult to conceive of such a quick agreement until Sunday, when talks brokered by Mr. Mbeki with Mr. Mugabe and Mr. Tsvangirai continued for about 14 hours, raising expectations that progress was being made. Their negotiating teams have been in discussions since July 22.

In his speech Monday, Mr. Mugabe said, "We had a long night negotiating on some little hurdles, and I thought I should raise my fist, but he [Mr. Mbeki] remained cool and said: 'Let us continue talking.'"

A deal that offered Mr. Tsvangirai anything less than full executive powers would likely frustrate opposition supporters, who have endured a vicious campaign of intimidation by ruling-party supporters since the March vote, according to human-rights groups and the opposition. The opposition has said in the past that it would reject any deal that allowed Mr. Mugabe to retain power, but may have softened its stance during the negotiations. An opposition spokesman declined to comment on the progress of the talks, citing a media ban imposed by Mr. Mbeki.

—Farai Mutsaka contributed to this article.



Morgan Tsvangirai



Robert Mugabe

China power woes may hit exports

BY ANDREW BATSON AND SHAI OSTER

BEIJING—The unexpectedly strong growth of China's manufacturing sector could still be undermined by worsening electricity shortages, which also threaten to fuel the country's already worrisome inflation rate.

China is facing its worst power shortages since 2004 because government-set prices mean many plants lose money with every spark of electricity they generate. More than a dozen provinces are rationing power to industrial users, and Beijing is struggling to guarantee enough electricity for the Olympics. Top executives from State Grid Corp., which controls most of China's power lines, have been dispatched to other cities hosting events to guarantee supplies.

"We are moving into a period where electricity outages are returning as a potential cap on economic growth," said Glenn Maguire, chief Asian economist for Société Générale.

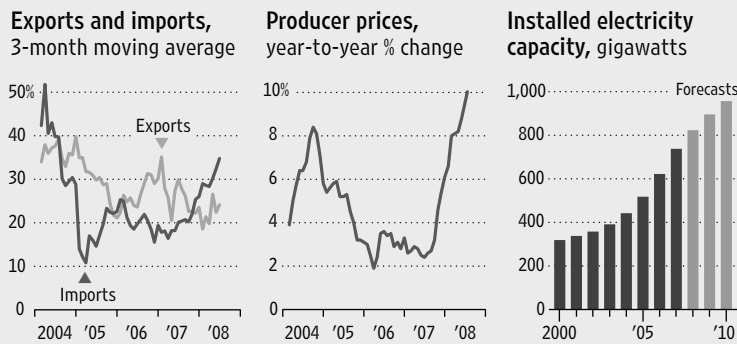
The price controls on electricity are running smack into China's still-strong growth rate. On Monday, China's customs agency reported that exports for July were up 26.9% from a year earlier, sharply higher than the 17.6% growth in June. That showed China's exporters are still faring better than many had expected.

But the inability of electricity producers to keep up with demand is having an impact on industry. With the weakening global economy likely to sap demand for China's exports, analysts expect the government to try to head off a worse slowdown by raising electricity prices after the Olympics end later this month.

While the price increases will get power plants to produce more electricity, they will add to already-high inflation. They also could end up squeezing corporate profits, which are already hurt by higher wages and raw-material prices. China's measure of producer prices was up 10%

Clouds on the horizon

China's export growth has held up well so far this year, but rising raw-material costs and electricity shortages pose a threat



in July from a year earlier, the National Bureau of Statistics said separately Monday, the highest increase since 1996. The rise in consumer prices, by contrast, has fallen back somewhat in recent months and is expected to drop below 7% in July.

The latest data seemed to only intensify investors' concerns over the economic outlook and corporate profits. China's benchmark Shanghai Composite Index fell 5.2% Monday to its lowest level in more than 18 months.

The government raised prices for electricity, gasoline and diesel on June 20, but the small increase left electricity producers still in the red. Now, the China Electricity Council, which represents power generators, is lobbying the government to overhaul the pricing system and subsidize the losses its firms have incurred. "We suggest that the government, at an appropriate time, continue to resolve the conflicts between prices of coal and electricity to help reverse power companies' loss-making situation as soon as possible," the council said in a report last week.

They are still largely unwilling to buy more coal just to sell electricity at a loss. That has left coal stockpiles low: The China Electricity

Council said inventories at power plants were enough for 11 days of production at the end of June, down from 17 days a year earlier. The government recently tried to intervene in the coal market—where prices were largely liberalized a few years ago—but has had great difficulty enforcing the policy, analysts said.

"Unless there is some large fundamental reform on pricing, there is simply no incentive for the power stations to do their thing," said Stephen Green, economist for Standard Chartered.

The council expects power shortages to reach about 2% of the nation's total installed capacity of 712 gigawatts. That low figure masks the severity of the impact in hard-hit areas: the gap in Shandong province, a major industrial center in the east, approaches one-third of its capacity. That has caused brownouts and led to rationing for big industrial power users such as mines and aluminum smelters.

The government has ordered factory shutdowns in the provinces surrounding Beijing in an attempt to improve air quality for the Olympics, which is likely to show up in an additional, shorter-term reduction in output for July and August.

Even in exile, Thaksin is likely to leave stamp

BY JAMES HOOKWAY

BANGKOK—Even after flying into exile in Britain to escape prosecution on corruption charges, former Thai Prime Minister Thaksin Shinawatra is likely to cast a long shadow over the future of one of Southeast Asia's most dynamic economies.

The telecommunications tycoon became prime minister in 2001, shaking up this centuries-old Buddhist kingdom's staid political culture with his shoot-from-the-hip, CEO-style of leadership and successive landslide election victories before he was ousted in a military coup in 2006.

After the coup, Mr. Thaksin, now 59 years old, continued to play a behind-the-scenes role in Thailand's affairs, selecting current Prime Minister Samak Sundaravej to lead the remnants of his political party to power in democratic elections last December. Mr. Thaksin did so even while facing an array of criminal charges brought under military rule for alleged corruption and other wrongdoing while in office. He has denied the allegations and had earlier promised to fight them in court in Thailand.

The key to Mr. Thaksin's enduring popularity is his unprecedented appeal to millions of poor and politically marginalized rural Thais, whom he wooed with grassroots programs that put money in their pockets and cemented their loyalty. Political analysts here say the success of his free-spending, populist policies means Mr. Thaksin's followers could continue to lock horns with Thailand's conservative military-backed political elite in Bangkok for years to come.

Monday—a day he was due in a Bangkok court—Mr. Thaksin embarked on a new life in self-imposed exile. With Thailand's courts trying him in several corruption cases and his wife convicted of tax evasion and sentenced to prison, Mr. Thaksin and his wife fled to London from Beijing, where they attended the opening of the Olympic Games, instead of returning to Bangkok.

In a handwritten statement faxed to Thai television stations after he arrived in Britain, Mr. Thaksin complained about political "interference in the justice system." He contended that the Thai armed forces and their political allies are still running Thailand despite the restoration of democracy last year. "What happened to me, my family and my close associates is the result of a desire to get rid of me politically," the former premier said.

Thailand's Supreme Court issued an arrest warrant for Mr. Thaksin and his wife on Monday after they skipped bail. The couple had been given permission to travel to Beijing for the opening of the Olympics and will have to forfeit around \$390,000 they posted in bail. His flight to London also makes it difficult for Mr. Thaksin to reclaim an estimated \$2 billion frozen in his bank accounts in Thailand since the 2006 coup.

There is an extradition treaty between Thailand and the U.K., but it's unclear whether authorities in Bangkok will seek to extradite him, especially as the current Thai government is controlled by his allies. If Thailand does make an application,

Mr. Thaksin is likely vigorously to seek its rejection. In his statement to the media, Mr. Thaksin didn't mention the possibility of seeking political asylum in Britain, where he owns the Manchester City soccer team.

Mr. Thaksin's parting swipe at Thailand's judiciary could make it difficult for him to stage a political comeback. Supreme Armed Forces Commander Gen. Boonsrang Niumpradit told reporters Monday that "such remarks by a former leader could damage Thailand's image."

Thailand's customarily pliant courts—which in the past rarely ruled against powerful political figures—have recently shown their determination to stand up to the country's politicians. The new posture follows influential monarch King Bhumibol Adulyadej's repeated exhortations to judges to help resolve Thailand's protracted political problems, which pit Mr. Thaksin's populist allies against a strong, grassroots royalist movement.

Already, Mr. Thaksin has suffered a series of legal setbacks since he returned to Thailand in February from an earlier period of self-imposed exile

that followed the 2006 coup. In addition to convicting his wife, Pojaman Shinawatra, on tax evasion charges last month, Thailand's courts have decided to try the former premier on a series of corruption charges relating to alleged abuses of power during his five years in office.

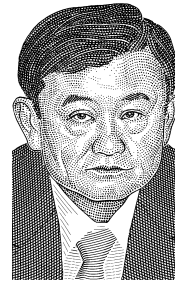
Thailand's Supreme Court has also ruled that a key ally of Mr. Thaksin was guilty of vote fraud. That verdict could lead to the banning of the pro-Thaksin People Power Party, which now leads Thailand through a coalition government. Also, the Supreme Court convicted and jailed three of his lawyers in June for attempting to bribe court officials with \$60,000 packed into a confectionary box.

With Mr. Thaksin out of the picture, political analysts said political tensions could ease in the short term, allowing the government to focus on steering the country's export-dependent economy through a global downturn instead of trading accusations with anti-Thaksin protesters on the streets of Bangkok. Indeed, investors reacted enthusiastically to Mr. Thaksin's decision to leave the country, driving the benchmark Stock Exchange of Thailand Index up 1.8% to 702.93 points.

But longer-term questions about Thailand's future—and the precise impact of Mr. Thaksin's legacy—remain.

The country remains badly divided between prosperous, modern Bangkok and the less well-off countryside, where it is still common to see farmers plowing their fields with water buffalo and living in simple wooden homes.

Somchai Phagapasvivat, a political-science professor at Bangkok's Thammasat University, says Mr. Thaksin's introduction of populist-style politics may have permanently changed this agriculturally rich nation by giving a voice to its marginalized rural population for the first time. The current government led by Prime Minister Samak pledged to continue Mr. Thaksin's populist policies, such as providing virtually free medical care and low-cost credit, in its successful election campaign last December.



Thaksin Shinawatra