



Liquid refreshment: A dip in Italy's Lago Bolsena

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Old story: The fight to control Games' narrative

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What's News —

Business & Finance

World-Wide

The global economy is slowing sharply, with four of the world's five largest economies flirting with recession. Euro-zone GDP contracted 0.2% in the second quarter, the first fall in output since the 1992-93 pan-European recession. **Page 1**

■ **U.S. inflation surged** to a 5.6% annual rate in July, a 17-year high, lifted by food, energy and clothing. **Page 9**

■ **Chances are better** than even the U.S. will bail out Fannie Mae and Freddie Mac, according to a Wall Street Journal economists' survey. **Page 9**

■ **Dominance at Heathrow** may be the key to whether the U.S. will clear BA, Iberia and American Airlines' request for antitrust immunity to cooperate on trans-Atlantic flights. **Page 4**

■ **InBev's profit rose 8.6%** in the second quarter, helped by a tax gain and stronger sales in Latin America. **Page 6**

■ **Wal-Mart's net jumped 17%** in the quarter, but the retailer warned of slower sales growth in the months ahead. **Page 5**

■ **U.S. stocks climbed** on a rebound in financial shares and a bounce in the dollar. European shares rose amid gains for commodity producers. **Page 18**

■ **UBS was accused** of civil fraud by New Hampshire regulators with regard to a student lender's issuance of auction-rate securities. **Page 17**

■ **TNK-BP's CEO was banned** from holding executive office in Russia for two years by a Moscow labor court. **Page 20**

■ **AstraZeneca will begin** co-marketing its cholesterol drug Crestor with Abbott Laboratories in the U.S. **Page 7**

■ **Google's Indian subsidiary** is being sued for defamation in the Bombay High Court by a construction-gear firm. **Page 7**

■ **Goldman Sachs's silence** over its plans regarding auction-rate securities is drawing ire from wealthy clients. **Page 19**

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11615.93	+82.97	+0.72
Nasdaq	2453.67	+25.05	+1.03
DJ Stoxx 600	285.91	+1.47	+0.52
FTSE 100	5497.4	+48.8	+0.90
DAX	6442.21	+20.02	+0.31
CAC 40	4420.91	+17.94	+0.41
Euro	\$1.4897	+0.0024	+0.16
Nymex crude	\$115.01	-0.99	-0.85

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■ **Bush renewed** his call for a cease-fire in Georgia and that Russia respect its "territorial integrity." With the Russian invasion apparently slowing, the U.S. and Europe face the challenge of Moscow's insistence that it is ready to help break up Georgia. Russia's claims that thousands of civilians were killed during a "genocide" in South Ossetia don't appear to be backed up with evidence. **Pages 1, 2**

■ **Poland and the U.S. reached** an accord on a U.S. missile-interceptor battery in Poland in exchange for American help in bolstering Poland's defenses. **Page 2**

■ **Pakistani President** Musharraf is expected to leave office in the next few days before Parliament takes up impeachment proceedings, following a breakthrough in secret talks. **Page 1**

■ **A suicide bomber blew** herself up among Shiite pilgrims south of Baghdad, killing at least 26 people and wounding 75. Two were killed in other bombings.

■ **The U.S. military said** six Navy guards face trial for allegedly assaulting prisoners in Iraq.

■ **A suicide bomber struck** near a police station in Lahore, killing eight people and wounding 16 as Pakistan's independence day was about to begin Thursday.

■ **Nepalese police detained** more than 500 Tibetan protesters amid clashes while breaking up a demonstration at China's diplomatic mission in Katmandu.

■ **The IOC said** it disapproved of Chinese security officials' rough handling of a British journalist who tried to report on a pro-Tibet protest in Beijing. **Page 8**

■ **Mauritania's military junta** appointed a former ambassador as prime minister. **Page 10**

■ **Zimbabwe officials** briefly confiscated the passport of opposition leader Morgan Tsvangirai as he tried to fly to South Africa to attend a regional summit.

■ **Iran and Turkey signed** cooperation agreements but failed to complete a deal to build a new natural-gas pipeline.

■ **A Nigerian militant group** said two German workers kidnapped recently will be freed.

EDITORIAL & OPINION

The euro zone unravels
A contraction in the second quarter raises fears of a recession. Review & Outlook. **Page 12**

Global economy slows

Downturn threatens emerging markets; exports are dropping

The global economy—for months resilient in the face of U.S. economic weakness—is now slowing sharply.

Recent reports show that four of the world's five largest economies,

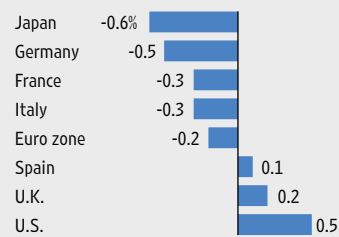
By Justin Lahart in New York and Alistair MacDonald in London

including the U.S., the euro zone, the U.K. and Japan, are flirting with recession. And while emerging economies weathered a U.S. slowdown, it isn't clear these once-hot economies can sail through a global downturn in the developed world.

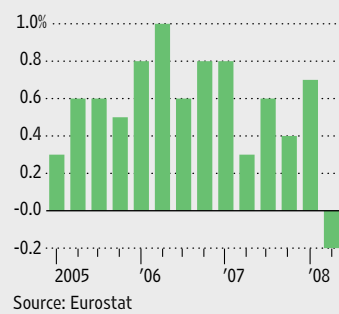
The latest example of distress: Thursday, the European Union's statistics agency reported that second-quarter gross domestic product in the euro zone contracted 0.2%—or 0.8% at an annual rate. It was the first time output has fallen overall in the 15 countries that use the euro since the pan-European recession of 1992-93. Weakness in Spain and Italy broadened to Germany and France.

Trouble ahead

GDP growth for selected economies, percentage change in the second quarter compared with the first quarter



Euro zone GDP growth rate, quarter-to-quarter



Other data show that the U.K. and Japan are possibly in recession and the U.S. has grown little in the past nine months.

Several factors are behind the
Please turn to back page

Euro-zone GDP fell 0.2% in quarter; brink of recession

By Marcus Walker

BERLIN—Economic output in the euro currency zone fell 0.2% in the second quarter, putting Europe's economic heartland on the brink of recession.

The contraction was the region's first since the creation of Europe's common currency in 1999, and the first time output has fallen overall in the 15 countries that use the euro since the pan-European recession of 1992-93.

Falling business and consumer confidence, as measured in surveys up to July, suggests a quick recovery isn't in the cards. Many economists now expect a euro-zone recession, defined as two or more quarters of shrinking economic activity.

"The odds of recession are definitely over 50%," says Michael Hume, European economist at Lehman Brothers in London.

Germany's economy, the biggest in Europe, contracted 0.5% in the second quarter. Spain's grew by a minimal 0.1%. France's economy,
Please turn to back page

Musharraf is expected to step down

By Zahid Hussain and Peter Wonacott

ISLAMABAD, Pakistan—President Pervez Musharraf is expected to leave office in the next few days before Pakistan's Parliament takes up impeachment proceedings against him, following a breakthrough in secret talks designed to ease his departure from office, people familiar with the situation say.

"Musharraf will neither face impeachment nor be prosecuted," one person said. Mr. Musharraf is expected to step down once a guarantee of safe passage and immunity from prosecution has been struck. "We expect a major development in the next 48 hours," this person said.

The secret talks have involved Mr. Musharraf's aides and members of the leading political party.

Mr. Musharraf has been under intensifying political pressure to quit after leaders from the ruling coalition government said they would press impeachment charges against him in Parliament, in part based on his actions late last year when he declared a temporary state of emergency. After doing so, he was re-elected to a five-year term as president in a controversial vote by an electoral college.

Since February, Mr. Musharraf, a key ally in the U.S.-led war on terror, has been sidelined politically after democratic elections in which the Pakistan People's Party, led by the wid-
Please turn to page 10



Georgian civilians reach for loaves of bread at a bakery in Gori on Thursday.

Russia's genocide claims are difficult to prove

Russia's claims that thousands of civilians were killed during a "genocide" in South Ossetia in recent days don't yet appear to be backed up with evidence.

President Dmitry Medvedev and Prime Minister Vladimir Putin have both repeatedly said that Georgian

By Andrew Osborn in Tskhinvali, Georgia, and Jeanne Whalen in Moscow

troops committed genocide against South Ossetians, and Mr. Medvedev on Tuesday referred to "thousands" of South Ossetians killed in the conflict. Russia has cited this as a main reason for sending troops into the region.

Other Russian and South Ossetian officials have pegged the death toll as high as 2,000, and maintained that Georgian troops razed the regional capital, Tskhinvali, and left it resembling Stalingrad after the long siege by Nazi troops during World War II. State-controlled television has shown lots of footage of burning buildings and badly damaged infrastructure.

But on the ground in Tskhinvali, where most of the fighting during the five-day conflict occurred, there is little evidence of a high death toll.

In the city's main hospital, Ada Djueva said she and her colleagues had processed 45 corpses and about 273 injured people. During the fight-
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FROM PAGE ONE

War in Georgia turns cold

As fighting abates, U.S., EU, Russia tilt on diplomatic front

BY NEIL KING JR.

With the Russian invasion of Georgia apparently slowing, the U.S. and Europe now face what could be a far pricklier challenge: Russia's insistence that it is now ready to help break up Georgia itself.

The U.S. responded sharply Thursday to comments from Russian Foreign Minister Sergei Lavrov that the world "can forget about any talk about Georgia's territorial integrity." Russian claims that the regions of South Ossetia and Abkhazia can't remain part of Georgia stand to greatly complicate the European-led effort to end the weeklong fighting.

Washington's escalating face-off with Russia broke out on another front Thursday as the U.S. and Poland struck a provisional deal to base a U.S. missile-defense system in Poland—a pact that Moscow deeply opposes as an anti-Russian provocation.

With Russian troops still deep inside Georgia, U.S. Secretary of State Condoleezza Rice joined efforts to coax Russia out of the country as part of a French-led peace deal that some critics say has given Moscow too much leeway. After meeting in France with President Nicholas Sarkozy, Ms. Rice plans to fly Friday to the Georgian capital of Tbilisi. Her job there will be to persuade Georgian President Mikheil Saakashvili to sign a cease-fire deal that would allow at least some Russian troops to remain in Georgia until international peacekeepers arrive.

Overshadowing the finer points of a cease-fire is the much larger

question of Georgia's ultimate fate and the future of the two breakaway provinces. Ms. Rice repeated President George W. Bush's pledge that the U.S. would stand by Georgia's "territorial integrity" and oppose any efforts to divide the country.

But Russian President Dmitry Medvedev sent a far different message. At a meeting in an gilded Kremlin reception hall, Mr. Medvedev assured the leaders of the two separatist provinces that Moscow would support whatever decision the peoples of South Ossetia and Abkhazia make on their status. "We'll not only support these decisions, we'll guarantee them in both the Caucasus and the world as a whole," he said.

The separatist leaders thanked Mr. Medvedev profusely. South Ossetian leader Eduard Kokoity said the U.S. bears some of the blame for what he called "the genocide of the small Ossetian people."

Both regions in the past have voted for independence from Georgia, and their leaders Thursday said the chances that their independence will gain international recognition—something even Russia so far has been unwilling to do—are now dramatically higher.

Before the crisis, Russian officials had said they were in no rush to recognize the territories. Earlier this year, the Kremlin blocked a move in Parliament toward recognition, saying it wouldn't copy the West in its recognition of Kosovo, which Moscow bitterly opposed. But now, the Kremlin has said it is securing not only the territories, but also a security zone of Georgian territory outside them.

Any move to secure the regions' independence, or to absorb them into Russia, would be a serious slap

at the U.S. and Europe. But it remains unclear how far the West is willing to go to ensure that Georgia isn't broken up. Despite Kosovo's move for independence, U.S. and European leaders still cling to the idea that no borders within Europe should be redrawn by force.

The gulf between the U.S. and Russia appeared to deepen as Russian officials dismissed U.S. warnings that the conflict could do long-lasting damage to ties between the two countries. At the Pentagon, Defense Secretary Robert Gates said he saw no prospect that the U.S. would employ military force against Russia. But "if Russia does not step back from its aggressive posture and actions in Georgia," he said, "the U.S.-Russian relationship could be adversely affected for years to come."

The Bush administration and its top diplomat face a number of serious handicaps as they wade deeper into the Georgian conflict. The U.S. has little real leverage—economic or otherwise—over Russia. Moscow itself has been almost dismissive of U.S. statements in recent days, devoting its diplomatic attentions instead to the leaders of France and Germany.

The U.S. is also hobbled by growing divisions within the European Union. Britain and some former East Bloc countries, such as Poland and Latvia, have backed U.S. suggestions that Russia be ostracized because of its actions this week. But France and Germany have taken a more measured approach, fueled in part by their distrust of Mr. Saakashvili and their leanness over goading Russia.

—Greg White and Marcus Walker contributed to this article.



Condoleezza Rice

Marauders beset Gori as Russian troops watch

BY YAROSLAV TROFIMOV

GORI, Georgia—A stocky man in camouflage fatigues who walked from behind a Russian tank seemed like any other Russian soldier at the main military checkpoint just inside this occupied Georgian city. Then, he pulled out a pistol, stuck it into the thigh of a United Nations official and demanded the keys to a gleaming SUV parked nearby.

Seconds later, he pointed the gun at the feet of another international official, collected another pair of car keys, and—unleashing a volley of obscenities—fired two shots in the air. Suddenly, dozens of journalists, aid workers and diplomats rushed to their cars as Russian troops sat atop several tanks, watching the mayhem around them with amused detachment.

Three staffers of the United Nations High Commission for Refugees, their vehicle seized at gunpoint, sought refuge in the back of a speeding Wall Street Journal car, breaking a window as they jumped inside. "This is not a very safe place," exhaled Nikolai Vanchev, the UNHCR field-safety adviser, as he tried to relay a protest to the Russian Embassy. Mr. Vanchev, a Bulgarian citizen, said his agency lost two sport-utility vehicles to the marauders at the Gori checkpoint.

The gunman's thin white armband meant he was almost certainly a member of Russian-backed fighters from South Ossetia, the breakaway province of Georgia where fighting first erupted a week ago.

His brazen behavior belied a series of claims made at the very same checkpoint by the top Russian commander in Gori, Gen. Vyacheslav Borisov—who assured reporters Wednesday night that there are no Ossetian irregulars in the city and that his soldiers would execute anyone found looting or marauding.

The most important of Gen. Borisov's promises was that Georgian police would be allowed to re-enter Gori on Thursday, and that

Russian forces would start to withdraw. Gori is claimed by Russian-backed Ossetian nationalists as part of their homeland.

Ossetian irregulars entered Gori on Wednesday, prompting an exodus of ethnic Georgian refugees who recounted tales of looting, burning and shooting. Most of central Gori is still held by Ossetian militias, while the Russian forces are deployed mainly in the outskirts.

In coordination with Russian authorities, a small contingent of Georgian police appeared on the outskirts of Gori Thursday morning. Georgian police manned some checkpoints jointly with Russian troops for about an hour but weren't actually allowed inside the city, Georgian interior ministry spokesman Shota Utiashvili said.

Tensions began to rise by midday, as Georgian military units edged closer to Russian positions. A Russian general then came out to announce that no armed Georgians would be allowed into Gori. Once journalists and international observers were chased off by the marauders, Russian tanks roared their engines and inched forward, forcing Georgian personnel to retreat. A few explosions rang out.

Before this confrontation, Russian soldiers tersely answered some journalists' questions as they sat atop T-72 tanks that, they said, were previously deployed in Russia's volatile Chechen republic.

Some of them wore American-made armored vests, marked in Georgian script with the names of their previous owners. The soldiers wouldn't explain how these vests came into their possession.

Crouching with a heavy machine-gun behind a bush nearby, a Russian soldier pondered for a minute when asked whether his unit is likely to proceed from Gori to the Georgian capital city Tbilisi. Then, he spat and answered: "Anyone who stands up to Russia, we shall destroy them."

—Marc Champion in Tbilisi contributed to this article.

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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:
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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 / Hürrilet 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 Telestamp Centro Italia s.r.l. Printed in Spain by Belmont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Basinevi.

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 Editeur responsable: Daniel Hertzberg M-17936-2003

THE RUSSIA-GEORGIA CONFLICT

Russia's genocide claims appear to be tough to support

Continued from first page
ing, when patients had been evacuated to the cellar, she said 220 surgical operations were conducted.

Dr. Djueva said the figure of 2,000 dead was "possible," adding that many corpses weren't brought to the hospital but buried in people's yards and gardens.

She said the situation had been complicated by the fact that a rocket had struck the city's morgue, rendering it unusable.

Alexander Ivanyus, the head of a temporary field hospital housed in about a dozen tents next to the hospital, said he and his colleagues had treated about 200 people since the start of hostilities, for gunshot, shrapnel, and landmine-inflicted wounds. He said his staff had processed only three dead bodies.

The Russian army says it isn't willing to show journalists the city's cemetery, where it says many of the dead are buried. Lt. Col. Andrei Bobrun said that local people were very hostile to Western journalists because of U.S. support for Georgia and that a visit to the graveyard could therefore be dangerous.

On Thursday the only dead bodies on show were those of five Georgian soldiers. The troops lay in the middle of a road in Tskhinvali. They had been stripped down to their underwear, and their corpses were bloated from the hot Caucasian sun.

Col. Igor Konoshenko said there had earlier been "a sea of bodies" in the city's streets, including many women, children and elderly people. He said that many had been buried close to where they fell because of the heat and the continuing conflict only to be reburied in the cemetery on Thursday. A local fighter, Murat Mestayev, said his father and a young man he was friendly with had been killed. He said they died when a Georgian tank opened up on the stairwell of

the apartment block they had been sheltering in. He said he had buried them in his garden.

Nazira Guchmazova, a schoolteacher, said three women in her street had been buried in their gardens. Col. Bobrun said it would take a while to ascertain the final number of fatalities. That was because some civilians were still buried beneath rubble, while others had been buried by their loved ones at great speed. The odor of decaying flesh was strong on some streets.

Civil-liberties group Human Rights Watch, which accused both Russians and Georgian troops of causing civilian casualties, issued a report Wednesday suggesting that the number of dead in Tskhinvali was in the dozens, not more.

Mr. Medvedev this week ordered Russian investigators to gather evidence of the alleged geno-



Associated Press
A woman walks past a Russian military convoy near the western Georgian town of Zugdidi.

cide and bring the guilty parties to justice. Russia issued passports to most of the residents of the region early in this decade and has treated

the Georgian attacks as crimes against its citizens.

On Thursday, investigators with the Russian prosecutor's of-

fice obtained a list of "more than 60 dead Russian citizens of Ossetian nationality," the Interfax news agency quoted an official with the prosecutors office as saying. The official, Vladimir Markin, said he expected the investigation to last a while. A spokeswoman for the prosecutor's office said she couldn't comment on death tolls. The population of South Ossetia is 70,000 people.

On Thursday, during a meeting with military commanders to thank them for their work, Mr. Medvedev maintained that South Ossetians had "lived through a genocide."

But even Russian television channels reported Thursday that life in Tskhinvali was getting back to normal, with people back out on the streets and fresh bread rolling off assembly lines at the local bread factory.

Cyberattacks alter definition of an act of war

BY SIOBHAN GORMAN

WASHINGTON—The cyberattacks in Georgia are re-energizing a debate over when a cyberattack is an act of war.

The Georgian conflict is perhaps the first time cyberweapons have been used alongside conventional military action. After Estonia was hit in 2007 with a cyberattack that disabled many government and bank Web sites, it made a formal request to the North Atlantic Treaty Organization to come to its defense. Earlier this year, the organization approved a cyberdefense policy that establishes a set of common principles recognizing the importance of cyberdefense.

The policy doesn't resolve many of the difficult legal and policy issues, such as when a cyberattack is an act of war or when and how NATO allies should retaliate.

"The document is the first, and an important step," said Lauri Almann, Deputy Minister of Defense of Estonia. Cybersecurity specialists and officials such as Mr. Almann said that the attacks on Georgia, because they were so public, will likely drive government leaders to better align the laws of war to cyberwarfare.

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CORPORATE NEWS

AEROSPACE

Rolls-Royce, Goodrich plan engine joint venture



ROLLS-ROYCE PLC and Goodrich Corp. said they plan to create a joint venture to develop and supply controls for Rolls-Royce's aerospace engines.

Each company would own half of the

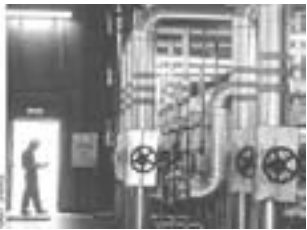
venture, which would combine Goodrich's U.K.-based engine-controls business with Rolls-Royce's expertise in the integration of those controls into engines. Rolls-Royce said it aims to complete the venture as soon as possible, pending talks with employees and regulatory review.

About 1,100 U.K.-based Goodrich employees and 500 Rolls-Royce employees in Europe and the U.S. may transfer into the venture.

—Jeffrey Sparshott

ENERGY

GDF Suez to buy Izgaz, extending Turkish reach



FRANCO-BELGIAN utility GDF Suez said it won a tender to buy Izgaz, the gas-distribution company of Turkey's northwestern industrial city of Izmit, with a bid of \$232 million.

GDF Suez outbid four Turkish companies, including Zorlu Enerji, the energy arm of Turkish conglomerate Zorlu Group.

A GDF Suez spokeswoman said the growth in Turkish demand for gas has been one of the highest in the world in recent years. GDF Suez already owns the Baymina gas-fired power station near Ankara.

The bid still needs approval from Turkey regulators.

—Adam Mitchell

MINING

Rusal calls for re-election of Norilsk Nickel's board



UNITED Co. Rusal demanded the re-election of the board of Russian miner OAO Norilsk Nickel, saying it believed it to be controlled by a rival shareholder.

The demand is the latest twist in the dispute between Rusal, holder of a 25%-plus-two-shares stake in Norilsk, and Interros, the investment vehicle of tycoon Vladimir Potanin, which holds about 30% of the Arctic miner.

Rusal, which wants a full merger with Norilsk, said the board was "incapable of reversing a slide in Norilsk's market value." Norilsk said it hadn't received a formal demand from Rusal and wouldn't comment until it does. Interros also declined to comment.

—Roundup

Airlines want antitrust immunity

BA, American, Iberia aim to cooperate across the Atlantic

BY PAULO PRADA

AMR CORP.'S American Airlines and its European partners filed a long-expected request for antitrust immunity Thursday, but whether the airlines will be allowed to cooperate more closely on trans-Atlantic flights hinges on one issue that has derailed two previous requests: dominance at London's Heathrow Airport.

In a filing with the federal Department of Transportation, American, British Airways PLC, and Iberia Lineas Aéreas de España SA petitioned for antitrust immunity that would allow airlines in their so-called oneworld alliance to cooperate on schedules, pricing, and marketing of flights across the Atlantic in ways that would otherwise be considered illegal collusion under U.S. law.

The trans-Atlantic market is the world's busiest in terms of international business traffic. If granted, the immunity would allow the alliance to act in many respects as a single carrier between the U.S. and Europe. Oneworld's two rival alliances—Star, anchored by UAL Corp.'s United Airlines and Deutsche Lufthansa AG,



Holding pattern: British Airways and One World alliance partners American Airlines and Iberia are seeking trans-Atlantic antitrust immunity.

and SkyTeam, led by Delta Air Lines Inc. and Air France-KLM SA—already hold such immunity.

Two previous efforts by oneworld airlines for trans-Atlantic immunity failed in 1999 and 2002. Regulators said immunity could be granted, but only if BA relinquished significant takeoff and landing slots at Heathrow, the British carrier's hub and the busiest airport in Europe by passengers.

American and its partners assert that since then the trans-Atlantic market has become more competitive due to the antitrust immunity granted to other airline alliances and the recent "open skies" treaty allowing greater access between the U.S. and Europe. European authorities also have since authorized the once-contested practice of buying and selling among carriers of the "slots" that allow airlines to fly into and out of Heathrow.

"There has been a lot of change since we last applied," said Gerard Arpey, AMR's chief executive. Dismissing opposition to the filing by other airlines, Mr. Arpey said: "We're hopeful people will be guided by the facts rather than

competitive, parochial rhetoric."

Still, British Airways alone controls 41% of the slots at congested Heathrow, and oneworld partners altogether are responsible for nearly half of the airport's takeoffs and landings, according to Airport Coordination Ltd., the com-

One problem is BA's dominance at Heathrow, where it controls 41% of slots.

pany that allocates London slots. By allowing oneworld partners to cooperate more closely, competitors argue, the alliance would have even greater control of an airport that sees more passenger traffic to and from the U.S. than any other in Europe.

The oneworld airlines say greater cooperation is necessary to help it catch up with the other alliances in terms of products and services they can offer across the Atlantic. As long as American, Brit-

ish Airways and Iberia must act as competitors in the lucrative market, the airlines have less ability to offer passengers flights and frequent flier perks throughout each other's networks.

Despite more flights to Heathrow by U.S. carriers since the open-skies treaty took effect earlier this year, other U.S. carriers are expected to urge regulators to ask oneworld partners to relinquish even more control there.

The most vocal opponent to the filing is Sir Richard Branson, whose Virgin Atlantic Airways Ltd. has long pushed for more access at Heathrow.

In letters to both major U.S. presidential candidates recently, Mr. Branson argued that immunity for the rival carriers would "be bad for passengers, bad for competition, and bad for the U.K. and U.S. aviation industry." American and British Airways, he argued, together would control 63% of the seat capacity between Heathrow and New York's John F. Kennedy International Airport, and even greater shares of the market between Heathrow and Boston, Miami, Chicago and Los Angeles.

But British Airways and its partners argue that competitors are unfairly singling out Heathrow as compared to other major gateways in Europe. SkyTeam, after all, dominates member hubs in Paris and Amsterdam, while Star has most of the access in Frankfurt. The airlines contend they shouldn't be required to surrender any Heathrow slots.

"People talk about the BA position at Heathrow, but very conveniently forget to mention what the other major carriers' hub positions are," said BA Chief Executive Willie Walsh. Heathrow is the busiest, he conceded, "yet it is the most competitive."

European authorities will also review the airlines' plans to forge closer ties. There is no deadline for U.S. regulators to complete their review, but the oneworld partners said they believe a decision could come before the change in the U.S. administration.

Russia's Mechel is found guilty of fixing prices

BY ALEXANDER KOLYANDR

Russia's antitrust body found OAO Mechel guilty of fixing the prices of its coking coal and said it might fine the mining company as much as 15% of its 2007 revenue from coking-coal sales.

The Federal Antimonopoly Service said Mechel had created discriminatory terms for certain buyers, unjustifiably declined to sign supply contracts, and set and maintained monopoly prices. However, the agency added it will take Mechel's cooperation with the investigation into account when assessing the fine, which will be at least 1% of last year's coking-coal-sales revenue. Mechel doesn't break out the revenue from its coking-coal sales.

On top of this, the miner will now be asked to cut domestic coking-coal prices by 30%, said Igor Artemiyev, the head of FAS. Mechel, owned by billionaire Igor Zyuzin, said it hasn't received the findings from FAS, and declined to make any comment until it has.

The antitrust watchdog launched its probe July 15 following complaints from two Russian steelmakers. Just days later, Prime Minister Vladimir Putin launched an unexpected public attack on the company, sending the shares of New York-listed Mechel into a tailspin.

The selloff—together with the hostilities between Russia and Georgia—have wiped 14% off the Russian stock market in just three weeks. Mechel itself lost around half of its market value in just a handful of trading sessions as investors feared a state-led assault similar to the one that bankrupted oil producer OAO Yukos.

At the end of July, FAS expanded its probe to include Evraz Group and OAO Raspaskaya, which is partly owned by Evraz. Together with Mechel, the two London-listed companies control more than half of Russia's coking-coal sales.

FAS could be in a position to formally consider its case against Evraz and Raspaskaya within 10 to 20 days, said Mr. Artemiyev. "We plan to speed the process up as much as possible in the interest of the market," he added.

Marketplace

A new quaff

Trying to halt a big drop in sales, some U.K. brewers tap women customers > Page 27



CORPORATE NEWS

Wal-Mart net jumps 17%

U.S. retailer warns about slowing sales in sluggish economy

BY ANN ZIMMERMAN

Profit at Wal-Mart Stores Inc. jumped an unexpectedly high 17% in the three months ended July, but the company warned that sales growth is being muted as U.S. shoppers struggle amid a slow economy, worsening inflation and the end of tax-rebate checks.

Sales excluding fuel rose 4.5% at U.S. Wal-Marts and Sam's Clubs that have been open at least a year, well ahead of the company's previously cautious prediction of flat to 2% growth. That cautious forecast reflected the company's initial uncertainty about the impact of the rebate checks—sent out by Washington as part of an economic-stimulus plan—which it now says boosted sales last quarter.

During the current quarter, however, the world's largest retailer expects to post sales gains of between 1% and 2% at stores open at least a year, as shoppers continue to face high gasoline and food prices.

The Bentonville, Ark.-based retailer said net income for the period ended July 31 was \$3.45 billion, or 87 cents per share, up from \$2.95 billion, or 72 cents per share, a year earlier. The per-share result beat Wall Street's expectations by three cents, according to Thomson Reuters.

Internationally, Wal-Mart's operating profit jumped 17% to \$1.2 billion on sales of \$25.3 billion.

But for its fiscal third quarter, Wal-Mart forecast earnings per share from continuing operations of between 73 cents and 76 cents a share, below Wall Street's mean estimate of 76 cents a share.

Wal-Mart credited some of the second quarter's strong results to operational improvements, especially stocking merchandise that consumers want to buy. A year ago, Wal-Mart made bad bets on trendy, higher-priced apparel that led to mounting inventory and a rash of markdowns.

"It begins with the inventory, and if the quality is good, mark-

downs are less," Wal-Mart Chief Financial Officer Tom Schoewe said in an interview.

In addition, he said a reduction in merchandise theft and damage, higher labor productivity and fewer accidents contributed to higher profits.

The company posted free cash flow, or net cash from operating activities minus capital expenditures, for the first six months of \$4.9 billion compared with negative \$800 million a year earlier. In June, Wal-Mart reduced its estimate for capital expenditures this year to a range of \$13 billion to \$14 billion, from a range of \$13.5 billion to \$15.2 billion.

Inflation is still a big concern for Wal-Mart suppliers and customers. Mr. Schoewe said suppliers are asking for price increases at a "higher level than I can remember since I began at the company," 8½ years ago.

Mr. Schoewe said the company

questions suppliers' costs. For example, a supplier may ask to raise prices 40% to offset a similar increase in fuel prices, but Wal-Mart will determine the portion of a supplier's product costs that depend on energy costs and accept price increases accordingly.

Mr. Schoewe wouldn't handicap the company's expectations for the holiday season, which analysts expect to be tough for retailers in general. While overall inflation will be up from last year, he said, prices for flat-panel television sets continue to fall.

"Our customer wants to have a happy holiday," he said. "Our success will be a function of the merchandise. When we put it out, customers get excited."

Wal-Mart now says it expects full-year earnings of \$3.43 to \$3.50 a share, in line with Wall Street estimates.

Sam's Club felt the impact of sup-



Inflation is still a **big concern** for suppliers and customers.

pliers' costs rising faster than its ability to offset them with higher prices, the same issue that led competitor Costco Wholesale Corp. to recently issue a profit warning. Sam's Club's operating profit for the quarter slid 3% from a year earlier to \$430 million.

Separately, Wal-Mart announced Wednesday that it will invest at least \$1 billion in Brazil to expand operations there. It plans to open 80 to 90 stores beginning in 2009. The company opened its first store in Brazil in 1995 and has 318 outlets there, employing 70,000 people.



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DOW JONES

Retailer's talks on worker votes may face probe

BY KRIS MAHER
AND ANN ZIMMERMAN

Prominent labor groups are seeking an investigation into whether Wal-Mart Stores Inc. violated U.S. election laws by telling employees that electing Democrats would lead to passage of legislation making it easier to unionize companies.

The labor groups are asking the Federal Election Commission to determine whether the company "made prohibited corporate expenditures" by organizing meetings to warn employees that a Democratic president would back the Employee Free Choice Act, which the company opposes.

Wal-Mart spokesman David To-var said anyone representing the company and telling associates how to vote were "wrong and acting without approval."

CORPORATE NEWS

Break.com hits big time

Site has signed up major firms to make branded Web videos

BY EMILY STEEL

Break.com, which features edgy videos aimed at young males, is getting its big break.

The site, along with several other niche video sites, including College Humor and Next New Net-

works, recently signed up major marketers including Samsung, Mountain Dew, Old Spice and Starburst for campaigns to produce branded entertainment programs, the practice that involves creating entertaining Web videos that subtly promote a brand.

One of the latest series is the "Ballpark Invasion" on Break.com created to promote Samsung's Instinct phone. The episodes take viewers on an insider's tour of several professional baseball stadiums and feature the phone's new technologies along the way.

It's a significant development because the online branded-entertainment market until now has been dominated by Internet giants like Microsoft and Yahoo and traditional media companies like MTV. Marketers have tended to advertise on those sites because they had established relationships with them but more importantly had the most traffic by a mile.

For marketers, the sticking point with sites like Break.com and College Humor was the dicey nature of the content. How did those sites get around that problem this time? They offered to create a tailored (read: G-rated) shows that featured the companies.

It isn't great news for major Web publishers like Microsoft and Yahoo, who are aggressive in the area of branded entertainment and have landed a number of these deals with big advertisers, such as a cooking show on Yahoo that promoted Unilever's Hellmann's and Best Foods brands mayonnaise. It is also further proof of how marketers are no longer solely dependent on the big



Dos Equis is among many marketers that have collaborated with Break.com to create branded-entertainment videos to sell their products.

portals for their online advertising needs, whether it's banner ads or other newer forms of marketing like video and games.

For online marketers, sites like Break.com and College Humor are compelling because of their ability to attract young men with their videos about sports, girls and comedy. At the same time, they have built up significant distribution networks for their videos so that the clips that appear on the own sites, often spread across the Web and end up on larger video sites like YouTube.

That has persuaded some big-name marketers to experiment with letting the niche sites create shows for them. So far, most of the advertising on these sites has come in the form of display of video ads that appear on the home page or adjacent to a video. But part of the problem has been that while the sites are popular with consumers for featuring interactive content, the ad options were far more static.

The branded entertainment shows mix right in with the other videos that show up on the sites. Old Spice, for instance, recently drafted College Humor to produce a series to promote its two-in-one body wash and moisturizer. The result: "The Great American Twofer Hunt." "A two-fer is a girl who's not only

hot, but smart too," reads the description for the show, which revolves around two hosts who quiz attractive young women on the streets of New York about subjects like politics and geography.

For Break.com and College Humor, it's too early to know whether their move into branded entertainment—which isn't cheap to produce—will pay off. Break, College Humor and others like Bebo, the social networking site owned by Time Warner's AOL, have hired production teams to take charge of creating original series and shows for advertisers.

Branded entertainment series are among the biggest-ticket ad options that these sites sell, but at the end of the day, they aren't much more lucrative. Costs for the shows, which are typically a couple of minutes long and included anywhere from two to 20 episodes, range from about \$250,000 to about \$750,000—an amount advertisers easily could spending on more basic display ads on the site.

Creating the series, however, typically requires a significant amount of labor on behalf of the sites. In addition, a sponsorship of a series usually is a package deal that includes other forms of advertising on the site to drive awareness of the campaign.

Toyota expects gradual U.S. gains

BY MATTHEW DOLAN

A top Toyota Motor Corp. executive predicts a recovery in the U.S. auto market but said a return to strong sales will happen more gradually than originally hoped.

Bob Carter, group vice president and general manager for the Toyota division at Toyota Motor Sales U.S.A., said at an industry conference in Michigan Thursday that total industry sales will reach 17 million vehicles a year and then exceed that figure. He didn't give a date to mark that recovery.

To support his prediction, he cited the growing U.S. population, which he said would increase by 32 million in the next 12 years. His assumptions also include gasoline stabilizing at \$3.50 a gallon through 2010 and then climbing after that. The average price of gasoline was \$3.81 a gallon this week, according to the Department of Energy. Mr. Carter also assumes the restoration of full-size light-truck

sales to two million vehicles. The estimate for trucks sales this year is 1.45 million vehicles.

Based on trends this year, the current estimate for 2008 U.S. sales of cars and light trucks is generally at or below 14 million, well under the 16 million figure considered healthy by the industry.

Today, the auto industry is in a "perfect storm," buffeted by rising costs and slumping orders for new vehicles, Mr. Carter said. But he added that "turbulence is always going to be a part of this business."

Mr. Carter said that he has changed his thinking about the nature of the current drop in U.S. sales. Once he believed that a sharp drop in sales would be followed by a dramatic increase, like the shape of a V. Now, Mr. Carter said, he thinks the trend will look like the swoosh of Nike's logo, with a more gradual recovery not taking real hold until 2010.

Toyota, once able to post strong sales even as U.S. auto makers strug-

gled, has been hit hard recently by a sharp downturn in the demand for trucks and sport-utility vehicles amid high gasoline prices. Toyota's sales dropped 11.9% in July from a year earlier. Overall, sales for the Japanese auto maker are down 7.6% this year.

In an interview Wednesday, Mr. Carter said he was confident that the U.S. market would see a substantial, if not full, return to strong sales in trucks and crossover vehicles. He expressed less optimism about the demand for full-size SUVs to match historical highs.

Mr. Carter's bullish outlook raises questions about how the market will be able to recover to previous heights, which were reached as auto makers in the U.S. invited customers to buy cars at employee prices, extended no-interest loans for up to six years and sold unprecedented numbers of vehicles to rental fleets. Those measures, some analysts say, inflated sales to artificial highs.

InBev's profit gets boost from Latin America sales

BY MATTHEW DALTON

BRUSSELS—Brewer InBev SA, which is in the process of taking over U.S. competitor Anheuser-Busch Cos., reported an 8.6% rise in second-quarter net profit, driven by a tax gain and stronger sales in Latin America.

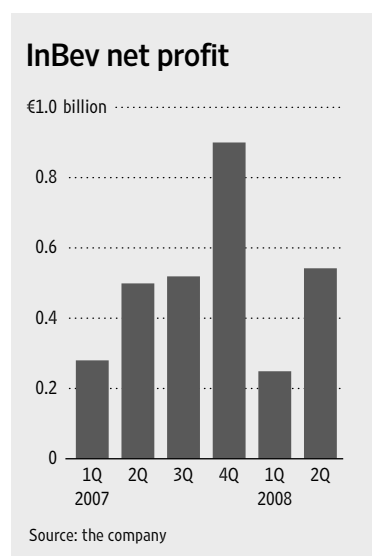
Net profit rose to €542 million (\$809.1 million) from €499 million a year earlier. A recovery in the Latin American market, particularly Brazil, aided results, but sluggish sales in Europe, Russia and Ukraine are still a cause for concern, analysts said.

InBev will become one of the world's biggest consumer-products companies when it completes its \$52 billion purchase of Anheuser-Busch, brewer of the Budweiser brand. The deal is on track to close by year end, said Chief Financial Officer Felipe Dutra.

Revenue edged lower to €3.71 billion from €3.72 billion. Sales in northern Latin America, which includes Brazil, grew 3.3%, and revenue rose 7.1% to €1.17 billion. Sales in southern Latin America grew 13% and revenue was up 29% at €224 million.

The company's tax expense fell to €63 million from €166 million a year earlier, largely due to an €83 million deferred tax gain.

InBev's margins should increase in the second half, said Chief Execu-



tive Carlos Brito, after a weak first quarter weighed on profit.

InBev, known for its cost-cutting abilities, was able to slash administrative expenses 13% in the quarter to €226 million, helping offset cost pressures from rising raw-materials prices. The cost of sales per unit of beer sold rose 6.5%, which analysts said was a hopeful sign after a 9.9% rise in the first quarter.

Total Russian sales declined, but sales of higher-price beers increased, driving revenue in the Central and European region up 8%.

Revival of United Artists clouded as CEO seeks to quit

BY LAUREN A.E. SCHUKER

In a shake-up at the recently revived United Artists movie label, Paula Wagner—the longtime business partner of Tom Cruise—is in talks with United Artists Entertainment LLC parent Metro-Goldwyn-Mayer Studios Inc. to leave her post as UA's chief executive.

Ms. Wagner's potential move has implications in the attempted comebacks of three familiar Hollywood names: MGM, United Artists and Mr. Cruise. It paves the way for MGM, which has struggled financially, to take increased control over UA's film projects and financing outlets. It also widens the gap between Ms. Wagner and Mr. Cruise, who seems eager to refocus on rebuilding his reputation as a top Hollywood actor rather than producer.

Ms. Wagner, a former talent agent, and Mr. Cruise arrived at UA in late 2006 to great fanfare and with plans for resurrecting the historic film company founded in 1919 by Charlie Chaplin and other artists.

Ms. Wagner and Mr. Cruise received a minority stake in UA estimated at the time to be around 30%. Under Ms. Wagner, the label secured a \$500 million film-financing deal with Merrill Lynch & Co. to make a slate of 15 to 18 films over five years.

Since then, however, UA has released only one film, the \$35 million "Lions for Lambs," which starred Mr. Cruise and flopped at the box office, bringing in only \$15 million in the U.S. UA's second film, "Valkyrie," also starring Mr. Cruise and costing upwards of \$65 million, comes out in late December, but an early publicity shot featuring Mr. Cruise wearing



Paula Wagner's potential move has implications for longtime business partner Tom Cruise.

military regalia and an eye patch generated poor buzz.

Ms. Wagner has other projects in development, but so far the studio hasn't given the green light to put any other films in production. A person familiar with the matter attributed that to disputes with MGM about money and which films to produce. Some at MGM, however, said Ms. Wagner was too slow in making decisions.

In a joint statement released Wednesday evening, MGM and UA confirmed that Ms. Wagner "will transition to the role of a producer" but that "nothing will change in regard to Mr. Cruise's involvement with UA." Ms. Wagner confirmed the discussions and her desire to return to producing in her own statement, issued Wednesday afternoon.

CORPORATE NEWS

Indian company presses Google over blog service

Gremach demands a Web user's name in defamation suit

BY TARIQ ENGINEER

MUMBAI—An Indian construction-equipment company is demanding in court that Google Inc. disclose the name of a person who used its blogging service, in a case that could change the way the Internet company does business in India. Google's Indian subsidiary, Google India Private Ltd., is being sued for defamation in the Bombay High Court by Mumbai-based Gremach Infrastructure Equipments & Projects Ltd., which runs a construction-equipment-lending business.

Last September, Gremach bought a 75% stake in 11 coal-mining licenses in Mozambique. Early this year, a blogger going by the name "Toxic Writer" attacked the company using Google's blogger.com, a blog-hosting site that allows individuals to create their own blog without necessarily revealing their identity to the outside world.

In February, Gremach said the posts were a "hate campaign" against it, and filed a defamation suit in the Bombay High Court against Google India. The High Court ordered the blog taken down on Feb. 26, saying: "At the present stage, there is merit in the contention...that the article put up by the Defendant on the blog site is defamatory."

The court ordered Google India

to reveal the identity of the blogger within four weeks from the date of the order. Google India has removed the blog but has yet to reveal the blogger's real name.

It is unclear what the next step in the case will be, but if Google ultimately loses, it would have to disclose the blogger's identity, a move that could set a precedent for future court challenges to the anonymity of blogger.com users.

Google India declined to comment on the case. "This case is sub judice, we are not able to comment," a company spokesman said in an email.

According to a spokesman from Rajani Associates, the law firm representing Gremach, Google India has claimed it doesn't exercise any control over its blogging service and therefore isn't responsible for what was posted by "Toxic Writer."

Pavan Duggal, a Supreme Court lawyer specializing in cyberlaw, said that under Indian law, Web-site hosts are responsible for the content on their sites. The only defense available to sites such as Google is to prove it was either unaware of any contravention of the law or that the offense occurred despite due diligence by the Web site.

Indian authorities have come down heavily on Internet sites in the past. In the aftermath of the commuter-train bombings in Mumbai that killed 207 people in 2006, India's Department of Telecommunications ordered whole sites—including blogger.com—blocked to stop access to a handful of blogs that could have incited communal tensions.

AstraZeneca enlists Abbott to help co-promote Crestor

BY SHIRLEY S. WANG

AstraZeneca PLC will begin co-marketing its blockbuster cholesterol drug Crestor with Abbott Laboratories in the U.S., an unusual commercial strategy for an already-successful drug.

Drug companies often agree to co-promote new therapies because they jointly developed the drug or have sales-force strength in complementary markets. But in this case, both Abbott and AstraZeneca already have substantial U.S. sales forces in the cholesterol space.

And Crestor has been quite successful financially, generating more than \$1.6 billion of it in the U.S.—for the first half of 2008. And it was the only branded drug in the class known as statins to gain U.S. market share in 2008, with a 10% increase in U.S. sales compared with the year-earlier period, according to AstraZeneca's most recent earnings statement.

For AstraZeneca, the partnership could help add to Crestor's U.S. market share by bolstering the London company's contingent of 2,200 sales representatives with Abbott's sales force of about 2,500 in the primary-care cardiovascular arena, says Richard Fante, head of AstraZeneca's U.S. commercial business.

Mr. Fante added that Crestor will be promoted only by Abbott staffers who aren't already selling the Abbott Park, Ill., company's re-

cently launched Simcor cholesterol treatment, which combines Niaspan and simvastatin.

Abbott's reasons for entering into the partnership are less clear. Both companies say Crestor isn't a direct competitor with any of the drugs in Abbott's own cholesterol portfolio. Some analysts speculate that because its Simcor launch has been less successful than expected, the company has extra sales-force capacity it would like to utilize.

Abbott says conversations about partnering with AstraZeneca began well before Simcor hit the market and the two are unrelated. Rather, Abbott was interested in the joint effort because the company will soon be launching a new cholesterol medicine called TriLipix, which when used in combination with Crestor is effective in treating all three components of cholesterol: LDL, HDL and triglycerides.

"We're particularly excited about working with AstraZeneca to get patients to goal across all three lipid parameters," says Mary Szela, president of Abbott's U.S. pharmaceutical business.

Wachovia analyst Larry Biegelson called the marketing agreement "a plus" for Abbott in a research note Thursday. The deal positions Abbott "as the company with the broadest portfolio of cholesterol drugs," he wrote, but he cautioned the move might "lead to some confusion" among sales reps and doctors regarding Simcor and Crestor.

GLOBAL BUSINESS BRIEFS

ThyssenKrupp AG

Steelmaker's net falls 21%, but firm's outlook improves

German industrial conglomerate and steelmaker ThyssenKrupp AG reported a 21% fall in net profit for its fiscal third quarter, yet increased its full-year outlook. Net profit for the quarter ended June 30 dropped to €573 million (\$855.4 million) from €729 million a year earlier, even though sales rose 5.5% to €14.18 billion from €13.44 billion amid high carbon-steel prices and strong demand for the company's products. ThyssenKrupp said a decline in stainless-steel prices weighed on the bottom line, while its steel division was hit by high raw-material costs, pre-operating expenses for new steel mills and restructuring costs.

RWE AG

German utility RWE AG said second-quarter net profit fell 67% because of a strong performance last year, one-time effects this year and higher expenses related to carbon-dioxide emissions. The Essen-based company also reiterated its downward profit outlook in light of charges related to the initial public offering of its American Water unit. Net profit dropped to €347 million (\$518 million) from €1.06 billion a year earlier, even as revenue rose 29% to €11.01 billion. RWE's weaker earnings were a result of its discontinued operation, American Water, which it intends to fully divest and didn't include in the current earnings. RWE spent €583 million on carbon-dioxide-emission certificates in the first half, up from €37 million a year earlier.

TUI AG

Tourism and shipping company TUI AG swung to a second-quarter net loss because of costs from the realignment of its charter-air-travel operations. The Hannover, Germany-based company posted a net loss of €55.6 million (\$83 million) compared with a profit of €58.9 million a year earlier, driven down by charges from the realignment of airline operations and TUI Travel and impairment charges for the airlines Hapag-Lloyd Flug and Hapag-Lloyd Express. These were compounded by the rising euro and currency fluctuations on a sale-and-leaseback agreement on 19 planes, which led to a charge of €102 million. Sales, however, were up 27% to €4.74 billion, boosted by growth in all segments as well as the first-time integration of TUI's First Choice brand.

CEZ AS

Czech power company CEZ AS reported a 67% increase in second-quarter net profit, driven by increased nuclear generation and a wider gross profit margin despite lower total power generation. Net profit rose to 13.07 billion koruna (\$810.5 million) from 7.82 billion koruna a year earlier, while revenue rose 7.1% to 41.82 billion koruna. Electricity sales, however, fell 1.7% to 35.73 billion koruna, said CEZ, which is 65%-state-owned. Power generation in the first half of the year fell 1.6% from a year earlier, and the company also lowered its coal-fired generation by 11%. CEZ expects full-year net profit of 48.6 billion koruna, up from a previous estimate of 46.6 billion koruna.

SAS AB

Scandinavian airline SAS AB swung to a second-quarter net loss, hit by higher fuel costs and competition on ticket prices, and said it plans to sell its 47% stake in regional carrier airBaltic. SAS Chief Executive Mats Jansson said SAS decided to divest itself of airBaltic after the Latvian government in June said it wouldn't privatize the Riga-based airline. SAS had sought a majority stake in airBaltic, which is jointly owned by SAS, the Latvian government and Russian carrier Transaero. SAS this year failed to find a buyer for its Spanair unit. The airline posted a net loss of 411 million Swedish kronor (\$65.4 million), compared with a net profit of 584 million kronor a year earlier. Revenue rose 8.7% to 17.7 billion kronor.

Protherics PLC

Protherics PLC said it has received several takeover approaches, triggering shares in the U.K. biotechnology company to soar more than 40%. Wednesday, Protherics, which specializes in critical care and cancer products, said it is considering approaches from "a number of parties," but cautioned that there can be no certainty that it will receive any formal offers. At Wednesday's close, Protherics had a market capitalization of about £188 million (\$352 million). The company, based in Runcorn, England, is developing CytoFab, a treatment for serious infections, with Anglo-Swedish drug-maker AstraZeneca PLC.

—Compiled from staff and wire service reports.

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BEIJING OLYMPICS 2008

Western media step up criticism of China

Reporter's detention, tight control stir up division over freedom

BY JASON DEAN
AND SHAI OSTER

BEIJING—Frustrations are escalating between the Western media and Chinese officials over the government's handling of the Olympic Games, reflecting deeper divisions over this country's policies.

Tensions bubbled to the surface Thursday at a daily news conference when several reporters confronted Olympics officials over the rough handling of a British television journalist by Chinese security forces, and over why the government hasn't approved applications to demonstrate in specially designated protest zones.

At the center of this fray is Wang Wei, the U.S.-educated Chinese official who has been the public face of Beijing's Olympic organizers. Mr. Wang, an executive vice president of the Beijing Games organizer known as Bocog, was part of the Chinese delegation that bid for and won the 2008 games seven years ago, in part by arguing that the Games would bring positive change, including greater freedom, to China.

At Thursday's news conference, Mr. Wang made an impassioned defense of China's performance as an Olympic host after reporters repeatedly asked a spokeswoman for the International Olympic Committee if it was embarrassed by China's alleged failure to meet its pledges.

"Some people are not satisfied. That is true," Mr. Wang told reporters. But, he argued, "China is developing quickly. People enjoy more freedom, and they have a lot to say. If you ask the ordinary Chinese on the

street they will say the same...You have to believe the majority of the people; otherwise you are misled."

Mr. Wang lashed out at critical foreign journalists. "I think a few, a very few people, come here to speak, to be critical, to dig into the small details...to find fault," he said. "That does not mean we are not fulfilling our promise."

The exchange is part of an intensifying struggle to determine how the Beijing Games are seen and remembered. China's government has steadfastly focused on the highlights of the Games, from a dazzling opening ceremony to the success of Chinese medal winners and the broader athletic dramas such as Michael Phelps's quest for eight gold medals.

But the Chinese government's overwhelming desire for control has attracted close attention from foreign media and visitors alike. Security measures have made it difficult for visitors to reach the pavilions of Olympic sponsors, upsetting companies that have spent tens of millions of dollars on promotional campaigns. The three parks that China's government announced with fanfare in July would be designated for protests have sat empty, while some Chinese petitioners who have applied for permission to protest have been detained.

News conferences at past Olympics have often been contentious, but generally over complaints of poor organization or bad food. In Beijing, the disputes tend to reflect a much deeper disagreement over China's political system and its place in the world.

The disconnect has been further aggravated by official moves that many Westerners see as dishonest, including the discovery that a young girl featured in the opening ceremony had lip-synced her song. The girl whose voice was heard was deemed less appealing for public view.

"The Chinese government's idea



Wang Wei, who has been the public face of Beijing's Olympic organizers.

of how you impress people is that everything is perfect, even if that means a little bit of deception," said Tim Wu, a professor at Columbia Law School who focuses on media policy and who is in Beijing for the Games. "And that's exactly the thing that drives the Western media crazy, because it seems sneaky."

The IOC has tried to avoid the most sensitive disputes. Giselle Davies, the organization's spokeswoman, tried to stick to sports under a barrage of questions at Thursday's news conference. "We are very pleased with how the organizers are putting up a great sports event," Ms. Davies said. "The organizers have put together an operationally successful event for the athletes.

That's what these Games are about."

But Ms. Davies sounded a different note when asked about the treatment of the British TV journalist, who was detained and roughed up Wednesday while trying to cover a demonstration by a pro-Tibet group. Officials have said that officers confused him for an activist. Ms. Davies said such actions wouldn't be tolerated. "We don't want to see it happen again," she said.

Mr. Wang, who received a master's degree in English literature from Rutgers University in New Jersey, has been the Chinese official most consistently in the hot seat. He has generally tried to avoid direct confrontation with reporters. But on Thursday he vigorously parried the aggressive questioning, telling one reporter: "This is not a debate, OK? You have your turn; I have mine."

Mr. Wang deferred questions about the empty protest zones to security officials who have so far refused to disclose how many people have applied for or been denied permission to protest.

According to petitioners and human-rights groups, part of the reason the protest zones have been empty is that the government has discouraged and intimidated Chinese activists and petitioners from applying for permission. Many have been evicted from Beijing, while others are being kept under heavy surveillance.

But many international rights groups and others critical of Beijing have simply chosen to stay away. In some cases, they are making a tactical choice to keep a low profile this time in the hopes of eventually fostering better relations with China's government down the line.

Amnesty International, which has long been critical of China's human-rights record, decided not to come because it assumed none of its members would be granted visas. The group also doesn't want to jeopardize

its talks with authorities on sending a research mission to China, said Roseann Rife, deputy program director for Amnesty's Asian-Pacific office.

"We are trying hard not to ruin the option of having a membership section in China at some point in the future," Ms. Rife said.

The environmental group Greenpeace, which has been in China for several years, hasn't tried any of the attention-grabbing stunts that have made it famous elsewhere. Instead, it has issued news releases and held news conferences before the Games to call attention to its cause.

Pro-Tibet activists said they figured they would never be allowed to protest legally because Chinese authorities don't tolerate anything that challenges the sovereignty of Chinese rule over Tibet.

Instead, they have been staging guerrilla-style actions like blockading the entrance to a park with chained bicycles or unfurling free-Tibet banners near Olympic venues. "We felt there was no reason to apply," said Han Shan, the Olympic campaigns coordinator for Students for Free Tibet. "If we did apply, it would just be a PR stunt. Our biggest challenge now is keeping focus on what's happening in Tibet."

Meanwhile, at the three parks, life goes on—albeit under the watchful gaze of the government. At the Purple Jade Park, near one of the Olympic stadiums, dozens of security "volunteers" patrolled alongside a lotus-filled pond. As pensioners gathered to sing old revolutionary songs, two guards with Secret-Service-style ear pieces looked on.

Down in the World Park, tourists admired a collection of miniaturized world monuments such as the Golden Gate Bridge and the pyramids. As Chinese tourists took photos of each other, plainclothes security agents took photos of a foreign reporter.

—Rebecca Blumenstein
contributed to this article.

Children in ethnic costumes came from Han majority

BY LORETTA CHAO
AND JASON LEOW

BEIJING—In the Olympic Opening Ceremonies, a procession of children bore a large Chinese flag into the Bird's Nest stadium, each child wearing a costume representing one of China's ethnic minorities.

However, the children actually were members of the Han majority, an arts official said in an interview. Yuan Zhifeng, deputy director of Galaxy Children's Art Troupe, said the children were drawn from the all-Han Chinese troupe. "I assume they think the kids were very natural looking and nice," Ms. Yuan said.

Games organizers didn't respond to requests for comment, and it wasn't clear what their motive was for using Han Chinese in ethnic costumes.

The ceremony has already been marred by news that a girl who appeared to sing a patriotic song was lip-syncing to a recorded version sung by a girl who was deemed less attractive.

Games organizers also said parts of one fireworks display were recorded and digitally enhanced for television.

China's 55 minority groups are officially celebrated, often as curios in pageants to the country's self-image as a harmonious, multi-ethnic society. But many live on the margins of the mainstream, poorer and less-educated than their Han countrymen.

From the time babies are born in China, they are assigned an ethnic identifier, a single word printed below their names on their national identification cards. Interethnic couples in China must choose to register their babies as one ethnicity only.

About 92% of China's 1.3 billion people are Han, and they dominate the economy and politics. The other 8%, or about 104 million people, belong to various groups, from the well-known Tibetans and Uighurs to the Zhang, Hani and Miao peoples.

Since the time of Mao Zedong, minority cultures have been made a central part of symbolic national events. Minority members are asked to wear traditional costumes—clothing they wouldn't normally wear today—during China's annual legislature meetings, while their Han counterparts wear Western-style suits. In China, neither the Han nor minorities appear to see much of a problem with the custom, viewing it as a way to preserve cultural diver-



Children in ethnic costumes carry the flag of China during the Olympics opening ceremonies.

sity. "The opening ceremony was wonderful," said Dan Zen, a resident of Lhasa, the capital of Tibet. "We recognized the third child on the left was wearing Tibetan clothes....It's OK if they're not real minorities."

Visitors to the Olympics can get a sense of how China portrays minorities at the Chinese Ethnic Culture Park, just south of the Olympic Green. It features elaborate model villages

and dancers in traditional costumes.

Han schoolchildren are bused to the culture park for field trips to look at the thatched-roof huts of the Jino, who live in the mountains of southern Yunnan province. They can see a display on the Li people of China's southern island province of Hainan, who believe in what is only described as "a primitive religion," according to exhibit brochures. There are per-

formances by minority dancers, most in their late teens and early 20s, who are brought to Beijing from their home villages for two-year stints.

"We have to protect minorities," said Wang Ping, who is Han and started the park because she feared minority cultures would be "polluted" by globalization.

—Andrew Batson
contributed to this article.

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ECONOMY & POLITICS

LEBANON

Border with Syria to be formally demarcated



Associated Press

SYRIA and Lebanon agreed to negotiate the demarcation of their border, a longtime demand of the Lebanese as they seek to normalize relations with their long-dominant larger neighbor.

A day after the countries' presidents agreed to establish full diplomatic relations, the two released a joint statement saying a committee would formally demarcate the border, which has been ill-defined since the two countries became independent from French rule in the 1940s.

The agreements are a victory for Lebanese President Michel Suleiman, above, who traveled to Syria Wednesday.

—Associated Press

LIBYA

Settlement may clear way for U.S. diplomatic ties



Associated Press

LIBYA and the U.S. settled all outstanding lawsuits by American victims of terrorism, clearing the way for the full restoration of diplomatic relations.

The top U.S. diplomat for the Middle

East, David Welch, above, signed the deal with Ahmed al-Fatouri, head of America affairs in Libya's Foreign Ministry.

The agreement paves the way for a full restoration of relations, including the opening of a U.S. embassy in Tripoli, the confirmation of an ambassador, direct U.S. aid and a visit by U.S. Secretary of State Condoleezza Rice before year end.

—Associated Press

EURO ZONE

M&A activity weakens as financing tightens



MERGER-and-acquisition activity in the euro zone has slowed markedly this year, reflecting reduced appetite for risk and tighter financing conditions in the aftermath of financial tur-

moil, the European Central Bank said.

"A rebound is not likely for the remainder of the year," the ECB added in its August monthly bulletin.

Nonfinancial firms bought equity valued at €83 billion (\$123.9 billion) in the first half, a 50% decline from the second half in 2007, it said. In the second quarter, euro-zone M&A activity slowed to its weakest pace since 2004, as nonfinancial firms bought equity valued at €32 billion. —Roman Kessler

Fannie, Freddie bailout?

Most economists in survey expect U.S. will step in with aid

BY PHIL IZZO

CHANCES ARE better than even that U.S. government money will be used to prop up Fannie Mae and Freddie Mac, according to economists in the latest Wall Street Journal forecasting survey, in which a sizable minority said the institutions should be nationalized.

When U.S. Treasury Secretary Henry Paulson went to Congress



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last month to defend his plan to extend credit to Fannie and Freddie or to purchase stock in the government-sponsored enterprises, if necessary, he made it clear that the proposal is a "backup facility [that] hopefully would never be used." However, sharp losses the two companies reported this month and continued concerns about the U.S. credit market have increased the chance that government funds would be needed.

On average, the 53 economists polled in the survey put the probability at 59% that the Treasury Department will have to step in to bail out Fannie or Freddie.

"Blank checks almost always get filled in and cashed," said Stuart Hoffman of PNC Financial Services Group.

The majority of respondents hope that it doesn't come to that. When asked how the government should handle the situation with Fannie Mae and Freddie Mac, 68% said the lenders should be pushed to raise capital privately and hope a recovering housing market will keep them from needing government money.

However, nearly one in three said the companies should be nationalized now, and then split into smaller companies when the housing market recovers.

Just one economist—Lou Crandall at Wrightson ICAP—said the Treasury Department should invest equity in them now, without nationalizing them. "The explicit backstop might buy them enough time to earn their way back to good health," Mr. Crandall said.

"The best solution is that they manage to muddle through," said Stephen Stanley at RBS Greenwich Capital. "At the end of the day, if you told Paulson and [Federal Reserve Chairman Ben] Bernanke that two years from now Fannie and Freddie would be solvent and not tap the government, they'd take that over any other option."

However, many economists agreed with former Fed Chairman Alan Greenspan, who in an interview recently criticized Fannie Mae and Freddie Mac as fundamentally flawed institutions that privatize profits and socialize losses. "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, and auctioned off," Mr. Greenspan said.

The government "needs to ultimately reduce, not increase their role, and doing this would put them back in their place," said Diane Swonk of Mesirov Financial.

Whether Fannie and Freddie are able to make it without government assistance will largely depend on the health of the housing and credit markets. However, uncertainty continues to permeate the economists' forecasts, as they remain almost evenly split for the third month in a row on whether the U.S. is in a recession. Their estimates for growth in gross domestic product were virtually unchanged from last month. They expect the economy to slow to a crawl in the second half, registering just 0.6% growth at an annual rate in the fourth quarter, compared with a 1.6% pace for the sec-

ond quarter.

At the same time, the forecasts call for continued job losses and elevated inflation, with oil prices above \$100 a barrel well into next year, though down from current levels. The economists on average expect consumer prices to rise 4.1% from a year earlier in December, down from the 5.6% rate recorded in July but still above the Fed's comfort zone.

Meanwhile, the economists remain divided about risks to the economy. When asked whether the Fed should be more concerned about inflation or economic growth, 40% said rising prices should take precedence and 60% chose economic weakness. When asked about the balance of risks to the global economy, 47% said inflation is the main threat. That comes despite reports of GDP contraction this past week in the euro zone and Japan.

Part of the reason for the disparity is the difference between the European and U.S. work forces. Some 94% of respondents said the U.S.'s risk of a wage-price spiral, where pressures from labor costs and high prices push each other up, is either minor or nonexistent. But 34% said that the euro-zone countries face a major risk of a wage-price spiral, and 9% said it is already beginning. A wage-price spiral is "much more of a risk [in the euro zone] than in the U.S. given the role of unions in setting wages, particularly in Germany," said Ms. Swonk, of Mesirov Financial.

Asia and the Middle East also face a greater risk of inflation, particularly in economies that have pegs to the U.S. dollar. "Asia has run a very easy monetary policy because so many countries are tied to the U.S. What might be acceptable to the U.S. is not the same for Asia," said Mr. Stanley, at RBS Greenwich Capital.

Though some of the pressure has eased with moderating oil prices, the Fed's low interest rates are expected to continue for the rest of this year. The economists on average expect the U.S. central bank to hold the federal-funds rate steady at 2% through year end, but they see an increase to 2.5% by June.

U.S. inflation rate soars on food and energy prices

BY BRIAN BLACKSTONE

U.S. inflation accelerated in July, as prices rose 5.6% from a year earlier, the fastest pace in 17 years.

The consumer-price index rose 0.8% from June, reflecting increased prices for food, energy, airline fares and apparel, the Labor Department said Thursday. That followed a rise of 1.1% the month before. Core inflation, which excludes food and energy, advanced 0.3% for the second consecutive month, and was up 2.5% from a year before. That's still well above the Fed's "comfort zone" of 1.5% to 2%.

"A truly ugly inflation report," said Harm Bandholz, economist at UniCredit Markets and Investment Banking, in a note to clients.

Yet slower inflation may already be on the way, economists said, because of a combination of factors: the recent drop in prices for oil and other commodities; the strengthening of the dollar, which lowers the price of imports; and continued weakness in the U.S. economy.

That suggests that U.S. Federal Reserve policymakers are unlikely

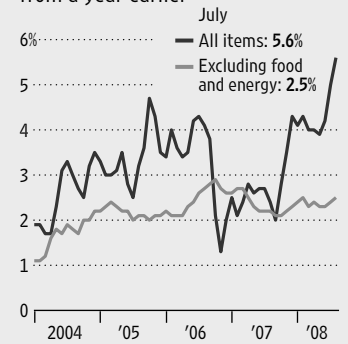
Energy prices swelled 4%, with gasoline prices climbing 4.1%.

to raise interest rates despite their policy statement last week that inflation remains a "significant" concern. The Fed is generally expected to keep official interest rates steady into next year—though rate increases could end up back on the table later this year if recent core-inflation increases persist.

Gary Stern, president of the Federal Reserve Bank of Minneapolis, said Wednesday that even though the U.S. is "probably...in for a few more sizable increases" in overall price measures, "assuming we don't get a resurgence of energy prices, we will see over time a diminution of headline inflation," which in-

Fueling inflation

U.S. consumer prices, change from a year earlier



Source: U.S. Labor Department

cludes food and energy. Mr. Stern said he also expects core inflation to slow.

Many economists agree. Lower oil and commodity prices and modest wage increases "will help to get inflation substantially lower over the coming quarters," said Dimitry Fleming of ING Bank in a research note. As a result, "we doubt the Fed will actually pull the rate trigger," he said.

Thursday's report showed that energy prices swelled 4% last month, while gasoline prices increased 4.1%, and natural-gas prices rose 7.4%. Food and beverage prices rose 0.9%. Medical-care prices, meanwhile, increased 0.1%.

Separately, the department said the average weekly earnings of U.S. workers, adjusted for inflation, fell 0.8% in July, suggesting incomes aren't keeping pace with prices. It also said that new jobless claims fell 10,000 last week. But at 450,000, claims remained well above levels economists usually associate with recession.

Meanwhile, continuing claims, which last for more than one week, jumped to their highest level in almost five years, suggesting it is taking the unemployed much longer to find new work than it did a few months ago. That, in turn, could further damp consumer spending, which appeared weak in July, according to a retail-sales report released Wednesday.

ECONOMY & POLITICS

Immigrants welcomed

Some U.S. states look to integrate, train newcomers

BY MIRIAM JORDAN

Behind the national debate over immigration in the U.S., a handful of Democratic governors are mounting a quiet offensive to integrate, rather than repel, foreign newcomers.

The governors of Illinois, New Jersey, Massachusetts and Washington have signed orders that make immigrant integration a priority for their states, focusing on language, job and citizenship training as well as access to services, such as health care and public safety, for immigrants.

The federal government's failure to enact comprehensive immigration reform has prompted states and localities to come up with their own solutions to illegal immigration. Governors are taking divergent paths to cope with the record influx of immigrants, particularly those here illegally.

In March, Rhode Island Gov. Don Carcieri, a Republican, signed an executive order that empowers state police and correctional officers to enforce some immigration laws. It also requires companies that do business with the state to use an electronic system to verify whether job applicants are in the country legally and eligible to work. Georgia and Arizona also have recently passed anti-illegal immigrant laws.

The U.S. has absorbed a record number of immigrants since 1990, mainly from Latin America, Asia and Africa. The country is now home to about 38 million legal immigrants and 12 million undocumented immigrants. An additional 31 million people are children of immigrants.

Supporters of the executive orders to promote integration of foreign residents say the orders counter the hostile rhetoric of the immigration debate. "It's creating a political climate where immigrants are seen as a net benefit to the state," says Ngoan Le, a senior official at the Chicago Community Trust, a private foundation. "The state's highest officeholder is sending a message that his state welcomes immigrants."

Groups opposed to illegal immigration have criticized the orders, which don't differentiate legal from undocumented immigrants. Ira Mehlman, spokesman for the Federation of American Immigration Reform, a national group that believes in curbing all immigration to the U.S., said the executive orders "send the wrong message...they blur the distinction between illegal and legal immigrants."

Massachusetts last month became the most recent state to adopt the strategy when Gov. Deval Patrick signed an executive order calling for a coordinated approach to integrating immigrants, who represent 14% of the state's population.

After holding fact-finding public meetings across the state, an advisory council composed of business leaders, immigrant advocates, academics and policy makers will submit

policy recommendations to the governor by July 2009. State agencies, faith organizations and private-sector employers then will be charged with implementing the programs.

"Were it not for immigrants and refugees, Massachusetts would have seen a population decline in the last seven years," says Richard Chacon, executive director of the state's office for refugees and immigrants. "Immigrants are becoming increasingly important to the health of the state economy," Mr. Chacon says.

In February, Washington Gov. Chris Gregoire issued a similar executive order creating the New Americans Policy Council, designed to make recommendations to the governor's office on immigrant matters, such as helping them learn English, transfer professional credentials and become civically engaged through public-private partnerships. About 12% of Washington state's population is foreign born.

In August 2007, New Jersey Gov. Jon Corzine signed an order that created an advisory panel on immigrant policy that is to present recommendations to the governor by the end of this year. About 20% of the state's residents hail from other countries.

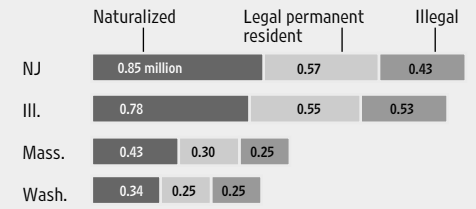
Illinois Gov. Rod Blagojevich, a Democrat, signed the New Americans Executive Order in November 2005, the first order of its kind. The order established a council comprised of business, faith, labor, community and government leaders to identify ways to improve the provision of services to immigrants and make recommendations to the governor.



An Illinois Coalition for Immigrant and Refugee Rights workshop in Chicago

A different approach

Approximate number of immigrants in four states whose governors have issued orders to integrate immigrants



Sources: Census Bureau, Citizenship and Immigration Services, Pew Hispanic Center

In 2006, members of the policy council completed the first phase of their work. One outcome of that effort was the inauguration late last year of a pilot "welcoming center" in a Chicago suburb where thousands of new immigrants have settled.

Meant to be a one-stop shop, immigrants who visit can access several state and local services, such as signing their children up for school, finding out about health-care eligibility and learning about job-training opportunities. Bilingual staffers encourage adults to take English courses, attend computer courses or enroll their children in a new soccer league.

"It's in the best interest of the state, communities and immigrant families to expedite their integration," says Grace Hou, assistant secretary for the state department of human services.

Other programs under consideration will focus on vocational English courses and community police relations, with funding expected to come from the state, foundations and community organizations.

The Illinois Coalition for Immigrant and Refugee Rights, a non-profit advocacy group that worked with Gov. Blagojevich to craft the executive order, has played a lead role in fostering integration initiatives in other states.

The coalition sponsored conferences to discuss with state officials and immigrant advocacy groups how to use executive orders to promote immigrant integration. The coalition then disbursed Carnegie Foundation grant money to three groups in other states to help them spearhead efforts there.

Mauritania gets diplomat leader

BY DAVID GAUTHIER-VILLARS

NOUAKCHOTT, Mauritania—A week after overthrowing this West African country's first democratically elected president, military leaders sought to firm up their grip on executive power and appease tensions with foreign donor countries by appointing a diplomat as prime minister.

A spokesman for military leaders who organized the coup said Mauritania's ambassador to the European Union, Moulaye Ould Mohamed Laghdaf, had been named prime minister by decree on Thursday. He was asked to form a new government, the spokesman said.

Supporters of the coup led by Gen. Mohamed Ould Abdel Aziz said the designation of a prime minister would help accelerate the return to normal functioning of state institutions after more than a week of political uncertainty. They said the new premier's diplomatic

skills could be an asset to fend off U.S. and EU protests against the military coup.

"His experience in Brussels can certainly help to deliver foreign governments a message of appeasement," said Sidi Mohamed Ould Mohamed Vall, a lawmaker who backs the Aug. 6, bloodless coup.

Opponents to the coup said the designation of a prime minister

Mauritania's ambassador to the EU has been named prime minister.

wouldn't change anything. "The coup goes against the constitution," said Mohamed Jemil Ould Mansour, leader of the moderate Islamic party Tawassoul. "A prime minister appointed by the army has no legal status."

Mauritania, a largely desert and poverty-stricken country, emerged from two decades of authoritarian governments in March 2007 when it held its first democratic, presidential elections since acquiring independence from its French colonial ruler.

Although Mauritania was portrayed as a rare example of democratic transition in Africa, elected president Sidi Ould Cheikh Abdallahi struggled to contain military influence over daily government affairs.

Mauritania, which imports about 75% of its food, has also been crippled by growing financial difficulties as world food prices have

soared.

The country thought it had found a new stream of revenue to help finance its massive food imports when an Australian oil company began to produce crude oil from an offshore field in 2006. But after starting with a production rate of 75,000 barrels per day, daily oil output quickly fell to 12,000 barrels.

On Aug. 6, military personnel acting on the orders of Gen. Aziz overthrew the president and put him under arrest. Military leaders explained their move, saying President Abdallahi had acted weakly in the face of growing terrorism threats.

International reaction has condemned the coup. The African Union has suspended Mauritania until further notice. The U.S. said it has frozen cooperation, mainly military, with Mauritania. France has suspended aid programs and the EU as a whole has said it is considering similar sanctions.

In Mauritania, however, opposition to the coup has thinned rapidly as several political parties announced their decision to side with military leaders.

Over the past days, supporters of Gen. Aziz have been staging what they described as "spontaneous" rallies, during which they drive across town with a portrait of Mauritania's military leader on their windshields.

"Democracy is when people are happy," said Sektou Mohamed Vall, the sister of Mr. Vall, the lawmaker, as she held a portrait of general Aziz at one of these rallies earlier this week. "With President Abdallahi, we were not happy."

—Charles Forelle in Brussels and Max Colchester in Paris contributed to this article

Musharraf is expected to quit

Continued from first page
ower of slain former Prime Minister Benazir Bhutto, was the biggest winner. It leads a coalition government.

Mr. Musharraf's continuation in office has been a constant source of friction between the coalition partners, who finally resolved to try to remove him if he wouldn't quit. Mr. Musharraf's political standing was further eroded this week when four provincial assemblies overwhelmingly passed resolutions that told him to call for a vote of confidence or step down.

Secret talks between Mr. Musharraf's aides and PPP officials began last week after the military, which so far has stayed out of the political fray, made it clear they wouldn't allow their former chief to be humiliated. Mr. Musharraf stepped down as army chief when he started his new presidential term.

The leadership of the military, however, has started to come to the conclusion that Mr. Musharraf wouldn't be able to remain in office given the groundswell of political opinion against him. Mr. Musharraf has consistently said he will fight the impeachment charges and, as recently as Wednesday night at a gathering at the presidential palace, told supporters he would contest and win, according to attendees.

Some people continued to suggest that Mr. Musharraf wouldn't be driven from office. Muhammad Intikhab Khan, a top official in the pro-Musharraf Pakistan Muslim League (Q), said he believed the president would fight impeachment. He said the president Wednesday told a group of about 40 officials that he would "fight the impeachment" and believed he still had the votes to pre-

vail. To the question of whether he would quit, "no he's not going to," Mr. Khan said.

But Mr. Musharraf's calls for reconciliation and political stability, made in a speech late Wednesday on the eve of Pakistan's independence day, were rejected by coalition officials Thursday, and an increasing number of political allies also have deserted him. Sherry Rehman, minister of information, said impeachment proceedings would begin Monday or Tuesday. She said the government had 325 votes, or a 30-vote cushion to impeach the president. "There's no turning back from this process," she said.

Mr. Musharraf, 65 years old, came to power in a bloodless coup in 1999, deposing then-Prime Minister Nawaz Sharif. Mr. Sharif, head of the Pakistan Muslim League (N) and a supporter of the coalition government, has been a major proponent of Mr. Musharraf's impeachment and of the reinstatement of judges, including the chief justice of the Supreme Court, who were fired by Mr. Musharraf last year.

While Mr. Sharif and the PPP have been arguing over what to do with Mr. Musharraf and how to reinstate the judges, Pakistan's economy has turned sour and the nation has faced a rising Islamist insurgency that is not only hurting the country but is feeding the insurgency against North Atlantic Treaty Organization troops in neighboring Afghanistan.

If Mr. Musharraf leaves office, it will remove one major political sticking point in the coalition. But it is unclear who would succeed him and whether the government could then move forward to tackle the country's growing problems.

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