THE WALL STREET JOURNAL.

WSJ.com

Dow Jones Newswires

EUROPE

DOW JONES
A News Corporation Company

VOL. XXVI NO. 137

THURSDAY, AUGUST 14, 2008

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THE WALL STREET JOURNAL.

Taiwan's baseball players carry gloves—and baggage

BEIJING OLYMPICS 2008 | PAGES 14-15

In cotton-price jump, swirling forces hit traders

NEWS IN DEPTH | PAGES 16-17

Russian troops, militias push deeper into Georgia

Gori is captured, houses set ablaze; Bush condemns act

By Yaroslav Trofimov

GORI, Georgia—The day after Russia agreed to a French-brokered cease-fire, Russian troops followed by irregular fighters pushed deep into Georgia, seizing the strategic city of Gori and cutting the main highway that crosses the country to the capital Tbilisi.

Russian troops Wednesday also fanned into the countryside near Gori, where mainly Ossetian militias drove ethnic Georgians from their villages and burned houses, according to fleeing residents and witnesses from Human Rights Watch, the civil liberties group.

U.S. President George W. Bush called on Russia to withdraw its military from Georgia. He expressed concern with reports the Kremlin isn't living up to a provisional cease-fire.

"We expect Russia to meet its commitment to cease all military activities in Georgia, and we expect all Russian forces that have entered

Please turn to back page

Associated Press

A **Georgian woman cries** in front of her destroyed apartment building in Gori Wednesday. Russian forces seized the city, which was then looted by militia forces.

Attack exposes defects in Kremlin's military

By Jeanne Whalen

MOSCOW—The Kremlin's short and victorious campaign in Georgia shows that Russia's military has improved from its dilapidated state in the 1990s, but analysts said the aging equipment and tactics also underscored how much more work Moscow faces in its quest to turn its army into a world-class fighting force.

Modernizing Russia's military has been a major priority for the Kremlin, which has boosted annual military spending from about $7 billion in the late 1990s to about $35 billion today, with further increases planned. Last year, then-President Vladimir Putin installed a new defense minister who vowed to accelerate efforts to make the military more compact, nimble and better equipped.

The military made fast work of what it called "Operation Clear Field," sending Georgian troops into retreat early in the five-day conflict over the South Ossetia separatist region. To many that was no surprise, given that Russia's million-strong military dwarfs Georgia's modest armed forces. "You would expect the Russians to roll over the Georgians," says Siemon Wezeman, a weaponry expert at the Stockholm International Peace Research Institute.

Some military experts said they saw signs of more modern equipment in Russia's armory, including smart bombs. And the losses Russia reported Wednesday—74 dead, 19 missing and 171 hospitalized with wounds—were "limited," says Alexander Pikayev, director of the department for disarmament and conflict resolution at the Institute of World

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Mortgage plan earns a critic in Greenspan

By David Wessel

Alan Greenspan usually surrounds his opinions with caveats and convoluted clauses. But ask his view of the U.S. government's response to problems confronting mortgage giants **Fannie Mae** and **Freddie Mac**, and he offers one word: "Bad."

CAPITAL

The former Federal Reserve chairman, who has been warning for years that Fannie's and Freddie's business model threatens U.S. financial stability, acknowledges that a government backstop for the shareholder-owned, government-sponsored enterprises was unavoidable. Not only are they crucial to the ailing mortgage market now, but the Fed-financed takeover of investment bank Bear Stearns Cos. made government backing of Fannie and Freddie debt "inevitable," he says. "There's no credible argument for bailing out Bear Stearns and not the GSEs."

His quarrel is with the approach the Bush administration sold to Congress. "They should have wiped out the shareholders, nationalized the institutions with legislation that they are to be reconstituted—with necessary taxpayer support to make them financially viable—as five or 10 individual privately held units,

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What's News—

Business & Finance

Alan Greenspan faults the U.S.'s approach in fixing Fannie Mae and Freddie Mac, saying the credit crisis offered an "ideal opportunity" to dismantle the mortgage giants. The former Fed chairman predicted U.S. home prices would reach their bottom in the first half of 2009. Page 1

■ **Tire maker Continental** will pursue talks with Schaeffler, but rejected the group's offer. Page 4

■ **The Bank of England cut** its economic-growth forecast for next year, while adding it couldn't rule out one or two quarters of contraction. Page 3

■ **Euro-zone industrial** output came in weaker than expected in June, further pressuring the outlook for the currency bloc's second-quarter GDP. Page 8

■ **The British pound fell** to a 22-month low against the dollar on concerns about slowing growth and soaring inflation in the U.K. economy. Page 21

■ **Big investment banks** are putting their weight behind start-up trading platforms, in a challenge to such established players as the LSE and Deutsche Börse. Page 19

■ **U.S. and European markets** traded lower, pulled down by banks, as fears resurfaced over economic prospects. The price of oil jumped 2.7% to $116. Page 20

■ **An emergency order** to limit short sales in 19 financial stocks appears to have backfired, a study found. Page 22

■ **ING Groep's net fell** 25%, in part on lower investment gains, as the Dutch bank and insurer said it weathered credit-market turmoil well. Page 5

■ **Chrysler's LaSorda sees** more partnerships and new consolidation in the sputtering U.S. auto industry. Page 4

■ **Japan's economy shrank** 0.6%, confirming fears it has entered a slump. Page 9

■ **Zurich Financial Services'** second-quarter net profit declined 2.5%. Page 5

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11532.96	-109.51	-0.94
Nasdaq	2428.62	-1.99	-0.08
DJ Stoxx 600	284.44	-7.40	-2.54
FTSE 100	5448.6	-85.9	-1.55
DAX	6422.19	-163.68	-2.49
CAC 40	4402.97	-115.51	-2.56
Euro	$1.4873	-0.0036	-0.24
Nymex crude	$116.00	+2.99	+2.65

Money & Investing > Page 19

World-Wide

Russian troops pushed deep into Georgia, followed by militias, a day after Moscow agreed to a cease-fire, seizing Gori and cutting the main highway to Tbilisi. Bush called on Russia to withdraw from Georgia and expressed concern Moscow isn't living up to the cease-fire, while dispatching ships and planes with humanitarian aid. Pages 1, 3, 32

■ **Russia targeted** energy pipelines in Georgia that transport fuel to the West, a row of bomb craters strongly suggest. Page 2

■ **A roadside bomb exploded** near a bus in Tripoli, Lebanon, killing 18 soldiers and civilians and raising suspicion an al-Qaeda-inspired group was seeking to avenge a 2007 military offensive.

■ **Syria and Lebanon agreed** to establish full diplomatic ties for the first time in a step toward improving relations.

■ **The U.S. military plans** to extend its reach deep into southern Iraq as part of an effort to assume responsibility for Basra as British forces leave. Page 9

■ **Indian police said** they would shoot on sight anyone violating a curfew in one Indian Kashmir town, as Muslims mourned the deaths of 16 people amid riots across the region on Tuesday.

■ **The Dalai Lama told** French lawmakers that China was engaged in a continuing crackdown in the Tibet region that included "arrests, summary executions and lethal torture." Page 8

■ **Zimbabwe opposition leader** Tsvangirai said power-sharing talks with Mugabe would continue, but a ban on international aid agencies must be ended.

■ **Militants ambushed** an International Rescue Committee vehicle south of Kabul, killing three female Western aid workers and their Afghan driver.

■ **A missile strike** in a Pakistani tribal region killed at least nine suspected insurgents, raising suspicion the U.S. was again targeting militants in Pakistan.

■ **The European Parliament** said part of the ceiling of its Strasbourg chamber fell last week. Repairs will be finished before lawmakers return next month.

■ **Brussels Airport returned** to normal Wednesday after a two-day strike by luggage handlers.

Editorial & Opinion

Air supremacy

A BA-American alliance would be a rough ride for consumers, says Richard Branson. Page 12

THE RUSSIA-GEORGIA CONFLICT

Raids suggest Russia targeted oil pipeline

Georgian officials show bomb craters in uninhabited plain

By Guy Chazan

NEAR RUSTAVI, Georgia—A neat row of large craters in a field in southern Georgia strongly suggests that Russia deliberately targeted oil and gas pipelines bringing fuel to the West in the conflict with its southern neighbor.

Georgian officials say Russian warplanes dropped bombs in an early Saturday raid close to the Baku-Tbilisi-Ceyhan pipeline, which pumps some 850,000 barrels of crude a day—or 1% of total global oil demand—from Azerbaijan to the Mediterranean. The bombs narrowly missed the line, but one exploded just 10 feet away from it.

"These were pinpointed attacks," says Zurab Janjgava, general director of the Georgian Oil & Gas Corp. in an interview. "It was sheer chance the pipeline didn't blow up."

He says another raid Tuesday a mile or so away appeared to have been aimed at a second pipeline, known as Baku-Supsa, which brings Azeribaijan oil from the Caspian Sea to a terminal in Georgia's Black Sea town of Supsa. Russia has categorically denied attempting to bomb pipelines on Georgian soil. And Georgian officials were unable to furnish definitive proof the craters were caused by Russian bombs.

But the physical evidence of a recent air attack, witnessed by a reporter, is compelling.

The line of craters left by the alleged Russian attacks runs through the middle of a hilly, uninhabited plain some 25 kilometers south of Tbilisi, near the town of Rustavi. The area has a distinct lack of military or even human targets: the only sign of civilization is a small farm surrounded by haystacks and grazing herds of cows and sheep. The 45 craters—each some 60 feet across—scar the hillside like the footprints left by a giant, trudging across the landscape.

Close by lies the BTC pipeline, operated by British oil company **BP** PLC and buried at a depth of nearly six feet. It is identified only by small markers spaced out at one-kilometer intervals along the pipeline's route. The craters are concentrated in an area close to where BTC and the Baku-Supsa line intersect, near BTC's 25-kilometer marker.

There were no other reported Russian attacks for many miles around. The raids suggest Russia wasn't only aiming to humiliate its neighbor militarily but also to damage its reputation as an energy corridor. Over the past few years, Georgia has worked hard to build up an image as a conduit for oil and gas from the Caspian, one of the world's great hydrocarbon regions, to Western markets. That work could easily unravel at the sight of bomb-damaged export pipelines.

The implications for future projects are profound. A consortium of European energy companies is planning a pipeline called Nabucco, named after a Verdi opera, which would bring natural gas from Central Asian nations like Turkmenistan to Europe via the Caucasus and Turkey. Nabucco would cross Georgian territory. "But [it] stands little chance of success if this tense situation in Georgia continues," Georgian Oil's Mr. Janjgava says. "And that's true not only of Nabucco but of all the planned Caspian transit corridors."

Guy Chazan/The Wall Street Journal

BTC was the centerpiece of Georgia's effort to carve itself a niche as an energy corridor. A 1,760-kilometer pipeline that snakes through Azerbaijan, Georgia and Turkey to bring high-quality crude to a port on the Mediterranean, the $2.95 billion project became fully operational only two years ago, and has a capacity of one million barrels a day. It was the first major pipeline to bring oil from the region that bypasses Russia and, as such, was strongly backed by the U.S. But even before the conflict between Russia and Georgia, it was in trouble, forced to close due to a fire in the Turkish section for which Kurdish rebels claimed responsibility.

The 45 craters scar the hillside like the footprints left by a giant.

With BTC out of action, BP had to pump all its Azerbaijan oil through Baku-Supsa, which has a much smaller capacity—about 100,000 barrels a day. But BP shut it down Tuesday, partly because the fighting meant Black Sea tankers weren't able to load up at Supsa, leading to a stockpiling of crude at the terminal.

BP also shut the South Caucasus Pipeline, which runs alongside BTC and ships natural gas from Azerbaijan to Erzurum in Turkey. On Wednesday, BP declared force majeure on its liftings from Baku-Supsa, meaning it may not be able to fulfill export contracts. Meanwhile, Kazakhstan says it has suspended shipments of crude via a rail link to the Georgian port of Batumi.

"We hope to restart the pipelines as soon as the situation becomes safe," says BP spokeswoman Rusiko Medzmariashvili. She declined to predict when that would be.

CORRECTIONS & AMPLIFICATIONS

Georgian President Mikheil Saakashvili studied law at George Washington University. A Leading the News page article Wednesday about U.S.-Georgia relations incorrectly said Mr. Saakashvili is Georgetown University-educated.

Joseph S. Fichera is an expert in auction-rate securities and a financial adviser to corporations and governments. A News in Depth article Monday describing him as a specialist and a financial consultant didn't mean to imply he was a broker.

Hearst Corp. magazine Marie Claire increased the number of advertising pages in its September issue compared with the year-earlier month. Tuesday's Advertising column incorrectly implied Marie Claire had fewer advertising pages this September than a year earlier.

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.

THE WALL STREET JOURNAL EUROPE (ISSN 0921-99)
Boulevard Brand Whitlock 87, 1200 Brussels, Belgium
Telephone: 32 2 741 1211 FAX: Business: 32 2 732 1102
News: 32 2 741 1600 Editorial Page: 32 2 735 7562
SUBSCRIPTIONS, inquiries and address changes to:
Telephone: +32 2 741 1414
International freephone: 00 800 9753 2000
E-mail: subs.wsje@dowjones.com Website: www.services.wsje.com
Advertising Sales worldwide through Dow Jones International. Frankfurt: 49 69 971428 0; London: 44 207 842 9600; Paris: 33 1 40 17 17 01
Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Basınevi.
Registered as a newspaper at the Post Office.

Editeur responsable: Daniel Hertzberg M-17936-2003

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

LEADING THE NEWS

U.S. boosts aid effort in Georgia

Bush sets up face-off with Russia in area; Rice to meet officials

By **John D. McKinnon** *and* **Neil King Jr.** *in Washington and* **Marc Champion** *in Tbilisi*

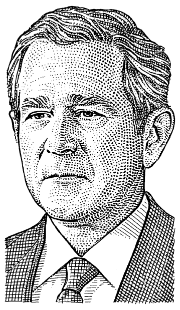
U.S. President George W. Bush set up a close-range confrontation between the U.S. and Russia militaries, dispatching navy ships and air-force planes to bring humanitarian aid to war-torn Georgia.

Mr. Bush also said he would send Secretary of State Condoleezza Rice to meet with Georgian officials in Tbilisi and "convey America's unwavering support for Georgia's democratic government."

The moves represented a dramatic escalation in the U.S. response to the crisis in Georgia, which has been widely criticized as weak in recent days. They also put U.S. and Russian military forces on opposite sides of the conflict.

The actions reflect the administration's conclusion that the conflict in Georgia hasn't ended after all and that Russia wasn't abiding by the peace deal brokered this week by French President Nicolas Sarkozy.

At a minimum, the White House moves raise the pressure on Russia to follow through on its promises to halt its attacks and withdraw its military. Mr. Bush signaled again that he is insisting on a return to the status quo before the violent clashes began, saying that "we insist that the sovereignty and territorial integrity of Georgia be respected."



George W. Bush

More broadly, the White House is using mercy missions in the wake of Russia's use of overwhelming force against Georgia to begin to reassert its own security influence in the Caucasus region. Essentially, the U.S. is daring Russia to block the U.S. diplomatic and relief efforts.

"We expect Russia to honor its commitment to let in all forms of humanitarian assistance," Mr. Bush warned. "We expect Russia to ensure that all lines of communication and transport, including seaports, airports, roads, and airspace, remain open for the delivery of humanitarian assistance and for civilian transit."

He added that the U.S. also expects Russia to meet its commitments to cease military activity and withdraw its forces. The president also repeated his warning that Russia's actions are risking its place in international organizations such as the World Trade Organization and the Group of Eight leading nations.

Mr. Bush's stern statements Wednesday contrasted sharply with the tone top administration officials struck the day before, when Russia appeared ready to accept a cease-fire and remove its forces from Georgia. Bush aides warned then that Russia could no longer invade other countries with impunity. But if it did withdraw, the officials suggested, no clear consequences would flow from the Russian invasion.

The continued reports of Russian shelling and troop movements in Georgia overnight and Wednesday morning prompted the White House to get much tougher. President Bush spent the morning in the White House Situation Room with his top security advisers, and then announced that he was sending Ms. Rice to Europe, and then on to the Georgian capital of Tbilisi. Georgian President Mikheil Saakashvili later said Mr. Bush told him he was up throughout the night weighing the move.

Russia's initial response to Mr. Bush's announcement appeared muted. Russian government spokesman Dmitry Peskov told CNN that Russian troops haven't broken the cease-fire. He said the column from Gori was deployed as part of an effort to "demilitarize the nearby zone to South Ossetia," one of the two separatist regions.

Foreign Minister Sergei Lavrov accused the U.S. of unfairly ignoring Georgia's aggression in attacking South Ossetia.

Mr. Lavrov told reporters that Russian forces hadn't targeted Georgian ships in Poti and that any actions around the city of Gori or the Senaki base were targeted at eliminating large troves of ammunition and supplies left behind by fleeing Georgian troops.

It remains unclear whether the U.S. will now help rebuild Georgia's military, which has been severely battered by the six-day conflict. Pentagon officials said they were sending in an assessment team to analyze what was needed.

Bank of England says economy is likely to stagnate

By Natasha Brereton

LONDON—The Bank of England cut its economic-growth forecast for next year and said it couldn't rule out one or two quarters of contraction, leading investors to expect a cut in interest rates before the end of the year.

In its quarterly Inflation Report, the central bank's rate-setting Monetary Policy Committee said the economy is likely to stagnate over the next 12 months as high energy and food prices eat into disposable incomes and credit conditions remain tight. It also predicted that the annual rate of inflation will fall sharply after a surge in the months ahead.

Also Wednesday, the Office for National Statistics said the number of people claiming unemployment benefits rose by 20,100 in July, the biggest gain since December 1992.

"The adjustment of the U.K. economy to higher commodity prices and a more realistic pricing of credit will be painful," Bank of England Gov. Mervyn King said. "The next year will be a difficult one, with inflation high and output broadly flat."

Mervyn King

According to the forecasts, the inflation rate will touch 5% this year but fall sharply from early 2009 to slightly below the central bank's 2% target in mid -2010. Growth will be "broadly flat" in the near term, the committee said, down from a prediction in May that annual growth would bottom-out around 1% in the first quarter of next year. Investors took the growth and inflation forecasts as a sign that the door had opened to cuts in the key bank rate.

"The MPC is signaling in this dovish report that if interest rates are left broadly unchanged then growth will weaken sharply and inflation will undershoot its target," said George Buckley, U.K. economist at Deutsche Bank. "This raises the risk that the MPC may cut interest rates more sharply—and quickly—than we are currently expecting." Deutsche Bank currently expects the central bank to cut its key rate to 4.5% in the first half of next year.

The pound sterling tumbled as the report was released, plunging to a near 22-month low of $1.8640 from around $1.8992 just before. The central bank said that if its growth forecasts were to turn out to be wrong, it is most likely that the economy would grow more slowly.

While warning of pain to come, Mr. King also stressed that the U.K. is not suffering a repeat performance of the economic downturn of the late 1980s. During those years, interest and unemployment rates soared, making it impossible for many Britons to make their mortgage interest payments.

According to its forecasts, the committee expects economic growth to rebound quickly from the middle of next year, bringing it back to around its 2.75% trend rate in late 2010. Perhaps the biggest surprise from the report came from the inflation forecasts, which now show inflation slightly undershooting the 2.0% target two years from now.

—Keith Jenkins contributed to this article.

Greenspan sees Fannie, Freddie plan as 'bad'

Continued from first page

and auctioned off," he says in an interview this week.

Instead, Congress granted Treasury Secretary Henry Paulson temporary authority to use an unlimited amount of taxpayer money to lend to or invest in the companies. In response to the Greenspan critique, Mr. Paulson's spokeswoman, Michele Davis, says, "This legislation accomplished two important goals—providing confidence in the immediate term as these institutions play a critical role in weathering the housing correction, and putting in place a new regulator with all the authorities necessary to address systemic risk posed by the GSEs."

At 82 years old, Mr. Greenspan remains sharp and his fascination with the workings of the economy undiminished. He maintains a high public profile, both defending his nearly 19-year tenure at the Fed from criticism that he is to blame for today's woes and promoting his book, the paperback version of which is to be issued next month with an epilogue.

In a conversation in his well-windowed, oval-shaped Washington office this week, Mr. Greenspan predicts U.S. house prices will begin to stabilize in the first half of next year. He also offers a novel suggestion to bolster the housing market: Increase the number of potential home buyers by admitting more skilled immigrants.

The former Fed chairman has argued for years that Fannie and Freddie shouldn't be allowed to borrow cheaply because of an implicit government guarantee of their debt and to finance a huge—and, in good times, profitable—portfolio of mortgage-backed securities. Their current vulnerability offered a chance to dismantle them, he says. "This was the ideal opportunity to come to grips with what is a fundamentally flawed model, which privatizes profits and socializes losses. That is fiscally tolerable in small amounts, but in trillions of dollars, it isn't," he says.

Nationalizing the companies and later selling them off in pieces sounds radical. It is far from clear that Congress would have embraced it even with President George W. Bush's blessing. But the notion has been raised by several other prominent observers. "If they are too big to fail, make them smaller," former Nixon Treasury Secretary George Shultz says. Critics say the Paulson approach, even if the government never spends a nickel, entrenches current management and offers shareholders the upside if the government's reassurance allows the companies to weather the current storm. The Treasury hasn't said what conditions it would impose if it offers Fannie and Freddie taxpayer money.

Fear that financial markets would react poorly if the U.S. government nationalized the companies and assumed their approximately $5 trillion debt is unfounded, Mr. Greenspan says. "The law that stipulates that GSEs are not backed by the full faith and credit of the U.S. government is disbelieved. The market believes the government guarantee is there. Foreigners believe the guarantee is there. The only fiscal change is for someone to change the bookkeeping."

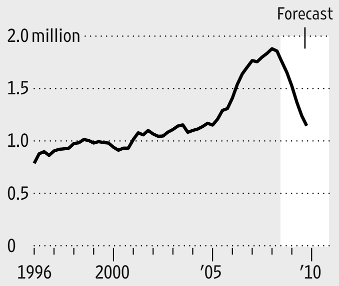
A longtime student of housing markets, Mr. Greenspan has been assembling data from government and trade-association sources to divine when house prices will stop falling. His desk, couch, coffee table and conference table are strewn with printouts of spreadsheets and multicolored charts of housing starts, foreclosures and population trends.

His bottom line: "Home prices in the U.S. are likely to start to stabilize or touch bottom sometime in the first half of 2009," he says. Tracing a jagged curve with his fingers on a tabletop, he cautions that even at a bottom "prices could continue to drift lower through 2009 and beyond."

An end to the decline in house prices, he explains, matters not only to American homeowners but is "a necessary condition for an end to the current global financial crisis."

Turning the corner?

Former U.S. Fed Chairman Greenspan forecasts a decline in the number of vacant, single-family homes for sale that will help stabilize house prices in the first half of 2009.



Note: Seasonally adjusted data

Source: Greenspan Associates LLC.

"Stable home prices will clarify the level of equity in homes, the ultimate collateral support for much of the financial world's mortgage-backed securities. We won't really know the market value of the asset side of the banking system's balance sheet—and hence banks' capital—until then," he says.

Mr. Greenspan's forecast rests on two pillars of data. One is the supply of vacant, single-family homes for sale, both newly completed homes and existing homes owned by investors and lenders. He sees that "excess supply"—roughly 800,000 units above normal—diminishing soon. (See his forecast in the chart accompanying this column.) The other is a comparison of the current price of houses—he prefers the quarterly S&P Case Shiller National Home Price Index because it includes both urban and rural areas—with the government's estimate of what it costs to rent a single-family house. As other economists do, Mr. Greenspan essentially seeks to gauge when it is rational to own a house and when it is rational to sell the house, invest the money elsewhere and rent an identical house next door.

In the past, Mr. Greenspan's crystal ball has been, at best, cloudy. He didn't foresee the sharp national decline in home prices. Recently released transcripts of Fed meetings do record him warning in November 2002: "It's hard to escape the conclusion that at some point our extraordinary housing boom...cannot continue indefinitely into the future."

Publicly, he was more reassuring. "While local economies may experience significant speculative price imbalances, a national severe price distortion seems most unlikely in the United States, given its size and diversity," he said in October 2004. Eight months later, he said if home prices did decline, that "likely would not have substantial macroeconomic implications." And in October 2006, nine months after leaving the Fed, he told an audience that, though housing prices were likely to be lower than the year before, "I think the worst of this may well be over." Housing prices, by his preferred gauge, have fallen nearly 19% since then.

Mr. Greenspan urges the government to avoid tax or other policies that increase the construction of new homes because that would delay the much-desired day when home prices find a bottom.

He does offer one suggestion: "The most effective initiative, though politically difficult, would be a major expansion in quotas for skilled immigrants." The only sustainable way to increase demand for vacant houses is to spur the formation of new households. Admitting more skilled immigrants, who tend to earn enough to buy homes, would accomplish that while paying other dividends to the U.S. economy.

He estimates the number of new households in the U.S. is increasing at an annual rate of about 800,000, of whom about one-third are immigrants. "Perhaps 150,000 of those are loosely classified as skilled," he says. "A double or tripling of this number would markedly accelerate the absorption of unsold housing inventory for sale—and hence help stabilize prices."

CORPORATE NEWS

VIDEOCONFERENCING

Tandberg discloses bid, sees share price jump 16%

NORWEGIAN videoconferencing-systems maker **Tandberg** ASA said it had been approached by an unnamed private-equity player interested in buying it.

Tandberg said the discussions are preliminary and that "there can be no certainty that an offer will be made." Tandberg has a market capitalization of roughly 12.88 billion kroner ($2.4 billion), after its shares rose 16 kroner each, or 16%, to 114 kroner.

Tandberg, which has dual headquarters in New York and Oslo, is a leader in the videoconferencing-systems market, along with with U.S. competitor Polycom Inc.

Tandberg it has hired J.P. Morgan as its financial adviser. *—Ola Kinnander*

AUTOMOBILES

Europe's car sales fall 8% as economies weaken

EUROPEAN car sales fell 8% to just under 1.3 million vehicles in July, while sales for the first seven months of the year were down 3% to 9.6 million vehicles, said VDA, the German car-maker association.

VDA blamed the rising cost of living and a lackluster economy for the decline.

July sales slumped 28% in Spain and 13% in the U.K. In Italy, new-car registrations dropped 11% in the month.

The new member states of the European Union together sold 8% fewer cars in the month, in light of sluggish demand in Romania. *—Hilde Arends*

BANKS

RBS to retain businesses of ABN Amro in Australia

ROYAL BANK of Scotland Group will retain ownership of its ABN Amro businesses in Australia and New Zealand after Commonwealth Bank of Australia walked away from talks to buy the operations, an ABN Amro Australia spokeswoman said.

Commonwealth Bank Chief Executive Ralph Norris said that recent bad news from two of its rivals had hurt the reputation of Australian banks in the international markets, making funding for such an acquisition harder to secure. RBS spokesman Neil Moorhouse said that RBS would "move to integrating [the ABN Amro businesses] with our existing franchise in Australia and New Zealand." *—Lyndal McFarland*

Continental AG will engage suitor in talks

Tire maker rejects Schaeffler's offer; family-equity push

BY MIKE ESTERL, DANA CIMILLUCA AND EDWARD TAYLOR

GERMAN tire and auto-parts maker **Continental** AG said Wednesday that it will pursue talks with the family-owned group that has bid €11.3 billion ($16.9 billion) for it, marking progress in what could become one of the biggest deals in Europe so far this year.

Continental formally rejected family-owned **Schaeffler Group**'s offer as "too low." But the tire maker said it will continue talks with the goal of "reaching a solution to the benefit of the company as soon as possible," even as it continues to evaluate other options.

Schaeffler, a maker of ball bearings based in the small Bavarian town of Herzogenaurach, informally offered to boost its bid to €75 a share from €70.12, people familiar with the matter said, and the two sides could reach a friendly agreement as early as this week.

As private equity retreats amid the credit crunch, a more traditional capitalist vehicle is moving into the fast lane in Europe's largest economy: family equity like Schaeffler's. Rich in cash and sensing opportunities amid falling prices for publicly listed companies, some German family-controlled firms are ditching their conservative ways and chasing acquisitions.

Schaeffler said in a statement that it was "very confident" it could reach a "positive result." Schaeffler has said it has access to more than 30% of Continental's shares already, mainly in the form of derivatives. Under German law, it could control Continental with a 30% to 50% stake. In fact, buying all of the company would trigger expensive change-of-control provisions attached to Continental's borrowings. But Schaeffler wants Continental to agree to its offer, in part because top customers of both companies have urged it to strike a friendly deal. Schaeffler formally launched a hostile bid for Continental last month.

"The timing is right. These families have deep pockets," said Alexander Gehrt, co-head of German mergers and acquisitions at the investment bank UBS.

Maria-Elisabeth Schaeffler, who with her son owns Schaeffler Group, was unavailable for comment. Schaeffler Group Chief Executive Jürgen Geissinger said that because Schaeffler is family-owned, "we are marked by a long-term strategic orientation." During its offer for Continental, Schaeffler has appealed to the tire maker's work force, touting its family credentials.

Family-controlled businesses have long formed the backbone of the German economy. Germany's stock-market capitalization is equal to roughly half its gross domestic product—about half the one-to-one ratio found in the rest of the world. Families are in the driver's seat of an estimated 95% of the country's more than three million companies.

More than 100 of these family-controlled companies top €1 billion in annual revenue—media conglomerate Bertelsmann AG is one of them—and roughly an additional 400 exceed €100 million. Schaeffler, with about €9 billion in sales, barely cracks the top 20.

Top 10 family-controlled companies in Germany

Company	Business	2005 revenue, in billions*
Metro	Retail	€55.72
BMW	Auto maker	46.66
Robert Bosch	Auto parts/Home appliances	41.46
Lidl & Schwarz	Retail	40.0
Sal. Oppenheim	Banking	32.03
Tengelmann	Retail	26.34
Franz Haniel	Retail	25.89
Celesio	Pharmaceutical services	20.49
Bertelsmann	Media	17.89
KarstadtQuelle/Arcandor	Retail	15.85

*Latest comparable available data

Source: Bonn Institute for Mittelstand Research

Most of these family concerns are highly secretive, making it difficult to predict big acquisitions. But the Schaefflers, who largely flew under the radar until the Continental approach, aren't the only ones who have been active lately. **Robert Bosch** GmbH, a privately held auto-parts and consumer-goods company, launched a €1.1 billion tender offer in June to take **Ersol Solar Energy** AG private. Two weeks ago, a member of the Quandt family, which controls publicly listed **BMW** AG, bought a 20% stake in wind-turbine manufacturer **Nordex** AG, which has a market capitalization of about €1.5 billion.The long-term perspective of family investors can help when times are tough. BMW issued a profit warning two weeks ago, but Chief Executive Norbert Reithofer hinted in a conference call that he still enjoyed the backing of the Quandt family, which controls 46.6% of the auto maker. "It is clear that our large shareholder is standing behind us," he said.

Jörg Appelhans, a spokesman for the Quandt family, adds, "We can confirm the statement by Mr. Reithofer. In 2009 the family Quandt will have been a majority investor in BMW for 50 years. This underlines the long-term investment philosophy."

Deals by family-controlled firms are picking up as private-equity takeovers slow down. Private equity was behind 16% of corporate takeovers in Germany in the first seven months of this year, down from 21% in 2007 and 33% between 2004 and 2006, according to Thomson Reuters. The Schaeffler bid for Continental, valued at $37.11 billion including debt, represented almost half the $82.17 billion in German merger-and-acquisition deals announced through July.

Chrysler's chief sees more auto consolidation

BY MATTHEW DOLAN

Chrysler LLC Vice Chairman and President Tom LaSorda said Wednesday he foresees more partnerships and more consolidation in the ailing U.S. auto industry.

As part of a speech to an industry conference in the U.S., Mr. LaSorda also announced a $1.8 billion investment in new-vehicle production and the expansion of a Detroit plant to build a new crossover vehicle.

Mr. LaSorda said the privately held auto maker plans to expand and upgrade the Jefferson North Assembly Plant in Detroit, including a new body shop. There are 1,400 employees at the plant on a single shift. Mr. LaSorda said the move will keep more than 400 jobs in Michigan, but a spokesman declined to elaborate on that figure.

The plant manufactures the company's Jeep products. Mr.LaSorda said the plant will see a 285,000-square-foot expansion. The new Jeep would replace the Grand Cherokee. The investment, according to Chrysler, includes the plant expansion, changing its manufacturing equipment to build the new, unnamed vehicle and other product-development costs, some of which are not directly related to the plant.

Tom LaSorda

His remarks come as U.S. auto makers struggle with changing consumer demand away from trucks and sport-utility vehicles, instead moving toward small cars as U.S. gasoline prices rose above $4.

At Chrysler, car and truck sales in July dropped 29%, compared with the same month last year.

"Despite the challenges, Chrysler is meeting—or exceeding—its financial targets," Mr. LaSorda said.

Chrysler, owned by the private-equity firm **Cerberus Capital Management** LP, already has a partnership with Japan's **Nissan Motor** Co. The alliance will build the Versa car for the South American markets in 2009, Mr. LaSorda said. He added that the trend will continue in 2010 with another joint venture for car production in North America, Europe and other markets.

Separately, **Ford Motor** Co. President of the Americas Mark Fields said the company's plan to consolidate its small-car production to one platform from two will yield double-digit percentage increases in profitability. He added that it will build on its successful SYNC technology system by creating a team devoted to providing more consumer electronics features for drivers and passengers.

Last week, The Wall Street Journal reported that Chrysler was in talks with Nissan about jointly producing midsize cars, a partnership that would move the U.S. auto maker toward a radical new business model.

The two companies agreed earlier this year to team up on pickups and subcompact cars. Since then, they have been discussing an agreement under which Nissan would produce midsize sedans that Chrysler would sell in the U.S. under its own name, people familiar with the matter have said.

CORPORATE NEWS

A defense for DHL plan

Deutsche Post CEO says switch to UPS is vital for U.S. unit

By Corey Dade And Alex Roth

Hoping to tamp the furor building for congressional hearings into DHL's outsourcing deal with **United Parcel Service** Inc., the chief executive of DHL parent **Deutsche Post** AG of Germany defended the deal as critical to saving the U.S. business and its 43,000 jobs.

Frank Appel, CEO of the Bonn-based delivery giant, in his first interview since the agreement became a target of presidential candidates John McCain and Barack Obama, said the only alternative is "more serious cuts to the whole operation" to stanch $5 million a day in losses.

He expressed sympathy for the more than 8,000 workers expected to lose their jobs in the closure of DHL's Wilmington, Ohio, air hub—shifting the airlift for all U.S. deliveries to UPS—and said he plans to dispatch "local advisers" to help them find other jobs.

"The dream that we can go back and say the world will be the same as before is just not doable," Mr. Appel said. "I can't afford to take losses of $1.3 billion forever. This is just not something a company can expect."

Concerns raised by Republican Sen. McCain and Democratic Sen. Obama, and other members of Congress are understandable given the likely negative effect on the local economy, Mr. Appel said. However, he said there are no legal grounds for their demands for an antitrust investigation. "I can't imagine what would be the legal position" to block it, he said.

UPS likewise has sought to clarify the deal as a vendor contract rather than a merger, which would trigger a federal anticompetition review. If consummated, the contract would make DHL the largest customer of UPS and generate $1 billion in annual revenue for the Atlanta shipping titan.

A spokeswoman for the House Transportation and Infrastructure Committee said Wednesday that a hearing likely will be scheduled for September, either before the committee or the Aviation subcommittee.

The Ohio congressional delegation first requested a hearing, and the committee chairman, Democratic Rep. James Oberstar of Minnesota, has expressed unease about the job losses and potential effects on customer service and competition.

Sen. McCain, along with Rep. Mike Turner, who represents Wilmington, on Tuesday said in a letter sent to Mr. Appel that they "are in no way passing judgment" on the UPS deal but urged him to visit the city and "hear firsthand the many important issues of concern to the affected community."

'I can't afford to take losses of $1.3 billion forever,' the CEO of DHL's parent said.

Mr. Appel in the interview said that task is being handled by DHL representatives in the U.S. "I already had plenty of interaction with local authorities," he said. "I should go there if I can tell people something, but we have said what we can say at the moment. Nevertheless, I think it's important to tell the people that I understand that it's a hardship for them."

Last week Sen. McCain met with DHL workers in Wilmington and pledged to marshal federal authority to try to prevent DHL from slashing their jobs. Sen. Obama voiced similar concerns in asking the White House to step in.

DHL announced the UPS deal in May as part of a downsizing of its expansion in the U.S., which has led to billions in losses over the past five years as DHL has failed to gain market share against UPS and **FedEx** Corp.

DHL bought the struggling express-delivery company Airborne Inc., and its Wilmington facility, in 2003 for $1.05 billion. DHL's Wolfgang Pordzik, executive vice president of corporate public policy, said a recent report in Cleveland's Plain Dealer mischaracterized the work of former Washington lobbyist Rick Davis regarding the acquisition. Mr. Pordzik sais Mr. Davis, currently Sen. McCain's campaign manager, was hired by DHL after the purchase was completed to "basically create goodwill" for DHL on Capitol Hill "without a specific legislative target...or regulatory target" in mind.

A new Obama campaign ad airing on Wilmington radio says Mr. Davis "helped push it through" and that Sen. McCain "used his influence in the Senate to help foreign-owned DHL buy a U.S. company and gain control over the jobs that are now on the chopping block in Ohio."

Mr. Davis declined to comment. But McCain campaign spokesman Brian Rogers says Mr. Davis represented Airborne before the acquisition and developed strategies for building support for the purchase. Mr. Rogers said "a very small portion" of his work involved directly lobbying members of Congress to support the acquisition.

Mr. Rogers said the new Obama campaign radio ad is "absolutely wrong" about Sen. McCain's involvement. He says the senator never publicly took a position on DHL's acquisition of Airborne but opposed an amendment to a military spending bill aimed at prohibiting foreign airlines from carrying U.S. military troops and equipment—legislation that appeared then to discourage DHL's acquisition of Airborne.

Arcandor posts loss, pares outlook

By Julia Mengewein

FRANKFURT—Tourism, retail and mail-order company **Arcandor** AG reported a net loss in its fiscal third quarter and lowered its target for fiscal 2009 in light of a weak performance in its domestic retail operations.

Net loss for the quarter ended June 30 was €119.3 million ($178 million). The Essen, Germany, company, formerly known as KarstadtQuelle AG, didn't provide a comparable year-earlier figure, because it has changed its reporting period and now reports the full earnings from travel company Thomas Cook Group PLC. Arcandor acquired the half of Thomas Cook that it didn't already own in the first quarter of 2007. Thomas Cook then merged with U.K. tourism company MyTravel in June 2007.

Revenue fell 4.1% to €4.66 billion from €4.86 billion, weighed down by a 12% drop in the contribution from Thomas Cook because of the strength of the euro against the pound.

The company adjusted its figures according to the company's portfolio restructuring last year.

DAILY SHARE PRICE

Arcandor

On the Frankfurt Stock Exchange
Wednesday's close: **€6.94, down 13%**
52-week change: **down 65%**

Source: Thomson Reuters Datastream

The adjusted operating loss at department-store chain Karstadt widened to €51 million from €8 million, as weak customer spending and charges for an efficiency program, aimed at cutting costs by offering more high-margin products, hit the bottom line.

Arcandor's earnings underscore economic problems in Europe's largest economy, where high inflation is taking a bite out of household spending. Last Friday, the German Federal Statistics Office reported that retail sales for June slumped 3.9% from a year earlier. German clothing stores SinnLeffers and Wehmeyer and department-store chain Hertie—all of which used to be part of KarstadtQuelle—filed for bankruptcy earlier this month.

The company reaffirmed its goal of reaching adjusted earnings before interest, tax, depreciation and amortization, or Ebitda, of more than €800 million for its full fiscal year, which ends Sept. 30. However, Arcandor lowered its forecast for fiscal 2009 Ebitda, saying it expects it to be about €1.1 billion, as the economic downturn has kept shoppers away from its department stores. It previously had forecast adjusted Ebitda of €1.3 billion for fiscal 2009.

Shares of Arcandor, which have shed more than 50% of their value since the beginning of the year, dropped 13%, to €6.94 Wednesday.

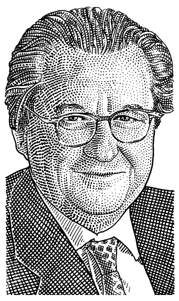
Arcandor said it will continue to lower its exposure to the retail business in Germany and focus on tourism and home shopping.

—Emese Bartha contributed to this article.

ING net declines 25% as investment gains fall

By Stefan Kloet

AMSTERDAM—**ING Groep** NV posted a 25% drop in second-quarter net profit, in part on lower investment gains, and said it weathered the credit-market turmoil well as it took a hit of €44 million ($66 million) in the quarter.



Michel Tilmant

The Dutch bank and insurer's net profit fell to €1.92 billion from €2.56 billion a year earlier, when ING posted a record net profit, boosted by a gain of €573 million on the sale of part of ING's stake in ABN Amro.

ING—which provides banking, investments, life-insurance and retirement services—said gross premiums fell 2.3% but rose 6.7% on a constant currency basis, reflecting good sales in the U.S., Central Europe and parts of Asia. In Japan and Taiwan, premiums fell because of lower sales.

Given current market conditions, ING said it is leaning away from acquisitions now. "Not even smaller fill-in acquisitions, as we would prefer to keep our powder dry," Chief Executive Michel Tilmant said. In recent months, the company said, it has turned down a number of opportunities.

ING realized €436 million in after-tax capital gains on equities as it "took advantage of the brief market rally in April to reduce its equity exposure."

Underlying profit, which excludes taxation and gains on divestments, dropped 29% to €1.95 billion from €2.74 billion, as ING booked fewer gains on its private-equity and alternative assets as well as on its real-estate portfolio, which accounted for the majority of the profit declines.

Lower investment gains hurt Zurich Financial's earnings

By Goran Mijuk

ZURICH—**Zurich Financial Services** AG reported a 2.5% decline in second-quarter net profit as lower investment gains undermined strong premium growth.

Net profit, helped by lower costs, stood at $1.25 billion, down from $1.29 billion a year earlier. Gross written premiums and policy fees rose 5% to $12.32 billion as the company benefited from market-share gains and recent takeovers, which helped counter sluggish market growth. In the U.S., Zurich Financial's Farmer's unit, which it manages but doesn't own, saw a 9% rise in premiums.

Zurich Financial has been on an aggressive buying spree for several quarters, acquiring more than half a dozen competitors in the U.S. and Europe, spending more than $1 billion.

Recent deals, which analysts say are likely to spur future growth, include the takeover of Germany-based Baden-Badener Versicherung AG, the acquisition of a majority stake in Brazil's Cia. de Seguros Minas Brasil and the 50% acquisition of the life-insurance, pension and general insurance operations of Banco Sabadell SA in Spain, one of Europe's fastest-growing markets.

"Although the figures were partly boosted by a reserve release of around $280 million in the second quarter, the fact that they were able to grow premiums bodes well for the future," said René Locher, analyst at Bank Sal. Oppenheim.

Analysts had expected Zurich Financial's bottom line would be hurt by lower investment gains, which dropped to $1.80 billion from $2.42 billion a year earlier due to lower equity gains. However, Chief Financial Officer Dieter Wemmer said the company was comfortable with its equity exposure, which currently stands below 5%, compared with the industry average of 7% to 10%.

E.on's profit fell 28% in first half, but the full-year forecast is raised

By Jan Hromadko

Germany's **E.on** AG posted a 28% drop in first-half net profit, as high wholesale power prices in its Central European and Nordic business failed to offset lower retail margins in the U.K. market and higher interest payments. The world's largest investor-owned utility by market value nevertheless raised its full-year net-profit forecast.

Net profit fell to €3.10 billion ($4.63 billion) from €4.32 billion from a year earlier, even though sales rose 16% to €41.22 billion from €35.56 billion. E.on said it recovered about €697 million less in book gains—mainly from the sale of securities in central Europe—in the first half of 2008 compared with 2007. It also booked restructuring and integration costs of €167 million and the revaluation of energy derivatives burdened results with an extra €809 million.

High power prices in its Central European and Nordic drove up earnings, said E.on, while the U.K. market unit was the biggest drag on profit.

The Düsseldorf-based company also reported earnings for the second quarter, when net profit slipped 2.1% to €882 million from €901 million, as sales were up 27% to €18.38 billion from €14.49 billion. However, in its statement, E.on only provided details for the first half.

In spite of the decline in profit in the first six months of the year, the company said it now expects adjusted net profit to rise between 5% and 10%; it previously projected an increase of 3% to 5%. Chief Financial Officer Marcus Schenck said E.on raised its outlook because it expects a lower tax burden in 2008 than previously anticipated.

Boston Scientific heart stent in question

Review of data finds research is flawed; U.S. approval likely

By Keith J. Winstein

A heart stent manufactured by **Boston Scientific Corp.** and expecting approval from U.S. federal regulators for U.S. sales is backed by research that is flawed, according to review of the data by The Wall Street Journal.

Boston Scientific submitted the results of the 2006 trial to the Food and Drug Administration to gain U.S. approval for the Taxus Liberte, which already is one of the top-selling stents outside the U.S.

Coronary stents—tiny scaffolds that prop open arteries clogged by heart disease—are among the most popular methods for treating heart patients, and have been implanted in more than 15 million people world-wide.

But Boston Scientific's claim was based on a flawed statistical equation that favored the Liberte stent, a Journal analysis has found. Using a number of other methods of calculation—including 14 available in off-the-shelf software programs—the Liberte study would have been a failure by the common standards of statistical significance in research.

Boston Scientific isn't the only company to use the equation, known as a Wald interval, which has long been criticized by statisticians for exaggerating the certainty of research results. Rivals **Medtronic** Inc. and **Abbott Laboratories** have used the same equation in stent studies.

But in those cases, any boost provided by the Wald equation wouldn't have changed the outcome of the study. In the Liberte study, the equation's shortcomings meant the difference between success and failure in the study's main goal.

The difference also sheds light on the leeway that device makers have when designing studies for the FDA. Studies designed to satisfy the requirements of the FDA's medical-device branch can be less rigorous than those aimed at winning U.S. approval for drugs. That's partly because of a 1997 federal law aimed at lessening the regulatory requirements on device makers. The FDA declined to discuss its consideration of the Liberte, which is still under review by the agency.

Boston Scientific doesn't agree that it made a mistake or that the study failed to reach statistical significance. It says the study, known as Atlas, was a success because the company's methodology, including the Wald equation, was accepted by the FDA before the study began, and it was bound to follow that method. "We used standard methodology that we discussed with the FDA up front, and then executed," said Donald Baim, Boston Scientific's chief scientific and medical officer. "We have no obligation to show that we can meet any arbitrary test."

Gregory Campbell, director of the biostatistics division of the FDA's device branch, said the Journal's analysis raised "good questions" but declined to comment on the Atlas study or the Liberte stent. Mr. Campbell called Boston Scientific's calculation approach "a standard methodology."

Boston Scientific, of Natick, Mass., has roughly 40% of the $5 billion-a-year world-wide market for coronary stents. The company's Taxus Express is the top seller in the U.S. To grant approval for Liberte, the FDA asked the company to show that its anticlogging performance in patients was "noninferior" to the Taxus Express.

In 2006, the company said that it met this test. Using a standard probability measure known as the "p-value," it said that there was less than a 5% chance that its finding was wrong. In April 2007, in the Journal of the American College of Cardiology, the company's researchers for the first time specified the p-value: 4.87%.

Scientists generally regard studies with p-values above 5% to be failures, and medical journals typically won't publish them, because they don't provide the high level of certainty needed to ensure that results would apply to all patients, not just those under study. Put another way, science traditionally requires 95% certainty that a study proved its premise.

But The Wall Street Journal's calculations found that the Liberte study's p-value was about 5.1%—failing to rule out the possibility that patients getting the Liberte stent will have markedly more artery recloggings than those receiving the Express. The calculations were verified by an academic expert at the University of Florida and a mathematician at the Massachusetts Institute of Technology.

Although the difference seems small—a mere 0.2 of a percentage point—it is the difference between success and failure for a product on which Boston Scientific has spent some tens of millions of dollars.

Liberte is made of thinner metal than the Express, making it easier to snake through patients' arteries. That ease of use appeals to doctors, and would help the company compete against newer stents from rivals Medtronic and Abbott.

Neither Boston Scientific's original press release reporting Liberte's success, nor the 2007 cardiology-journal article, disclosed that the study used the Wald method, an approximation technique that is among the easiest and least accurate for analyzing statistical results.

The equation is named after mathematician Abraham Wald, who taught at Columbia University in the 1940s. Experts in statistical methods have found fault with it over the years. "The Wald interval is broken," said Lawrence Brown, a statistics professor at the University of Pennsylvania. Dr. Brown, who has criticized the method in journals, called the method a "deficient technique" that "should not be used." Brent Coull, a statistics professor at Harvard University, said the Wald method "overstates the certainty" of clinical results.

The FDA hasn't approved Liberte for sale in the U.S. But the agency has given Boston Scientific an "approvable" letter that indicates it will approve the stent when it lifts a new-product moratorium it imposed on the company two years ago for reasons unrelated to the Liberte application. The company has said it expects the moratorium to be lifted this year.

In the Atlas study, Boston Scientific tested Liberte in 871 patients. Partly because the Liberte stent uses a design similar to that of its predecessor, the Express, the FDA allowed Boston Scientific to conduct an easier test than would be required for more novel products.

The difference reflects the device branch's discretion in interpreting a 1997 law that required it to ask manufacturers only for the "least burdensome appropriate means" of proving that new devices work. No comparable leeway exists for drug approvals.

The FDA permitted Boston Scientific to omit a comparison, or control, group of patients newly implanted with the Express, which would have made the study more expensive to conduct. Instead, Boston Scientific was allowed to compare Liberte's fresh results with data it had collected on Express patients a few years earlier.

Boston Scientific didn't have to "blind" participants in the study. Patients and doctors were aware that the stent being implanted was the model on trial—a Liberte. That can lead to a placebo effect—or patients saying they felt relief merely because of the psychological effect of knowing they were getting a new treatment.

Boston Scientific wasn't required to prove that Liberte was "superior" than a previous treatment, the agency decided—only that it wasn't "inferior" to Express. Boston Scientific proposed—and the FDA approved—a benchmark in which Liberte could be up to three percentage points worse than Express—meaning that if 6% of Express patients' arteries reclog, Boston Scientific would have to prove that Liberte's rate of reclogging was less than 9%. Anything more would be considered "inferior." Control groups, blinding and a superiority standard are features that the agency's drug branch usually requires to approve new products.

"The burden is lower for devices than for drugs," said Jeffrey Tice, an internist at the University of California, San Francisco. "I don't believe the FDA would approve a new drug on the basis of nonrandomized, nonblinded trials," he said.

Thomas Fleming, a statistics professor at the University of Washington, said the "flexibilities that are being allowed here are reflective of what is much more likely to be permitted in devices than in drugs."

In the end, the Atlas study found that 8% of the patients suffered reclogging. In comparison, historical data on 991 patients implanted with the Express stent show a 7% rate. Boston Scientific then had to answer this question: Could the study have gotten such results if Liberte truly were inferior to Express?

Answering that question calls for a bit of statistical hypothesis since observing reclogging in just 871 patients is only an estimate of the total population. Assume that the rates of reclogging do differ by at least three percentage points. In that case, what would be the chance that a trial with 871 patients would report a difference equal to or less than one percentage point, which was the actual difference among patients in the study? If the chance is less than 5%, by statistical convention, the assumption that the Liberte is inferior can be rejected.

In a vital part of its calculation, called the "standard error," Boston Scientific assumed that the difference between the true rates of reclogging between Liberte and Express was one percentage point—what the trial showed. In a sense, the company's equation assumed that Liberte definitely isn't inferior. That's a problem, since the equation was supposed to be deciding whether Liberte might be inferior after all. As a result, Boston Scientific's equation gives wrong answers that consistently favor the Liberte.

To remove that flaw, the standard-error calculation should be modified so that it assumes the true difference between rates is three percentage points. When done that way, the chance falls above 5%—meaning the results failed to reach statistical significance.

Jonathan Shuster, a statistics professor at the University of Florida, agreed that the Atlas study overstated its certainty. He said the Wald method is commonly used but imperfect. "Most statisticians would accept this approximation," he said. "But since this was right on the border, greater scrutiny reveals that the true, the real, p-value was slightly more than 5%."

The Journal also asked a mathematician, Travis Schedler, to confirm its calculations by doing them from scratch. Dr. Schedler, a mathematics Ph.D., is a researcher at the MIT and a 2008 fellow of the American Institute of Mathematics, of Palo Alto, Calif. His calculations agreed with the Journal's.

"We're not going to say there's anything mistaken in your mathematical calculations, but the issue is really the relevance of that analytical thread," Boston Scientific's Dr. Baim said.

—Charles Forelle contributed to this article.

Genentech is open to higher offer

By Jacob Goldstein

Roche Holding AG's proposed buyout of **Genentech** Inc. moved a step closer to becoming reality as Genentech's outside directors on Wednesday rejected the Swiss-based drug giant's pending $44 billion bid but said they would consider a higher offer.

Although Roche responded that its $89-per-share offer was "fair and generous," the market continued to bet that a significantly higher price is likely. Genentech's stock hit a 52-week intraday high of $99 on Wednesday before falling to $98.43 in afternoon trading in New York.

Roche already owns 56% of the California-based biotechnology company, which means no third party can trump it with a higher offer. Instead, several Wall Street analysts suggested Wednesday that Roche is likely to raise its bid, perhaps to somewhere in excess of $100.

Under a longstanding agreement between the companies, Roche's offer was considered by a special committee made up of the three independent members of Genentech's board. They concluded that Roche's offer "substantially undervalues the company," Genentech said in a statement Wednesday.

But, the statement added, the "special committee would consider a proposal that recognizes the value of the company and reflects the significant benefits that would accrue to Roche as a result of full ownership."

The question now is how high Roche would have to go to satisfy the special committee, and whether the Swiss drug giant will be willing to do so.

As the drug industry has been struggling with expiring patents and weak development pipelines, traditional pharmaceutical companies have been eagerly acquiring biotech companies whose drugs for conditions such as cancer command high prices and hold strong patent protections. Genentech has been among the most successful of these, with a product portfolio that includes Rituxan for cancer and arthritis and Avastin, Herceptin and Tarceva for cancer.

While Roche's majority stake means it is unlikely to pay as high a premium as Genentech would command on the open market, it has been widely assumed that the company's initial offer was merely a starting point for negotiations.

Sanford Bernstein analyst Geoffrey Porges said there is an 80% chance that Roche and Genentech's special committee would agree on a price. If they don't agree, Roche could make a tender offer directly to shareholders, he noted.

American speeds purchase of jets

By Paulo Prada

AMR Corp.'s American Airlines said it would accelerate its purchase of 737-800 aircraft from **Boeing** Co. to modernize its fleet and retire older, fuel-guzzling airplanes.

The move, which speeds up the delivery of an existing order for 70 737s and adds six to the order, follows American's decision earlier this year to accelerate plans to begin replacing its aging fleet of 300 MD-80s. That aircraft has an average age of 18 years at the airline and burns about 35% more fuel than the 737s that will replace them, American said.

Like other carriers, American, the world's biggest as measured by passenger traffic, is responding to the recent run-up in fuel prices by grounding aircraft and reorganizing its fleet to fly more fuel-efficient planes. Aging aircraft are a problem for most of the big U.S. carriers, which kept older planes longer than they would have preferred, as they restructured following the post-Sept. 11 industry crisis.

"Fleet replacement remains a key element of the actions we are taking to better position our company," said Tom Horton, AMR's chief financial officer.

To help pay for the 76 aircraft, which will be delivered progressively through 2010, American said it secured a financing option that could fund about two-thirds of the total cost. The funding is important at a time of tight credit for most industries and amid an operating climate for airlines in which most are hoarding their cash as a buffer against further instability in the fuel market.

While the terms of the revised order haven't been disclosed, the market price for a 737-800 is about $65 million.

—J. Lynn Lunsford contributed to this article.

GLOBAL BUSINESS BRIEFS

Dr Pepper Snapple Group Inc.

Net income declines 21% on costs, weakness in bottling

Dr Pepper Snapple Group Inc. reported a 21% drop in second-quarter net income amid weakness in the bottling segment and high costs, though it boosted its full-year earnings outlook. Shares of the maker of Snapple teas and Dr Pepper soda rose $1.40, or 6.5%, to $23.06 in late-day New York Stock Exchange composite trading Wednesday. The Plano, Texas, company, which was spun off from Cadbury PLC in May, posted net income of $108 million, or 42 cents a share, down from $136 million, or 54 cents a share, a year earlier. Revenue rose 0.9% to $1.56 billion, as higher pricing offset volume declines. Gross margin slid to 54.7% from 55.1% amid higher commodity costs. The company raised its full-year outlook, excluding items, by three cents to "at least" $1.94 a share.

Tata Steel Ltd.

India's Tata Steel Global Holding Pte. Ltd., a unit of **Tata Steel** Ltd., on Wednesday signed a joint venture pact to build a 4.5 million-metric-ton steel complex in Vietnam. Tata Steel Global and its partners, Vietnam Steel Corp. and Vietnam Cement Industries Corp., will invest as much as $5 billion in the project. "While the ultimate capacity of the steel complex will be 4.5 million tons per year, the first phase of the complex will be a cold rolling mill to be commissioned by end-2010," the companies said. Tata Steel will hold a 65% stake in the project, which will be located in the Vung Ang economic zone in Vietnam's Ha Tinh province. Vietnam Steel will hold a 30% stake and Vietnam Cement will hold the remaining 5%.

Axel Springer AG

Axel Springer AG, the German publisher of tabloid Bild Zeitung, said second-quarter net profit rose 73% on strong sales in its online and international operations. Net profit rose to €73.5 million ($109.7 million) from €42.5 million a year earlier, helped by lower taxes and a better financial performance. Sales increased 14% to €701.4 million from €617.3 million. Chief Executive Mathias Döpfner added that he expects the Berlin company's strong performance to continue in the second half. "We are less dependent on advertising revenue and we benefit from a shift of advertising budgets to online media," he said. The company said it also gained from its international operations, partly thanks to acquisitions.

British Energy Group PLC

Nuclear-power producer **British Energy Group** PLC reported a 65% fall in net profit for its first quarter and said in a statement it is still in discussions concerning a potential transaction, widely believed to be takeover talks with French utility **Electricité de France** SA. Chief Executive Bill Coley declined to comment further on those talks. British Energy's purchase by EDF fell apart earlier this month after two major British Energy shareholders objected to the price, people familiar with the situation said at the time. Higher electricity prices helped to partly offset costs related to problems at British Energy's power plants. Net profit fell to £62 million ($117.6 million) from £179 million a year earlier. Revenue fell to £629 million from £668 million.

Standard Bank Group Ltd.

Standard Bank Group Ltd., the largest African lender by assets, posted a 16% rise in first-half net profit as corporate banking and operations outside South Africa more than offset a rise in bad loans in its home market. Consumers in South Africa have been squeezed by the central bank's efforts to tame rising inflation with a series of interest-rate increases that have coincided with a slowdown in the economy, thanks largely to power shortages early in the year. Standard Bank's profit rose to 7.4 billion rand ($947 million) from 6.35 billion rand a year earlier. Credit-impairment charges, however, more than doubled, and impairments as a percentage of advances increased to 1.27% from 0.78%. The Johannesburg-based lender, which has twice reined in its guidance for the full year, said it was unable to forecast earnings for 2008. Standard Bank operates in 18 sub-Saharan countries and 21 internationally.

H. Lundbeck AS

H. Lundbeck AS said second-quarter net profit fell 52% as the Danish pharmaceutical company was hit by write-downs on a failed drug candidate. The Copenhagen company reported net profit fell to 240 million Danish kroner ($48 million) from 498 million kroner a year earlier. The result was hurt by 481 million kroner in write-downs after Alzheimer's treatment candidate Flurizan failed in late-stage trials. Sales rose 12% to 2.94 billion kroner. Earnings before interest and taxes fell to 363 million kroner from 692 million kroner. Excluding the write-down, operating profit would have risen 22% from a year earlier. The sales increase was driven by a 20% rise in sales of depression treatment Cipralex.

Hypo Real Estate Holding AG

Hypo Real Estate Holding AG reported second-quarter net profit of €12 million ($17.9 million), down from the €148 million in the first quarter and hit by additional markdowns and a decline in revenue. The company didn't provide a comparable net-profit figure for the second quarter of 2007. Total operating revenue—made up of net interest income, net commission income, trading income and net income from investments—fell 55% to €236 million. The German commercial-property and public-sector financier marked down €145 million on its portfolio of collateralized debt obligations, after €175 million in the first quarter, bringing total crisis-related markdowns to €786 million since last summer.

Vontobel Holding AG

Swiss bank **Vontobel Holding** AG Wednesday said that first-half net profit fell 31% to 114.7 million Swiss francs ($105.5 million) from 166.6 million francs. But the Zurich-based asset manager and investment bank said it posted a relatively strong net new-money inflow of 3.2 billion francs versus 2.5 billion francs in the year-ago period. Vontobel said it expects markets to remain volatile, adding it will continue to focus on international growth. Smaller Swiss asset managers like Vontobel have gained market share from large wealth managers, benefiting from money transfers from clients disaffected with the subprime exposure involvement of heavyweights such as UBS AG. Earlier this year, Vontobel reiterated its 2010 targets, which include client assets of at least 100 billion francs and a cost-income ratio of 65% to 70%.

Lanxess AG

Lanxess AG said it swung to a second-quarter net profit as price increases offset higher raw-material costs at the German chemical company. Net profit was €53 million ($79.1 million) compared with a loss of €59 million a year earlier, when it booked charges related to the sale of its Lustran Polymers unit. Sales rose 2.2% to €1.77 billion. The result was helped by the first-time contribution of Petroflex, a Brazilian rubber maker in which it acquired a majority stake this year. Adjusted earnings before interest, taxes, depreciation and amortization rose 5.7% to €223 million. In the first half of the year, net income rose to €156 million from €32 million a year ago. Sales fell 4.1% to €3.44 billion. Lanxess said it plans to move its headquarters to Cologne from Leverkusen by 2011.

Swisscom AG

Telecommunications company **Swisscom** AG reported a 13% drop in second-quarter net profit, as a charge linked to termination of a leasing contract erased part an otherwise strong quarter. The Bern-based company said net fell to 412 million Swiss francs ($379 million) from 475 million francs in the year-earlier period. Swisscom Chief Executive Carsten Schloter said the company's decision to scrap the leasing contract was due to the current financial-market turmoil. Swisscom said sales jumped 13% to 3.06 billion francs from 2.72 billion francs a year earlier, driven by the acquisition of Italy's Fastweb. Operating profit increased 22% to 743 million francs. The former incumbent was able to counter price declines by widening its product range and attracting new customers, especially at its television unit. Cost cuts also helped spur profits, the company said.

PKN Orlen

Poland's largest oil refiner and retailer by capacity and market capitalization, **PKN Orlen**, posted a 47% jump in second-quarter net profit as higher production volumes and foreign-exchange gains offset weaker margins in its refining and petrochemical businesses. Net profit rose to 1.67 billion zlotys ($762.8 million) from 1.14 billion zlotys a year earlier, while sales were up 36% to 22.09 billion zlotys. Foreign-exchange gains and 82 million zlotys in profit contributed by PKN Orlen's mobile-telephone unit Polkomtel boosted the bottom line. The company said the combined negative effect of weaker margins and a strong zloty cut its operating profit by 470 million zlotys. In addition, refining margins suffered from the company's relatively high internal crude-oil consumption.

Prudential PLC

U.K. insurer **Prudential** PLC said Wednesday that it appointed Harvey McGrath, a veteran of hedge-fund company **Man Group** PLC, as its new chairman. Prudential said Mr. McGrath, 55 years old, will succeed David Clementi as chairman Jan. 1, and will join its board as a nonexecutive director on Sept. 1. Mr. Clementi, 59, has been in the post since 2002 and was widely expected to step down this year or next. Having worked for Man Group since 1980, Mr. McGrath was appointed chief executive of Man Group in 1990 and then became its chairman in 2000. He left Man Group in 2007. Prudential said the annual fee for McGrath as nonexecutive director and chairman will be £500,000 (about $950,000). The company isn't related to Prudential Financial Inc., of the U.S.

ArcelorMittal

ArcelorMittal, the world's largest steelmaker, and its Chinese partner Hunan Valin Iron & Steel Group Co. agreed to set up a joint venture to produce electrical steel. The joint venture, Valin ArcelorMittal Electrical Steel Co., will have registered capital of 2.6 billion yuan ($378.7 million), Hunan Valin Group's listed unit Hunan Valin Steel Tube & Wire Co. said. Ownership will be split equally between ArcelorMittal and Hunan Valin Group. ArcelorMittal estimated the companies' total investment in the joint venture at 6.5 billion yuan. In June, the two companies agreed to set up an auto sheet joint venture, and this marks their second joint venture. The new joint venture will be ready to start production in 2010 and have an annual production capacity of about 600,000 metric tons, ArcelorMittal said. The joint venture still requires approval from the Chinese government, Hunan Valin said.

Royal Dutch Shell PLC

Royal Dutch Shell PLC violated industry rules by claiming in a Financial Times ad that two oil projects in Canada and the U.S. involved sustainable forms of energy, Britain's advertising watchdog ruled. The Advertising Standards Authority investigated the Shell ad after a complaint from the World Wildlife Federation. The advertisement focused on two of Shell's projects: the exploration of bitumen, a tar-like form of petroleum, in Canada's oil sands, and Shell's plan to build one of the largest oil refineries in the U.S. in Texas. The watchdog ruled Shell had breached regulations relating to substantiation, truthfulness and that the advertisement "was defined primarily in environmental terms." Shell argued that it also used "sustainable" to refer to the social and economic impact of the projects. "It was never our intention to be misleading in our advertisement," a Shell spokeswoman said.

Liz Claiborne Inc.

Liz Claiborne Inc. swung to a second-quarter loss amid expenses related to streamlining operations and the sale or closing of some of its clothing brands. The apparel maker also projected third-quarter earnings below analysts' expectations and cut the high end of its forecast for 2008 earnings. Liz Claiborne shares fell sharply lower, losing $2.31, or 15%, to $12.60 in early-afternoon composite trading on the New York Stock Exchange. The company reported a net loss of $23.1 million, or 25 cents a share, compared with year-ago net income of $13.6 million, or 13 cents. Excluding restructuring costs, earnings from continuing operations fell to nine cents from 23 cents. Sales fell 7.1% to $973.8 million.

Balfour Beatty PLC

U.K. engineering and construction company **Balfour Beatty** PLC reported a 76% rise in first-half net profit, driven by a strong order book and acquisitions, and said it expects to deliver further revenue and profit growth in the second half. The U.K. infrastructure contractor said that net profit from continuing operations rose to £106 million ($201 million) compared to £60 million a year earlier. Balfour has been largely shielded from the construction market's downturn as a large part of its work is for the public sector. Balfour's order book stood at £12.1 billion, up 6% since the year end, and the company highlighted healthy demand in its U.S. and U.K. construction businesses, along with its U.K. and Dubai engineering businesses. Revenue grew 28% to £4.33 billion. The group will be looking to acquisitions to strengthen its regional foothold in the U.K., said Chief Executive Ian Tyler.

Biovail Corp.

Biovail Corp. swung to a second-quarter loss, reflecting a variety of charges. The Toronto-based pharmaceutical company also said it expects annual declines in its product sales for the next several quarters and no meaningful revenue contribution from its development pipeline until 2010-2011. Biovail's net loss totaled $25.3 million, or 16 cents a share, on revenue of $186.1 million. In the year-earlier quarter, revenue was $203 million, while earnings were $67.8 million, or 42 cents a share. The latest results include restructuring costs of 32 cents a share for planned facilities closures and 15 cents a share in legal costs related to a U.S. Justice Department investigation.

Macy's Inc.

Macy's Inc. said net income eased 1% in its fiscal second quarter on weaker sales, and the company cut its fiscal-year earnings outlook amid what it called a "poor economic environment." For the quarter ended Aug. 2, the U.S. department-store operator posted net income of $73 million, or 17 cents a share, compared with $74 million a year earlier. Excluding charges as well as trademark write-downs in the latest quarter, per-share earnings were flat at 29 cents. Revenue fell 3% to $5.72 billion while same-store sales declined 2.1%. "While we are never fully satisfied when sales are down, we continued to outperform most of our major competitors in same-store sales and to gain market share," Macy's Chairman and Chief Executive Terry J. Lundgren said. However, the Cincinnati company cut is fiscal-year earnings target to $1.70 to $1.85 a share from $1.85 to $2.15.

CSL Ltd.

Australia's **CSL** Ltd. Wednesday signed an agreement to buy **Talecris Biotherapeutics Holdings** Corp. for $3.1 billion to boost its share of the $15 billion-a-year global plasma therapeutics market. Talecris is the third-largest producer of plasma-medicines in the U.S, behind CSL, which is No. 2 behind **Baxter International** Inc. The three companies control 83% of the U.S. market. CSL Managing Director Brian McNamee said CSL's sales of plasma products should rise to about 3.8 billion Australian dollars (US$3.32 billion) after the purchase, compared with Baxter's annual revenue of about A$5 billion. CSL also reported net profit for the fiscal year ended June 30 rose 30% to A$701.8 million from A$539.3 million, as annual sales rose 15% to A$3.79 billion.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

MAURITANIA

Group linked to al Qaeda urges holy war after coup


Associated Press

A TERROR GROUP linked to al Qaeda called for holy war in Mauritania following a coup last week that overthrew its democratically elected government.

"You Muslims prepare for war and raise the banner of jihad," said a statement on an Islamic Web site, signed by Abu Musab Abdulwadood, the leader of al Qaeda in Islamic North Africa, a cell blamed for attacks in Mauritania, including last year's murder of four French tourists.

The military-led coup last Wednesday toppled the government of President Sidi Cheikh Ould Abdallahi, above, the country's first democratically elected president in more than two decades. *—Associated Press*

LEBANON

Bus blast leaves 18 dead, raises fear of more attacks


Associated Press

A BOMB ripped through a bus during morning rush hour in the northern Lebanese city of Tripoli, killing 18 soldiers and civilians, security officials said, raising fears that an al Qaeda-inspired militant group is stepping up revenge attacks against the military.

The bombing was Lebanon's deadliest in more than three years, hitting a main Tripoli street crowded with people heading to work. It was the first significant bombing in Lebanon in months, and comes as the country is making moves to put three years of back-to-back crises behind it. *—Associated Press*

POLAND

U.S. missile-defense talks pick up amid area conflict


Associated Press

POLAND and the U.S. launched further negotiations on a proposed U.S. missile-defense system, with Poland saying its demand for additional security guarantees is justified by the fighting between Russia and Georgia.

Washington has insisted that the system it wants to install in Poland and the Czech Republic isn't directed against Russia, but Moscow has said it regards the system as a threat.

The fighting between Russia and Georgia was certain to loom large as Foreign Minister Radek Sikorski and U.S. negotiator John Rood began two days of talks. *—Associated Press*

Dalai Lama blasts China

Paris visitor accuses Beijing of repression during the Olympics

By Stacy Meichtry
Paris

THE DALAI LAMA accused China of conducting a "Cultural Revolution" against Tibetans while the Olympics Games are under way in Beijing, allegations that may stoke renewed tensions between the Tibetan leader and the Chinese government.

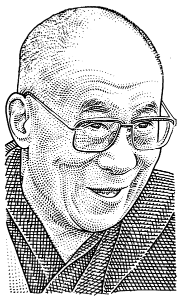
During a visit to the French Senate, the Dalai Lama told a group of 40 legislators that China was engaged in a continuing crackdown in the Tibet region that included "arbitrary arrests, summary executions and lethal torture," according to a statement issued by the Senate after the meeting.

Wangpo Bashi, an official at the Dalai Lama's offices in Paris who accompanied the Tibetan leader during the visit, said the Dalai Lama made the comments in response to a question from a lawmaker.

Asked whether Tibetans and the Chinese government were participating in an "Olympic truce" while the Games were underway, the Dalai Lama responded "No, not at all." He then compared the climate in Tibet to the 1960s' Cultural Revolution, according to Mr. Bashi and the Senate statement.

Several phone calls to the Chinese embassy in Paris weren't returned.

The Dalai Lama leveled his accusations just days after Beijing kicked off the Games with an extravagant opening ceremony aimed at showcasing China's arrival on the world stage. The Dalai Lama's comments were some of his strongest criticism of Beijing since the Chinese government quashed violent riots that broke out in Tibet and surrounding provinces in March.


Dalai Lama

The Tibetan leader also said Beijing planned to relocate a million Han Chinese, China's majority ethnic group, to Tibet once the Games come to a close. Tibetans have bemoaned the growing number of Han Chinese in the region as an attempt by Beijing to dilute Tibetan culture. "It's a form of demographic aggression," Mr. Bashi said.

The Dalai Lama's visit to France also is likely to exacerbate tensions between Paris and Beijing.

French retailers, including Carrefour SA, were hit by widespread boycotts in China after the Olympic torch's journey through the streets of Paris. The Dalai Lama also was named an honorary citizen of Paris, prompting Beijing to temporarily cut off the flow of Chinese tourists to the French capital.

French President Nicolas Sarkozy has tried to mend relations by sending a delegation to China to apologize for the torch's treatment in Paris. He also ruled out meeting with the Dalai Lama during the Tibetan leader's Paris visit, after China's ambassador to France threatened "serious consequences" if such a meeting took place. Mr. Sarkozy's wife, singer and former model Carla Bruni-Sarkozy, plans to meet with the Dalai Lama during a religious ceremony to open a Buddhist temple in southern France on Aug. 22.

The Dalai Lama is officially visiting Paris to attend a Buddhist conference on the outskirts of the city. But he also is using the visit to press his agenda with China's leadership.

China's communist government agreed to reopen talks with the Dalai Lama after an international outcry that resulted from the violence in Tibet. The talks have made little progress. China continues to regard the Dalai Lama as a "splittist" who is plotting Tibetan independence from China. The Dalai Lama says he seeks only greater autonomy for the region, such as a local democratically elected government.

During his meeting with French lawmakers, the Tibetan leader warned that support for his push to reconcile with China is waning among younger generations of Tibetans who favor a more hard-line approach.

U.S. retail sales declined in July

By Anton Troianovski

U.S. retail sales declined in July for the first time in five months, in a signal that consumer spending, a key driver of the American economy, continues to weaken.

The 0.1% drop in sales from June of retail goods and food services, reported by the Commerce Department on Wednesday, reflected a sharp drop in auto sales. The sales declines suggested that the lift to spending from the government's stimulus checks, mostly sent out in April to July, has faded. Sales in June rose a revised 0.3%, more than previously thought.

Among the challenges facing consumers is the high cost of imports ranging from food to fuel. On Wednesday, the Labor Department reported that import prices increased 1.7% in July from June, and were 21.6% higher than a year earlier.

The retail-sales report offered fresh evidence of the toll that the economic downturn is taking on consumer demand. Total retail and food-service sales fell to $384.6 billion in July from $385.1 billion in June, after seasonal adjustments. Excluding motor vehicles and parts, sales rose 0.4% in July, and were up 6% from July 2007.

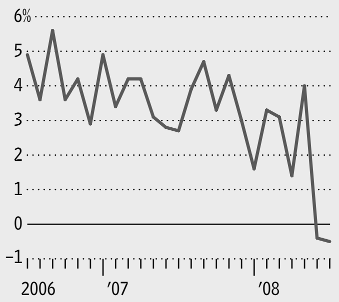
Motor-vehicle and parts sales, hit hard by gas prices and deepening consumer gloom, dropped to $67.9 billion in July. That's a decline of 2.4% from June and 10.5% from July 2007. Sales of furniture and building material, hurt by the housing-market slump, also fell from a year ago.

Soft industrial output dims euro-zone outlook

By Emma Charlton

Sliding

Euro zone's industrial production, year-to-year percentage change



Source: Eurostat

LONDON—Industrial output in the 15-country euro zone was weaker than expected in June after a series of contractions in southern European economies, data released by the Eurostat statistics office showed.

In Spain, where business activity and housing prices are falling despite a government effort to stimulate the economy, industrial output fell 9% from the same month last year.

The data reinforced expectations that euro-zone gross domestic product is likely to turn negative in the second quarter when Eurostat reports euro-zone GDP data Thursday. The currency bloc is feeling the force of a strong euro, rising commodity prices and slowing global demand; Italy already has reported a second-quarter contraction.

Eurostat said industrial production across the euro zone was flat in June from May, and fell 0.5% from a year earlier. Economists had expected the measure to rise 0.1% from May and 0.2% from last year.

The bloc is feeling the effects of a strong euro and slowing demand.

"The lack of change in June left industrial output in the second quarter 0.6% down on the first quarter," said Martin van Vliet, an economist at ING Bank. "This adds to evidence that euro-zone overall gross domestic product will likely also show a contraction." ING Bank expects second-quarter gross domestic product to contract 0.2%-0.3% on the quarter, roughly in line with market expectations.

The data coincided with news that Spanish inflation accelerated to 5.3% in July. A spokesman said Wednesday that Spanish Prime Minister José Luis Rodríguez Zapatero will interrupt his summer holidays to preside over an extraordinary cabinet meeting Thursday that will center on more measures to counter a rapidly deteriorating economy.

Mr. Zapatero will hear proposals ahead of the meeting to speed up already-planned measures to reactivate the economy that faltered when activity in its construction sector collapsed last year, hobbling what had been one of the euro zone's high-fliers.

Meanwhile, Germany's Ifo economic-research institute said Wednesday that its quarterly "economic climate" index for the euro zone fell for the fourth time in a row in the current quarter, and to its lowest level in 15 years.

"The economic climate has further clouded over in nearly all countries of the euro area in the third quarter of 2008," said Hans-Werner Sinn, the Ifo's president. "The slowing in economic activity will continue in all countries of the euro area in the coming six months."

The Ifo survey, which quizzed 273 euro-zone economists on current economic conditions and the outlook, showed the climate index in the euro zone falling to 61.9 in the third quarter from 76.3 in the April-June period.

As recession fears grow in Europe, many economists now predict that the European Central Bank will leave interest rates on hold at 4.25% and wait for slowing demand and falling commodity prices to stem inflation.

—Christopher Bjork in Madrid contributed to this article.

U.S. proposes Basra shift

Extending military into southern Iraq would relieve British

By Yochi J. Dreazen

BAGHDAD—U.S. commanders have developed a plan to extend the military's reach deep into southern Iraq as part of a broader effort to assume responsibility for the oil-rich city of Basra as British forces currently stationed there leave Iraq.

The plan, if implemented, would result in the U.S. controlling Iraq's second biggest city for the first time since the 2003 invasion. It would also accelerate the trend of the U.S. taking more responsibility for the war effort as troops from other countries withdraw.

Military officials cautioned that no decisions have been made and that the proposed Basra shift would need to be approved by the American, Iraqi and British governments. "Based on the conditions on the ground, units may be repositioned or adjusted in order to meet the security requirements or mission for a particular area," said Col. Bill Buckner, an American military spokesman. "At this point there are too many factors to project unit moves."

Still, a number of U.S. commanders said the plan had strong high-level support in Baghdad and was likely to be implemented early in 2009.

The proposal highlights the new reality in Basra in the wake of an Iraqi-led assault last spring that cleansed the country's second-largest city of the Shiite militants who long held sway there. The city, a vital oil center, is now controlled by the Iraqi army, and the British government has made clear that it hopes to withdraw most of its 4,100 troops next year.

Iraqi Prime Minister Nouri al-Maliki has been critical of the British effort in Basra, and U.S. and Iraqi officials have come to believe that American troops would be better equipped to preserve the city's recent security gains than the British forces, according to people familiar with the deliberations. British troops have long had a hands-off approach to Basra, which is blamed for allowing militias to take control of the city.

"It will give us a much better range of command and control in the area," one senior U.S. commander said.The plan would add to the continuing influx of American military personnel into Basra.

Close to 1,000 American military advisers rushed to the city in March alongside the Iraqi units assigned to Operation Charge of the Knights, the assault that ultimately wrested control of the city away from militants loyal to radical cleric Moqtada al-Sadr.

Many of those advisers remain in the city, and hundreds of American military police personnel have been arriving in Basra in recent weeks as part of an effort to train Basra's corrupt and ineffectual police force.

The proposals call for Multi-National Division-Center, the American command responsible for central Iraq, to extend its authority down to Basra.

Officials familiar with the plan said the hundreds of military personnel assigned to the command, which is led by a two-star American general, would physically relocate to Basra, though the officials said there was a small possibility that the headquarters would remain near Baghdad's airport.

Maj. Gen. Michael Oates, the division's commander, said the U.S. had contingency plans in place in case the continuing negotiations between London and Baghdad result in a decision to withdraw most British forces early next year.

"If those negotiations result in the British departure from Iraq—and that's a big if—one of our contingencies would be how we address Basra," he said. "And I think we'll factor into that."

Gen. Oates noted that his command was already slated to assume responsibility for the southern province of Qadasiyah in early October when Poland withdraws its last remaining troops.

Still, Gen. Oates stressed that no final decisions about a move to Basra had yet been made. "In terms of taking over the province, I've not been directed to do that," he said.

Maj. Paul Smyth, a spokesman for the British forces in Basra, said that he couldn't comment on future military planning but noted that British Prime Minister Gordon Brown has talked about a "fundamental change of mission" in Basra in early 2009. "Iraqi forces are in the lead here, and that is absolutely key for us," he said.

In an interview earlier this month, Maj. Gen. Barney White-Spunner, the top British commander in Basra, said improvements in the Iraqi security forces meant that the U.K. could soon shift to "a long-term military training" mission in Basra. Such a mission could be accomplished with a fraction of the British contingent now in Basra, according to other senior U.K. officials in the city.

The likely British drawdown would further shrink the U.S.-led coalition here. Georgia had the third-largest foreign contingent in Iraq, but it rushed its troops home this week to help fight the Russians.

Australia is in the process of withdrawing almost half of its 1,400 military personnel, Poland plans to withdraw its 900 troops by this fall, and El Salvador just announced plans to cut its contingent to 200 from 280 troops.

Moving south

Iraq is divided into six areas of responsibility maintained by multinational forces, four of which are headquartered by U.S. forces. The U.S. is planning to move personnel south to assume responsibility for Basra.

Source: U.K. Ministry of Defense

Japan's economy contracts 0.6%

By Yuka Hayashi

TOKYO—Japan's economy shrank for the first time in a year in the April-June quarter, confirming fears the world's second-largest economy has entered a slump at the same time as the U.S. and some other major countries.

Gross domestic product, the widest measure of economic activity, fell 0.6% from the previous quarter on a seasonally adjusted basis, the government said. That translates to an annualized rate of decline of 2.4% and represents the first quarterly contraction in a year.

The decline was the largest in nearly seven years, coming as rising prices of energy, food and raw materials hit consumers and corporations. Many Japanese companies are suffering higher costs as their sales decline around the world, and they are responding by cutting production and capital spending. Japan is particularly vulnerable to higher energy prices, as it relies nearly entirely on imported oil.

Economists say they expect that Japan's economy will continue its rough patch for at least the next several months. Consumer prices, which hadn't risen consistently for years, are now climbing steadily, even as incomes decline and the job market weakens. Declines in exports are also accelerating, as global inflation is now cutting into demand from China and other Asian nations that have in the past propped up Japan's exports.

Economists say Japan's GDP will probably improve in the third quarter, but they are divided on whether it will turn positive. Another quarter of shrinking GDP would place Japan in a recession under the widely used definition of two consecutive quarters of GDP declines.

"We expect very sluggish economic momentum" throughout the year ending March 31, said Mamoru Yamazaki, an RBS Securities economist in Tokyo. Mr. Yamazaki, however, rules out a severe economic downturn, as Japanese companies are leaner and more efficient than they were during past slumps.

To address increasing concerns about a slowing economy, Tokyo is putting together a stimulus package. The package, expected to be unveiled at the end of August, will include steps to help companies and people hurt by higher energy and commodities prices.

Japanese consumers appeared resilient earlier this year, but they have begun trimming spending because of price increases in gasoline and basic food items.

Muslim charities turn to Better Business Bureau

By Tamara Audi

Muslim charities in the U.S., hit by a drop in donations after the terrorist attacks of Sept. 11, 2001, are enlisting an unusual ally, the Better Business Bureau, to help them earn a seal of approval and give donors the confidence to open up their wallets again.

Under the agreement, announced Wednesday, seven Muslim charities have agreed to submit to an auditing process designed by the Better Business Bureau that vets charitable activities for transparency and financial accountability. The effort was led by Muslim Advocates, a San Francisco advocacy group, which is planning a national push to encourage more U.S.-based Muslim charities to participate.

The plan is intended to address the fears of anxious donors who worried about becoming inadvertently tangled in terrorism-financing investigations. In the years since 2001, the U.S. Treasury Department designated scores of charities as providing funding to terrorist groups, alleging that donations wound up in the hands of organizations such as Hezbollah in southern Lebanon and the terrorist group al Qaeda. The Treasury Department froze the assets of seven U.S.-based charities—six of them Muslim. In some cases the leaders of those charities were prosecuted in U.S. courts, though so far none have been convicted on terrorism charges. Still, the stigma from those cases spread to other U.S.-based Muslim charities.

"American Muslim charitable organizations have been under intense scrutiny since 2001 and even lawful organizations have been feeling the intense scrutiny as well, even if they themselves have not been under investigation," said Farhana Khera, president and executive director of Muslim Advocates. "It's created a chilling effect that has affected donors and volunteers." Charities say that they have seen a decline in donations, as Muslim-Americans have directed their giving away from Muslim-specific charities to nondenominational groups in recent years.

"People don't want to be affiliated or be drawn into an area where there may be questions raised as to where the funds are used," said Inayat Malik, president of the Islamic Center of Greater Cincinnati. The center, which raises around half a million dollars a year to fund mosque operations and charitable activities like food drives, has seen a small decline in donations in the last few years, Mr. Malik said, even though all its charitable activities are local. He added, "I can understand the hesitancy people have." Mr. Malik is hoping that winning BBB accreditation will prove to donors that the center is transparent.

While there are no statistics measuring the decline in giving to Muslim charities, OMB Watch, a nonprofit government watchdog organization based in Washington, D.C., wrote in a 2006 report that the "crackdown on Muslim charities has profoundly altered the emotional and financial process of Muslim giving in this country. In this climate of fear and suspicion, donations to Muslim charities have declined significantly since last Ramadan."

During Ramadan, the Muslim holy month which begins this year on Sept. 2, faithful are compelled to give a portion of their wealth to the needy. But charity, a pillar of Islam, has become a complicated undertaking since the Treasury Department investigations began.

Muslim charities hope that the link with the Better Business Bureau will lead to a renewed surge in giving by demonstrating to potential donors that the charities have agreed to open their books and operations to an independent accountant. Under the plan, the Better Business Bureau's charity watchdog arm, the Wise Giving Alliance, would put the organizations through a vetting process it developed to monitor charities.

Out of the nation's roughly one million registered charities, only 1,100 have requested accreditation themselves, or had a third party, such as a donor, request that a charity undergo the Better Business Bureau vetting process. Of those, only 450 have won accreditation. Others have failed the process, or refused to cooperate.

The Wise Giving Alliance evaluates a charity on 20 standards, from how often its board meets to the group's conflict-of-interest clause. The evaluation also calls for a detailed review of how the money collected by the charity is spent. If the charity fails to meet the standard in one category, it does not win approval. Regardless of the outcome, the Better Business Bureau publishes a report on its finding that is available to the public.

The Better Business Bureau doesn't charge for the vetting process, said H. Art Taylor, president and chief executive of the bureau's Wise Giving Alliance. However, if charities that win accreditation want to display an official BBB seal of approval in promotional material, they must pay a fee on a sliding scale that is based on the charity's wealth. That fee can range from $1,000 to $15,000 for multimillion dollar charities.

Muslim Advocates' Ms. Khera said that while the Bureau's accreditation process won't check for terrorist links, it will "create transparency and better governance, which we think will create that safe space to build trust among the public, donors, the U.S. government." The Bureau's Mr. Taylor noted that groups engaged in funding terrorism are not likely to submit to a thorough financial vetting. Ms. Farhana said federal officials have also privately encouraged the Better Business Bureau accreditation initiative.

The initiative comes at a critical juncture in relations between the Muslim-American community and federal officials seeking to negotiate better working protocols on vetting charities' overseas work. On Friday, Muslim- and Arab-Americans will meet with officials from the Treasury Department to discuss terrorism financing and charitable giving.

"Charities are still one of the primary ways that terrorist organizations raise funds and legitimize themselves," said Daniel Glaser, deputy assistant secretary for terrorist financing and financial crimes at the Department of Treasury.

Muslim and non-Muslim charities have complained that Treasury guidelines suggesting charities ferret out potential terrorist links abroad are difficult to follow, especially for groups working on thin budgets.

ECONOMY & POLITICS

Probe to net another plea

U.S. Army officer third to admit guilt in troop-supply plot

By Joel Millman

A third U.S. Army officer is set to plead guilty in a corruption scheme involving supplies to U.S. troops in Kuwait and Iraq, in a case investigators now believe may grow to include more than 100 conspirators.

Maj. James Momon Jr., 36 years old, a career U.S. Army officer who served in Kuwait during the Iraq war, planned to plead guilty Wednesday in U.S. District Court in Washington to accepting bribes or arranging kickbacks from U.S. and Kuwaiti defense contractors selling items such as bottled drinking water and performing maintenance at military installations in Kuwait and Iraq, his lawyer says, after negotiating a plea agreement in June.

A case that once was thought to involve only a handful of contractors and military officers seems to be widening. The case is one of several probes into contracts supporting U.S. troops in Iraq.

The prosecutors' case against Maj. Momon as described in court records alleges he and his colleagues at Camp Arifjan in Kuwait instigated corruption by recruiting retired soldiers to seek deals in which kickbacks were a condition. The charges allege that the conspiracy's principal operators arranged to continue their scheme even after their tours of duty in the Middle East ended.

"We're talking about a boatload of people actively engaged in a conspiracy," said a U.S. official familiar with the case. This official believes there may be as many as 30 U.S. Army officers involved and "70 or more of their relatives and associates engaged as facilitators."

Criminal charges against Maj. Momon allege that contracts ranging from $3 million to $20 million each were awarded in which military officers conspired to siphon off as much as 10% of each deal. In one case, prosecutors allege, Maj. Momon arranged a $15 million bottled-water contract after the contracting company agreed to pay 50 cents per case back to Maj. Momon, with half those proceeds going on to Maj. John Lee Cockerham Jr. in Texas. Maj. Cockerham, who pleaded guilty in the case, preceded Maj. Momon as a contracting officer at Camp Arifjan.

Maj. Momon didn't return calls seeking comment. "Mr. Momon regrets his participation in this matter," said his attorney, J. Burkhardt Beale. "He always had an honorable career."

Since 2005, U.S. authorities have opened 361 investigations related to contract fraud in Iraq and Kuwait, according to the Special Inspector General for Iraq Reconstruction. Sixty-one of those probes remain open.

Taken altogether, the number of cases and emerging scale provide the clearest evidence yet that controls were inadequate throughout the military supply chain as billions of dollars in contracts were dispensed to support the U.S. military effort in Iraq.

This latest Kuwait supply scandal broke a year ago when investigators from the Pentagon's Defense Criminal Investigative Service identified Maj. Cockerham, who had worked in the Army's contracting office at Camp Arifjan. Maj. Cockerham, who served three tours in Kuwait, was arrested in Texas, together with his wife, Melissa, and a sister, Carolyn Blake. Mr. and Mrs. Cockerham have since entered guilty pleas on federal charges that they accepted millions of dollars in bribes and kickbacks. Ms. Blake has maintained she is innocent. She has a trial date set for October. Her lawyer didn't respond to requests for comment.

One other officer named in the probe, Lt. Col. Levonda Joey Selph, pleaded guilty in June to lesser charges involving improperly accepting gifts from a Kuwait-based contractor. Another officer, Maj. Gloria Davis, took her life in late 2006 right after Army investigators confronted her with evidence of participation in the conspiracy.

Arrests related to the Cockerham case were expected to be completed months ago. But now government agents are culling through dozens of additional contracts as Army officers who have pleaded guilty lead investigators to new suspects.

Court documents in Maj. Momon's case identify the participant in the bottled-water contract only as Contractor One. However, in a separate case awaiting trial, Terry Hall of Rex, Ga., a 42-year-old former U.S. Army sergeant, is facing bribery and conspiracy charges in an identical set of incidents. Mr. Hall is contesting the charges, according to court documents. He didn't respond to requests for comment. His attorney, Tony Miles of the federal public defender's office, said in an email that he advised his client not to speak on the case.

Maj. Momon as recently as last month was still considered on active duty. His attorney said he was "in the process" of leaving the military. Under sentencing guidelines, he faces as many as five years in prison.

—Leslie Norman contributed to this article.

Procurement woes

Since 2005, U.S. authorities have opened 361 investigations related to contract fraud in Iraq and Kuwait

Investigations initiated	361
Investigations closed or referred	300
Open investigations	61
Arrests	16
Indictments	17
Convictions	8
Court-ordered restitution/forfeiture	$17.4 million

Note: Through July 30

Source: Special Inspector General for Iraq Reconstruction

WSJ.com
Online today
See court documents in the case against Maj. Momon, at WSJ.com/OnlineToday

India expects growth of nearly 8%

By C.R. Jayachandran And Gaurav Raghuvanshi

NEW DELHI—The Indian government expects the economy to grow nearly 8% in the current fiscal year, faster than an estimate by a panel that advises the prime minister.

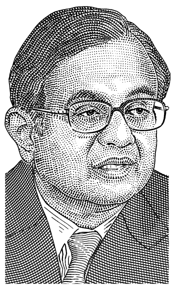
"If the prime minister's Economic Advisory Council has set 7.7% [as economic growth expectations for the current fiscal year], I can confidently say it will be near 8%," Finance Minister P. Chidambaram said after a meeting with chiefs of state-run banks.

Mr. Chidambaram also said the government expects no slowdown in credit flow to the productive sectors of the economy such as infrastructure and agriculture.

The economic-advisory panel, in its outlook for the current fiscal year ending March 2009, said economic growth is expected to slow to 7.7% because of a global slowdown and a sharp rise in inflation.

The panel expects the inflation rate to exceed the central bank's estimate of around 7% for the fiscal year and cautioned that subsidies will stretch the government's finances, with off-budget items amounting to 5% of gross domestic product.

"Considering the magnitude of the adverse economic developments in 2008, the projected drop from 9.0% last [fiscal] year to 7.7% this [fiscal] year is in fact modest," the Economic Advisory Council, which advises the prime minister, said in its economic outlook.



P. Chidambaram

Suresh Tendulkar, the chairman of the council, said at a news briefing, "The regressive effects of inflation are quite serious, growth is likely to suffer somewhat."

The downside risk to growth expectations in the current fiscal year is primarily from a further deterioration in global conditions, in such areas as oil prices or capital markets, the report said.

"Domestically, aside from the plethora of challenges already on the table, there is also some danger on the food price inflation front," it said.

A tight monetary stance is necessary, and coordinated policy actions can bring inflation down to between 8% and 9% this fiscal year, the report said. "However, in view of the large backlog of fuel price adjustments, achieving a reduction to 7% will take considerable effort and a confluence of favorable factors," it said.

India's inflation rate for the week ended July 26 rose to 12.01% from a year earlier, slightly above 11.98% the previous week.

The Reserve Bank of India has been tightening monetary policy in an effort to tame inflation. It has raised its lending rate, or repo rate, by 0.75 percentage point since June after a pause for more than a year. It also has increased the cash-reserve ratio by 1.25 percentage points since the beginning of the year.