



How tennis's new No. 2 plans to get his game back

WEEKEND JOURNAL | PAGES W8-W9

For champions, the gold isn't just in the medals

BEIJING OLYMPICS 2008 | PAGE 26

What's News —

Business & Finance

World-Wide

Continental accepted a revised, \$17.84 billion bid from Schaeffler that sets the stage for a global auto-parts supplier in hybrid and electric-vehicle technologies. The firm also began searching for a new CEO as its current one resigned. **Page 5**

■ **Crude-oil futures jumped** 4.9% as the dollar weakened and relations between the U.S. and Russia deteriorated. **Page 17**

■ **U.S. blue chips rose** slightly despite a litany of concerns about the global financial system and soaring oil prices. European shares fell. **Page 16**

■ **Fannie Mae and Freddie Mac** need to refinance \$225 billion by the end of September, but they may have trouble finding investors. **Page 15**

■ **Price declines** among investment-grade corporate bonds pushed their spreads to a record, Merrill Lynch data show. **Page 15**

■ **German state-owned bank KfW** said it will sell its 90.8% stake in subprime casualty IKB to a unit of U.S. private-equity firm Lone Star Funds. **Page 5**

■ **The Fed called Credit Suisse** last month in response to a rumor to learn whether it had pulled a line of credit from Lehman Brothers. **Page 18**

■ **Economic data reinforced** the view the euro zone is slipping into recession but a stalling economy may also be easing inflationary pressures. **Page 7**

■ **IAC/Interactive spun off** its four biggest units including HSN home-shopping network and Ticketmaster, as the media conglomerate tries to reverse a long stock decline. **Page 4**

■ **Microsoft is turning to Jerry Seinfeld** to star in a new \$300 million advertising campaign, one of the largest in the software giant's history. **Page 4**

■ **Merrill Lynch reached** a settlement with the state of Massachusetts to buy back illiquid auction-rate securities. **Page 17**

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11430.21	+12.78	+0.11
Nasdaq	2380.38	-8.70	-0.36
DJ Stoxx 600	278.44	-2.32	-0.83
FTSE 100	5370.2	-1.6	-0.03
DAX	6236.96	-80.84	-1.28
CAC 40	4304.61	-61.26	-1.40
Euro	\$1.4886	+0.0158	+1.07
Nymex crude	\$121.18	+6.20	+5.39

Money & Investing > **Page 15**

Russian forces dug trenches and built fortifications in key areas of Georgia, yet rolled tanks toward Russia elsewhere Thursday. As Moscow moves closer to recognizing Abkhazia and South Ossetia, it appears increasingly likely that Georgia's internal refugees may never go home. Abkhazians staged an independence rally. **Pages 1, 28**

■ **The U.S. and Iraq have made** progress in finalizing the principles of a security deal that calls for the withdrawal of U.S. troops by 2011. It faces hurdles gaining Iraqi government approval. **Page 2**

■ **Just 13% of U.S. voters said** Iraq was the top priority facing the country in a Wall Street Journal/NBC News poll, placing the war behind the economy, energy and health care. **Page 1**

■ **Spanair officials refused** to speculate on the cause of the MD-82 jetliner crash on takeoff Wednesday in Madrid that killed 153 people. **Page 5**

■ **Two suicide bombers blew** themselves up at the gates of Pakistan's main munitions factory, killing at least 59 workers. Pakistan's future appears to rest increasingly on its army chief. **Page 8**

■ **Czechs and Slovaks held** ceremonies Thursday marking the 40th anniversary of the Soviet-led invasion of Czechoslovakia that ended an era of reforms known as the Prague Spring.

■ **The U.S.-led coalition said** over 30 insurgents were killed in eastern Afghanistan. An Afghan official said they were fleeing an area where French troops were ambushed this week.

■ **A car bomb exploded** near a bus in western Turkey, wounding 16 people, mostly police officers and soldiers, officials said.

■ **Pirates hijacked** a Japanese tanker, an Iranian bulk carrier and a German cargo ship off Somalia's coast Thursday, two days after a Malaysian tanker's seizure.

■ **Monsoon rains** in northern India caused floods and houses to collapse, killing at least 74 people. Typhoon Nuri was expected to make landfall in China east of Hong Kong Friday afternoon.

■ **Police seized** foreign pro-Tibet activists and some disgruntled business owners from Hong Kong after they displayed protest signs in central Beijing.

EDITORIAL & OPINION

The party is over
The U.S. has drunk more from the punch, but Europe has the economic hangover. **Page 11**

Wage-inflation cycle is tale of two continents

Euro-zone workers keep pace with prices as U.S. lags behind

Consumer prices are rising at their fastest pace in more than a decade in the U.S. and the euro zone. But it is affecting workers on the two sides of the Atlantic in very different ways.

In Montgomery, Ala., Steve Murphy, an instructor for adults with

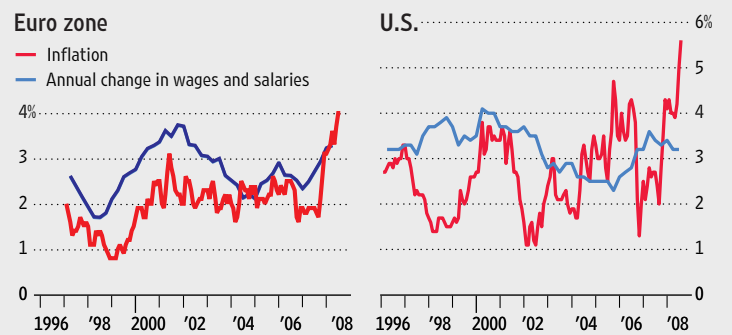
By **Joellen Perry** in Frankfurt and **Sudeep Reddy** in Washington

mental disabilities, doesn't expect to get a raise because his employer is getting squeezed by higher fuel bills. In Madrid, travel agent Ignacio Temprano gets raises to match inflation because Spanish unions helped negotiate such increases into law. He said he considers the extra money "a bonus."

Unions are more powerful in the 15-nation euro zone than in the U.S., and many laws and practices there are more worker-friendly. That is

Wage gap

Wage increases have largely kept pace with inflation in the euro zone, but not in the U.S. Change from a year earlier in consumer prices and wages:



Note: Wage-growth figures are based on seasonally adjusted labor cost indexes. Sources: Eurostat; European Central Bank; U.S. Labor Department

part of the reason why many European workers are keeping up with inflation better than their U.S. counterparts.

Wages and salaries in the euro zone were 3.4% higher in the first quarter than in the year-earlier period, matching the first-quarter annual inflation rate. It was the steepest wage increase in the 15 countries that share the currency in nearly six

years. Inflation in the euro zone hit 4% in July, and many economists expect wages to keep rising this year.

In the U.S., where unions are weaker and wages aren't often indexed to inflation, workers fell behind. Consumer prices were 4.1% higher in the first quarter than in the year-earlier period, but workers' wages and benefits increased

Please turn to page 27



Georgian refugees displaced by earlier fighting live in this abandoned Tbilisi hospital block. Families exiled by the South Ossetia conflict will move into the block next door.

For Georgian refugees, the way home gets sealed off

By **MARC CHAMPION**

TBILISI, Georgia—Indira Gamakharia lives with her extended family in a single, partitioned room in a disused Tbilisi hospital block for people displaced by war. She is 22 years old now. She was six when she fled her home in western Georgia.

A refugee from an earlier war in Abkhazia, one of Georgia's two pro-Russian separatist territories, Ms. Gamakharia, her two young children, her husband and his parents are now

among an estimated 330,000 displaced people in Georgia waiting to go home. Most, like Ms. Gamakharia, have been waiting 15 years already.

As Moscow moves closer to recognizing Abkhazia and South Ossetia, a move that would create new de facto international borders under the protection of Russian troops, it looks increasingly as though Georgia's internal refugees may never go home. Georgia's government says this is a creeping ethnic cleansing

Please turn to back page

Differences in U.S. election blur over Iraq

By **NICK TIMIRAOS**

A tentative agreement between Iraq and the U.S. over the long-term status of U.S. forces shows how the once-striking differences between Sens. Barack Obama and John McCain have narrowed as improvements in Iraq and the deteriorating economy have reordered voters' concerns.

Sens. Obama and McCain both secured their parties' nominations with strong—and opposite—stances on the war. Sen. McCain led even President George W. Bush in championing the surge of U.S. troops, and he repeatedly argued that the U.S. should prepare to keep troops in Iraq for decades. Sen. Obama argued for ending the war within months, and his outspoken opposition to the initial invasion helped him stand out in a crowded Democratic field.

The tentative security deal between the U.S. and Iraq has yet to be finalized but calls for withdrawal of U.S. combat troops by 2011. But the war isn't the top concern for most voters.

Just 13% of voters said that Iraq was the top priority facing the country in a Wall Street Journal/NBC News poll conducted Aug. 15-18, placing the war behind the economy, energy, and health care. By contrast, some 24% of voters cited Iraq as their top concern in the June poll.

Please turn to page 2

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LEADING THE NEWS

U.S., Iraq closer to pact

Rice reports progress on new security deal; Doubts in Baghdad

BY GINA CHON

BAGHDAD—U.S. Secretary of State Condoleezza Rice and Iraqi Foreign Minister Hoshiyar Zebari said Thursday that both sides had made progress in finalizing the principles of a long-term security deal, but any deal still faces significant challenges winning the Iraqi government's approval.

U.S. and Iraqi negotiating teams have concluded their formal talks aimed at hammering out details of a draft agreement, but Iraqi legislators, party leaders and government officials can now try to make their own revisions. The proposed deal will set the conditions for a continued U.S. military presence in Iraq.

The draft now circulating sets 2011 as a goal for the withdrawal of U.S. combat troops, said Iraqi Deputy Foreign Minister Mohammed al-Haj Humood, the lead Iraqi negotiator, and other people familiar with the talks.

Another aspiration is to have U.S. troops leave population centers by June 30, 2009, and move to bases on the outskirts of those areas, these people said. Any agreement on a date would also allow for flexibility if security conditions suddenly worsen, these people said.

Terms of the deal—including draw-down dates—could still change, and any deal faces significant hurdles in Iraq's sectarian government and legislature. Underscoring the difficulty, Iraqi government spokesman Ali al-Dabbagh suggested a deal doesn't have to be wrapped up before U.S. President George W. Bush leaves office.

"There are still some points we are working on and we are not in a rush to finish this during the Bush administration," he said. "The most important part is protecting Iraqi interests."

Ms. Rice emphasized Thursday that a final agreement hasn't been reached. "We'll have an agreement



A U.S. Army soldier, left, and Iraqi Army soldier stand in front of shuttered shopfronts during a raid in Baghdad on Thursday.

when we have an agreement," said Ms. Rice, who was in Baghdad to lobby for support of the draft agreement.

Ms. Rice met with Prime Minister Nouri al-Maliki and Vice President Adel Abdul Mahdi, both of whom are Shiite Muslims. She also met with Vice President Tariq al-Hashimi, a Sunni, and Mr. Zebari, a Kurd. The Bush administration considers the deal to be an executive agreement that doesn't need approval from the U.S. Congress.

But first, the deal must pass through several layers of Iraqi officialdom. The document will first be sent to the executive council, which is made up of Iraq's top leaders, plus Masoud Barzani, head of the semi-autonomous Kurdistan Regional Government. It then goes to the national security committee, a broader leadership group that also includes the national security adviser.

The council of ministers, essentially the Iraqi cabinet, then will vet it. Finally, the deal must be presented to Iraq's parliament.

This year, Mr. Maliki has made some gains boosting solidarity among the various parties in government and in parliament, thanks in large part to efforts at reining in mili-

tiamen from his own sect. But tensions between Sunni, Kurdish and Shiite factions in all layers of the government have increased recently over a stalled provisional election law. That law is supposed to lay out how polling will be conducted in the oil-rich region of Kirkuk, which is claimed by Kurds, Arabs and Turkomen.

The law failed to pass in several emergency sessions before parliament went on recess earlier this month. A similarly contentious bill that would set the legal framework for foreign investment in the oil industry has also stalled.

The tensions in parliament could make it more difficult for Iraq's various parties to reach an agreement on the security deal.

"We're redoubling our efforts," Mr. Zebari said of the next steps in the approval process.

One likely sticking pointy for Iraqis will be immunity for U.S. troops from prosecution under Iraqi law. Under the proposed pact, joint committees made up of U.S. and Iraqi officials will be formed to resolve such controversial cases when they arise, according to people familiar with the draft.

McCain, Obama converge

Continued from first page

placing it behind only the economy. The draft agreement allows both candidates to claim victory—Sen. Obama over timetables, and Sen. McCain over the success of the surge. The timetable in the agreement seems to split the difference between the two: Sen. Obama has pressed for combat troops to leave Iraq by mid-2010, while Sen. McCain has said all combat troops could be out by the beginning of 2013.

"Their policy preferences are certainly narrowing," says Stephen Biddle, a senior fellow at the Council on Foreign Relations. "The Obama desire to get out and the McCain desire to succeed could be coming together in the form of an ability to get out while succeeding."

The so-called status-of-forces agreement, which authorizes U.S. forces to operate in Iraq when the United Nations mandate for Iraq expires at the end of the year, stalled earlier this year. Washington had rejected Iraqi demands to end legal immunity for troops in combat situations, though it dropped objections to immunity for private contractors.

As little as three months ago, the war seemed likely to dominate the general election. Democrats seized on Sen. McCain's comment that U.S. forces might stay in Iraq 100 years as long as violence against troops ended. "The distinction between the two candidates was extremely stark," says Mr. Biddle. "Republicans want to stay for decades. Democrats want to get out within months."

Sen. McCain has pressed for more troops in Iraq since late 2003, when he chided then-Defense Secretary Donald Rumsfeld. "The simple truth is that we do not have sufficient forces in Iraq to meet our mili-

tary objectives," he said at the time.

President Bush announced the surge more than three years later, when violence in Iraq was near an all-time high and most Democrats and some Republicans were calling for withdrawal. With the war's unpopularity increasing, Democrats derisively called the buildup of troops the "McCain surge."

But in recent weeks, both candidates have tried to tack to the center. Sen. Obama has defended his opposition to the surge while showing flexibility on his proposed 16-month withdrawal. "Facts have to affect your decision making, and...over the course of 16 months, things are going to constantly change," he said after visiting Iraq last month.

Sen. McCain has tried to keep the pressure on his rival. "He values withdrawal from Iraq above victory in Iraq, even today with victory in sight," Sen. McCain said Wednesday. But the Arizona senator has opened himself to the possibility of considering a time horizon for withdrawal, something he once resisted and argued would be equivalent to providing a calendar for defeat.

The McCain campaign has a good reason to keep the issue from fading too much. The recent Wall Street Journal/NBC poll shows Sen. McCain has a 10-point advantage on the question of who would better manage the situation in Iraq.

In mid-July, Mr. Bush signaled for the first time openness to a "time horizon" for withdrawing combat troops, though the White House insists that conditions on the ground must dictate the speed of withdrawals. Iraqi Prime Minister Nouri al-Maliki also publicly endorsed a target date for withdrawal at the end of 2010, near the mid-2010 time frame advocated by Sen. Obama.

Civilian's war-crime trial opens

ASSOCIATED PRESS

RIVERSIDE, Calif.—A former U.S. Marine charged with killing unarmed detainees in Iraq did what he did to save his comrades, his attorney said Thursday as opening statements in the defendant's first-of-its-kind federal trial began.

Jose Luis Nazario Jr., 28 years old, is the first civilian to be tried under a federal law that allows the prosecution of former military ser-

vice members for war crimes.

Prosecutor Charles Kovats described Mr. Nazario as a man who killed "unarmed, submissive, docile" detainees and encouraged men under his charge to do the same thing.

Defense attorney Kevin McDermott countered that Mr. Nazario killed insurgents to save his comrades in Fallujah in November 2004, during some of the fiercest fighting of the war.

INDEX TO BUSINESSES

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

Ahlmann Baumaschinen27	Cemex18	Deutsche Telekom6	HSBC Holdings16	Merrill Lynch15,17
American International Group16	Chevron16	Dubai Holding20	IAC/InterActiveCorp4	Michelin16
Anascape6	China South Locomotive & Rolling Stock21	easyJet16	Iberia Líneas Aéreas de España5	Morgan Stanley16,17
Apple4	Continental Corp.5	Eurasian Natural Resources5	IKB Deutsche Industriebank5,16	National Aviation Co. of India6
Asciano Group20	Corporación Interamericana de Entrenamiento SAB de CV6	European Aeronautic Defence & Space5	Immersion6	Natixis15
Asia Media21	Crédit Agricole21	Exxon Mobil16	Instinet21	News Corp.4
ASX21	Credit Suisse Group18,21	Fairfax Media6	Interpublic Group4	Nintendo6
AXE ECN21	Crispin Porter + Bogusky4	Fannie Mae15,16	J.P. Morgan Chase17,18	Old Mutual17
Babcock & Brown21	Denso5	Fiat18	KfW Bankengruppe5,16	Omnicom Group4
BHP Billiton5	Deutsche Bank16	Fortis17	Kuoni Reisen Holding6	Persimmon16,17
BMW16		Freddie Mac15,16	Lehman Brothers Holdings15,16,18,21	Peugeot Citroën18
Bosch Robert5		Goldman Sachs Group16	Liquidnet Holdings21	Publicis Groupe4
Burger King Holdings6		Google4	Live Nation6	Qantas Airways6
Bursa Malaysia21		Haitong Securities17	Logitech International6	Renault18
		Hillcrest Laboratories6	London Stock Exchange Group21	RHJ International5
		H.J. Heinz6	Lone Star Funds5,16	Rio Tinto5
		Hogg Robinson Group6	Lufthansa16,27	Ripplewood Holdings5
		Holcim6	Macquarie Group20	Sama Dubai20
		Hong Kong Exchanges & Clearing21	Massey Energy27	SAS5
				Schaeffler Group5
				Singapore Exchange21
				Sony6
				Tamweel20
				Tianjin TEDA Investment Holding17
				Transurban Group20
				UBS15,21
				Umicore6
				Universal Electronics6
				U.S. Steel27
				Vienna Insurance Group6
				Volkswagen6,18
				Wachovia17
				WPP Group4

INDEX TO PEOPLE

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



For more people in the news, visit [CareerJournal.com/WhosNews](http://www.CareerJournal.com/WhosNews)

Almarri, Abdulsalam 20	Harding, Ben 19	Neumann, Karl-Thomas .. 5
Al Shirawi, Adel 20	Hedblom, Marcus 5	Nosworthy, Elizabeth .. 20
Atteberry, Tom 15	Hippe, Alan 5	Paatsch, Dean 20
Babcock, James 20	Jersey, Ira 16	Perry, Miguel 5
Ballmer, Steve 4	Johnson, William R. 6	Reid, Dustin 16
Bartsch, Elga 27	Kalthoum, Feras 20	Renner, Chris 5
Bernanke, Ben 27	Katkov, Neil 21	Russ, Oliver 16
Bing, Steve 6	Kerkorian, Kirk 6	Ryan, Neal 17
Christensen, Terry 6	Kerkorian, Lisa Bonder .. 6	Saito, Atsushi 21
Clifford, Rob 5	Kirk, David 6	Scibetta, Charlie 6
Dampier, Mark 19	Klinger, David 21	Seiberg, Jaret 18
Diller, Barry 4	Lai, Peter 21	Setia, Rajiv 15
Dunkelberg, Benedict 27	Larkin, Michael 20	Sittard, Johannes 5
Einhorn, David 15	Lee, Greg 21	Slendebroek, Maarten . 19
Elstone, Robert 21	Loynes, Jonathan 7	Teeter, Brook 21
Esperdy, Therese 16	Marchionne, Sergio 18	Treviño, Rodrigo 18
Farley, Mike 17	Marver, Joel 16	Trichet, Jean-Claude 27
Fine, Camden 18	McDermott, Darius 19	van Dijk, Erik 19
Gates, Bill 4	McInerney, Tom 4	Walker, David 19
Geyer, Günter 6	Menon, Raghu 6	Wellink, Nout 7
Gilbert, Steffen 17	Mohideen, Khaleel 21	Wennemer, Manfred 5
Glaser, Patricia 6	Moulton, Jon 19	Wood, Karen 5
Green, Phil 20	Murton, Art 18	Zaremski, Mike 17
		Zayas, Manuel 5

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LEADING THE NEWS

Nobel winners debate need for regulation

Economics laureates cite flaws in system; vetting products

BY JOELLEN PERRY

LINDAU, Germany—Some of the world's brightest economic minds agree the current financial crisis exposed major flaws in the system, but disagree about the role regulators should play in preventing a repeat.

At an annual gathering Thursday of economic Nobel laureates on a tiny, medieval island in southern Germany, three winners of the Nobel Prize in economics and one Peace Prize winner lamented the excessive risk-taking, lax management and impenetrable complexity at the heart of the financial system's current turmoil.

Many of the laureates' criticisms focused on the notion that banking has drifted from its fundamental purpose. Amid a rush to

profit, "what's been lost is the idea that a banker has some responsibility to protect the client's interest," said Daniel McFadden, who won the Nobel Memorial Prize in Economic Science in 2000 for research focused on modeling individuals' decision-making processes.

While a market in which homeowners' mortgages can be packaged into securities sold to banks across the globe might be efficient, Mr. McFadden said, "the most efficient way to organize economic activity may also prove to be the most brittle. Congress needs to consider the costs of volatility and instability."

But a rush to regulation could have dire consequences, warned fellow laureate Myron Scholes, who took a Nobel Prize in 1997 for a method of valuing derivatives, which are financial instruments whose price changes based on the value of related assets. Ticking off the financial systems' basic func-

tions—including financing large-scale projects, facilitating saving and assigning prices to assets—Mr. Scholes attributed decades of economic growth to innovations that let institutions "perform these functions more efficiently."

Mr. Scholes, who also co-founded Long-Term Capital Management, a hedge fund that collapsed amid the East Asian and Russian financial crises of the late 1990s, said, "Sometimes, the cost of regulation might be far greater than its benefits."

One example, Mr. Scholes said, are the Sarbanes-Oxley accounting rules implemented after Enron's collapse earlier this decade. The rules have been criticized as undercutting the U.S.'s attractiveness as a base for investment.

Joseph Stiglitz, a professor of economics at Columbia University who won the Nobel in 2001, suggested misguided innovation itself

caused the current turmoil. Noting that homeowners' most important risk assessment is the likelihood that they can retain their home amid market volatility, Mr. Stiglitz said, "These are the problems [financial markets] should have created products to match. But they created risks, and now we're bearing the consequences of this so-called innovation."

There were some areas of agreement. The standards that gauge how much capital banks should hold—called Basel II for the Swiss city in which they were developed—focus too tightly on managing daily risk and not enough on handling crises. "What happens most of the time is not important," said Mr. Scholes, noting the current financial turmoil comes on the heels of the dot-com bubble's bursting and the Asian financial crisis of the early 1990s. "We have to learn how to handle the shocks when they occur."

One idea that might prevent a re-

peat of the turmoil: a commission that would vet financial products before their release, akin to the U.S. Food and Drug Administration's evaluation of drugs before they are released to the market. Mr. McFadden said, "We may need a financial-instrument administration that tests the robustness of financial instruments and approves only the uses where they can do no harm."

But tinkering with a fundamentally flawed system may not be enough, said Muhammad Yunus, whose success in lending small amounts of money to people too poor for ordinary credit led him and his Grameen Bank to win the Nobel Peace Prize in 2006.

"Our banking is sub sub sub prime," said Mr. Yunus, noting his model requires no collateral, offers no insurance, and boasts "no lawyers." The upshot: "Our repayment rate is very high. Like 98 or 99%."



Myron Scholes



Muhammad Yunus

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CORPORATE NEWS

AUTOS

Fiat to build engines at new plant in China



ITALY'S Fiat SpA has signed a memorandum of understanding with the city of Chongqing in southwestern China to make light diesel engines there.

Each year the plant will make

100,000 Fiat Powertrain Technologies engines, 70% of which will be exported, the Chongqing Development and Reform Commission said. Chongqing's economic-planning agency said the Italian auto maker would invest 1.8 billion yuan (\$262.6 million) to build the plant. The agency didn't say when the plant would start operation. The facility would be Fiat's largest overseas parts-production base, the agency said.

—WSJ News Roundup

SUPERMARKETS

Tesco sells, leases stores to tap value from property



TESCO PLC, the U.K.'s biggest retailer by sales, said it sold and leased back 13 stores valued at £605 million (\$1.06 billion) as part of its program to extract more value from its property portfolio.

The properties were sold to the Universities Superannuation Scheme, a U.K. pension fund; Prupim, the property-investment arm of U.K. insurer Prudential PLC; LaSalle Investment Management, a unit of Jones Lang LaSalle Inc.; and Canada Life Assurance Co.

Pali International analyst Nick Bubb said the deal shows there is "still good pension-fund appetite for supermarkets."

—Lilly Vitorovich

PUBLISHING

Bertelsmann is a bidder for Reed Elsevier division



GERMAN media conglomerate Bertelsmann AG is among the bidders for Anglo-Dutch publisher Reed Elsevier NV's trade-magazine division, a spokesman for Bertelsmann unit Gruner

+ Jahr said.

The German publisher has placed a nonbinding bid for Reed Business Information via Gruner + Jahr, the spokesman said. The business is valued at £1 billion to £1.25 billion (\$1.86 billion to \$2.33 billion), said people familiar with the matter.

Reed Elsevier wants to sell the trade-publication unit as it is growing too slowly and is too reliant on advertising revenue.

—Archibald Preuschat

Microsoft's comic relief

Software company enlists Jerry Seinfeld to counter Apple ads

BY SUZANNE VRANICA AND ROBERT A. GUTH

MICROSOFT CORP., weary of being cast as a stodgy oldster by Apple Inc.'s advertising, is turning to Jerry Seinfeld for help.

The software giant's new \$300 million advertising campaign, de-

vised by a newly hired ad agency, has been closely guarded. But Mr. Seinfeld will be one of the key celebrity pitchmen, say people close to the situation. He will appear with Microsoft Chairman Bill Gates in ads and receive about \$10 million for the work, they say.

The new ad effort is expected to use some variation of the slogan "Windows, Not Walls," according to several people familiar with the matter. Those people say the point is to stress breaking down barriers that prevent people and ideas from connecting. The campaign, said to debut Sept. 4, is one of the largest in the company's history.

The attempted image overhaul comes as Microsoft executives privately acknowledge that Windows—the company's most important brand—has grown stale and has been battered by Apple's "Mac vs. PC" ads. Those ads, created by Omnicom Group Inc.'s TBWA/Chiat/Day, feature a nerdy PC guy getting upstaged by a hip Mac counterpart.

Microsoft's immediate goal is to reverse the negative public perception of Windows Vista, the latest version of the company's personal-computer operating system. Windows is Microsoft's largest generator of profit and revenue, accounting for 28% of the company's revenue of \$60.4 billion in the year ended June 30.

The software has sold well, and Microsoft retains an overwhelming share of the market for operating system software over Apple. But Apple's computer sales have been rising, and Vista is dogged by the notion that it has technical shortcom-

ings and is hard to use. Apple's latest Mac vs. PC ads take swipes at Vista. Microsoft says early problems with Vista have been largely alleviated.

While Apple's digs at Microsoft through its advertising campaign have been vexing, Apple is on a hot streak with its products that Microsoft hasn't been able to match. Apple's Macintosh computer business is dwarfed by Microsoft's share of the PC software market, but it has been gaining on its larger rival, accounting for 7.8% of new PC shipments in the U.S. in the second quarter, compared with 6.2% during the same period the prior year, according to research firm IDC. The vast majority of the rest of the market is made up of Windows PCs.

During the second quarter, Apple said it sold 41% more Macs than it did during the same period the prior year; that compares with growth of 15.3% in total PC shipments world-wide, according to IDC. Apple's desktop and notebook computers have won converts among onetime Windows loyalists.

Microsoft's campaign highlights the crucial role of Windows in the company's broader efforts to expand into new areas. Money from that division is invested into other areas, such as online services that are crucial to Microsoft's long-term growth. Windows is also a bedrock product for sales of other Mi-

crosoft software, such as the Office group of programs.

"They are not seen as cool," says Robert Passikoff, president of Brand Keys, a New York branding firm. "Apple is cool. Can anyone even recall a Microsoft ad? No." Apple and its brand-obsessed CEO, Steve Jobs, have been producing distinctive advertising since its famous "1984" campaign, which debuted that year in the Super Bowl.

The planned appearance of Mr. Gates in the ads is one sign that Microsoft will continue to use its cofounder's own celebrity status, even now that Mr. Gates has stepped away from full-time work in software to focus on philanthropy. Over the past decade, Microsoft has paired Mr. Gates with a range of celebrities in lighthearted videos. A recent video, shown at computer-industry events, portrayed a comical depiction of Mr. Gates's last day at Microsoft, showing him with rapper Jay-Z, rocker Bono, and actor Matthew McConaughey, among others.

A spokeswoman for Mr. Seinfeld declined to comment. A Microsoft spokesman declined to comment on details of the campaign.

In an email to Microsoft employees in July, Microsoft Chief Executive Steve Ballmer wrote, "Now it's time to tell our story."

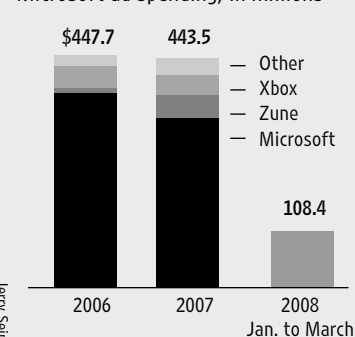
He added: "In the weeks ahead,



Microsoft plans to spend \$300 million on an ad campaign featuring Jerry Seinfeld

Serious business

Microsoft ad spending, in millions



Source: TNS Media Intelligence

we'll launch a campaign to address any lingering doubts our customers may have about Windows Vista." He said that later in the year the company will roll out "a more comprehensive effort to redefine the meaning and value of Windows for our customers."

Microsoft's large business-to-business presence has always made for a difficult marketing mix with consumer branding. Windows is used by both constituencies.

Mr. Seinfeld is just one piece of the makeover. The campaign will likely include videos of recent consumer focus groups that Microsoft held. In the studies, participants—who said they had negative impressions of Vista—were shown a version of Windows called "Mojave." After trying Mojave and liking it, the participants were told that the software was actually Windows Vista.

The campaign is the brainchild of Crispin Porter + Bogusky, a Miami-based ad shop that has helped revitalize brands such as Burger King. Microsoft hired the firm earlier this year after considering several ad agencies including WPP Group PLC's JWT, Publicis Groupe's Fallon and its longtime agency Interpublic Group's McCann Erickson.

The campaign is a big test for Crispin Porter + Bogusky. In choosing the firm, a unit of MDC Partners, Microsoft broke from McCann Erickson, which has managed the software maker's previous efforts including the 2002 "Realizing Potential" Microsoft corporate ad campaign and the "Start Something" campaign for Windows XP in 2005. McCann remains on Microsoft's agency roster working on other Microsoft ad duties such as Xbox.

—Nick Wingfield contributed to this article.

IAC slims down to halt decline in share price

BY SHIRA OVIDE AND DAVID BENOIT

It took more than a decade for media mogul Barry Diller to piece together Internet conglomerate IAC/InterActiveCorp. Now the challenge for Mr. Diller will be to show a smaller, more focused IAC can be a better business.

IAC on Thursday spun off four of its biggest properties, including the HSN home-shopping network and Ticketmaster, into separate public companies. As the four—Ticketmaster Inc., HSN Inc., Interval Leisure Group Inc. and Tree.com Inc.—began trading as separate companies, inves-

tors pushed shares in all four higher intraday. But in midafternoon trading Thursday, IAC shares were down 7.4%, or \$1.31, at \$16.36.

Ticketmaster—which will lose its largest client, Live Nation Inc., at the end of the year—was trading up 13% at \$23.23, while Tree.com, the operator of LendingTree.com, was up four cents at \$7.69.

IAC is left as a collection of more than 35 Internet companies, including search engine Ask.com, dating site Match.com and online-investigation service Evite.



Barry Diller

The split is a test of whether a slimmer IAC can temper investor frustration with its jumble of assets—which have included Internet businesses, cable-TV networks, travel services and mortgage lending—and reverse a long-declining stock price. IAC shares had lost 51% of their value in the past five years.

IAC units already are moving toward closer collaboration. Graphic display ads on sites like Evite and Match.com are being handled by a common sales force. Searches across the company's Web

sites are handled under a contract with Google Inc. The units swap expertise about marketing and other strategies. "Because you're starting from the same business—broadly defined, generating revenue from Internet advertising—then by definition there's a lot to do and share together," said Tom McInerney, IAC chief financial officer.

Ask.com—which will generate about half the new IAC's revenue, analysts say—remains a minor player, with a 4.3% share of online searches in June, according to comScore Inc.

News Corp.'s Dow Jones & Co., publisher of The Wall Street Journal, jointly owns a personal-finance Web site with IAC.

CORPORATE NEWS

Spanair keeps MD planes

Carrier won't ground its aging fleet of jets after fatal accident

BY JASON SINCLAIR
AND BERND RADOWITZ

MADRID—Spanair SA has no plans to ground its aging fleet of McDonnell Douglas planes after the deadliest aviation accident in Spain in two decades, General Director Marcus Hedblom said Thursday.

A Spanair MD-82 aircraft crashed shortly after takeoff Wednesday, killing 153 people on board. The aircraft had been in operation for 15 years, company officials said.

Mr. Hedblom said the airplane originally aborted takeoff after the malfunction of an air-intake probe, but mechanics disabled the mechanism, allowing the plane to take off roughly an hour later. Mr. Hedblom said the air-intake probe wasn't part of a list of instruments required for the plane to operate safely.

He said pilots conduct preflight checks on the planes, but mechanics deal with most technical issues.

Spanair, Spain's second-largest airline by passengers carried after Iberia Líneas Aéreas de España SA, has been under pressure amid labor unrest and rising fuel costs, exacerbated partly by its ineffi-



The crash of a Spanair MD-82 airplane shortly after takeoff Wednesday was Spain's deadliest aviation accident in two decades, as it killed 153 people on board.

cient fleet of MD aircraft.

Following a failed attempt to sell Spanair to chief rival Iberia earlier this year, owner SAS AB last month unveiled plans to shed more than 1,000 jobs at the airline.

"Spanair was in a very complicated situation before the crash and its economic viability was already in doubt," Fortis analyst Manuel Zayas said.

SAS's restructuring plan for Spanair, designed to save about €90 million (\$132.7 million) in 2009, also foresees cutting capacity 24% by phasing out 15 MD aircraft

from a total fleet of 65.

Meanwhile, Spanish flag carrier Iberia is phasing out its remaining 11 MD aircraft from its fleet, replacing them with more-modern Airbus planes. Airbus is a unit of European Aeronautic Defence & Space Co.

A few hours before Wednesday's crash, pilots union Sepa threatened to strike in response to Spanair restructuring plan. A Spanair spokesman said the airline is honoring previous agreements with labor unions.

—Santiago Perez
contributed to this article.

KfW to sell stake in IKB to Lone Star

BY ULRIKE DAUER

German state-owned bank KfW Bankengruppe AG said it is selling its 90.8% stake in subprime victim IKB Deutsche Industriebank AG to a unit of U.S. private-equity firm Lone Star Funds. The deal is a major step in KfW's yearlong effort to rid itself of one of the earliest casualties of the credit crunch.

IKB has received roughly €10.5 billion (\$15.3 billion) in several bailout packages. KfW alone shouldered €7.9 billion, while the government contributed €1.2 billion and a group of banks roughly €1.3 billion, said a person familiar with the matter.

The companies didn't specify the purchase price, saying only that it was a low three-digit million euro amount.

KfW Chief Executive Wolfgang Kroh called the price received from Lone Star Germany "appropriate and positive," but acknowledged that the German government didn't get what it initially wanted. Finance Minister Peer Steinbrück, who is the deputy chairman of KfW's supervisory board, had earlier this year forecast proceeds from the sale of around €800 million.

"What is important is that we have now closed the chapter on IKB's rescue," Mr. Kroh said.

IKB's shares rallied recently on hopes of a deal but are still down 90% from mid-July 2007. Thursday, the shares rose €0.24, or 9%, at €2.92, valuing the bank at €282 million.

As part of the deal, KfW and Lone

Star Germany agreed to share certain portfolio risks and risks related to potential lawsuits, and KfW agreed to buy a smaller than expected part of IKB's on-balance portfolio, KfW said. In addition, the government guarantees around €600 million for IKB's portfolio risks and Lone Star will contribute its own capital to IKB, said KfW.

Lone Star outbid RHJ International SA, a Euronext-listed company created from portfolio contributions by private-equity funds affiliated with Ripplewood Holdings LLC. RJH bid more than Lone Star but wanted loan commitments from KfW for financing the deal, said another person familiar with the matter.

—Ruediger Schoss
contributed to this article.

BHP mines for big-client gold as Games sponsor

BY JASON DEAN

BEIJING—To most Olympic sponsors, backing the Beijing Games is a way to reach consumers around the world—especially China's 1.3 billion people. BHP Billiton Ltd. has a smaller audience in mind.

For the Anglo-Australian mining giant, these Games are a chance to build goodwill with some of its most important clients in the world—the Chinese government and its companies, most notably big steelmakers.

"We're in a different space than most other sponsors because we don't have a consumer product or consumer brand that we're trying to promote," says Karen Wood, BHP's chief people officer. She says BHP decided to sponsor the Beijing Games mainly because "we thought that it was very important for us to demon-

strate our commitment to China."

BHP's only previous experience with the Olympics was as a backer of the 2000 Sydney Games, in its home country. In 2008, it has provided the raw materials from its mines in Chile and Australia to make the 6,000 gold, silver and bronze medals for Olympic and Paralympic winners—plus 51,000 commemorative medals for participants and others. The 13.04 kilograms of gold it contributed is valued at about \$340,000 at current market prices.

The world's largest mining company, BHP now gets about 20% of its revenue from China, up from 2% in 2000. China's demand for raw materials is a big reason BHP this week reported record annual earnings for the seventh straight year, with net profit rising 15% to \$15.39 billion. Revenue jumped 25% to \$59.47 billion.

China's reliance on big miners like BHP is sometimes a sore point. In June and July, BHP and smaller rival Rio Tinto Ltd. reached deals with China to raise prices by at least 79% for iron ore—a key ingredient in steel. The agreements capped one of the longest and most contentious annual negotiations ever for iron ore.

Meanwhile, BHP wants China's approval for its effort to acquire Rio Tinto. While most Olympic sponsors are consumer or business-to-business concerns, BHP in China is "really a business-to-government" company, says Chris Renner, China president of Helios Partners Inc., a sports-marketing consultancy that worked with BHP on its Olympic sponsorship.

—Kersten Zhang
contributed to this article.

Schaeffler's revised bid accepted by Continental

BY EDWARD TAYLOR

Continental AG began a search for a new chief executive Thursday after the German tire and auto-parts supplier agreed to a revised €12.1 billion (\$17.84 billion) takeover offer from rival Schaeffler Group, a move the current CEO didn't support.

Schaeffler Group made substantial concessions, including a raised offer of €75 a share and guarantees not to take a majority stake before 2012, to win over Continental's management.

Continental said Thursday that CEO Manfred Wennemer asked to be relieved of his responsibilities Aug. 31. A person close to the matter said a successor could be named as early as this weekend. Mr. Wennemer, whose term would have ended in 2011, had signaled that Chief Financial Officer Alan Hippe and Chief Technology Officer Karl-Thomas Neumann could be possible successors. Continental's supervisory board, akin to a board of directors, will lead the search for a new CEO.

The deal sets the stage for the creation of a large global auto-parts supplier specializing in hybrid and electric-vehicle technologies. It also avoids prolonging a bitter struggle for control of Hannover, Germany-based Continental.

In a statement Thursday, Continental said it "expects smooth cooperation" and it will "examine the possibilities for strategic cooperation projects" under terms set out in an investment agreement. In a separate statement also released Thursday, Schaeffler Group welcomed the agreement as a "constructive solution that is in the interest of both companies."

Schaeffler formally raised its offer by €800 million euros, from €11.3 billion, and pledged to provide an amount of "up to €522 million" to compensate for possible disadvantages such as lost tax credits and the cost of refinancing debt that could ensue in the event of a transaction. Schaeffler also agreed to a deal that guarantees Continental's independence, which can be legally enforced by an independent arbitrator.

Former German Chancellor Gerhard Schröder was named in the agreement as someone who is "authorized and empowered to enforce" the agreement.

52-WEEK SHARE PRICE PERFORMANCE

Continental

Thursday: €73.80, up 0.4%

52-week change: down 21.2%



Source: Thomson Reuters Datastream

Continental's management won guarantees that prevent Schaeffler from raising its stake beyond 49.99% in Continental before 2012, and that Schaeffler couldn't "demand the sale of activities or seek other material structural measures," including changes in the location of its headquarters, form of incorporation or business divisions, "against the wishes of Continental AG." The deal gives the tire and auto-parts maker's shareholders until Sept. 16 to tender their shares.

The deal will combine Schaeffler's engine-management technology, ball bearings and clutch business with Continental's expertise in fuel-saving and safety technologies as well as vehicle electronics.

The combined entity will compete head to head with rivals Robert Bosch GmbH and Japan's Denso Corp.

Continental, with 152,000 employees, specializes in systems and components for the auto industry, including electronic safety systems, tires and fuel-economy technologies. Continental expects 2008 revenue of €26.4 billion.

Schaeffler has 66,000 employees and posted revenue of €8.9 billion for 2007. Continental had rejected Schaeffler Group's previous €70.12-a-share offer as too low. Schaeffler had already secured control over more than 30% of Continental's shares using option agreements.

ENRC's profit more than triples

BY JEFFREY SPARSHOTT

LONDON—Eurasian Natural Resources Corp. said first-half net profit more than tripled, helped by higher profit margins, and the London-listed, Kazakhstan-based miner said it expects a "very strong" second half with steady prices for key steelmaking commodities.

ENRC said net profit jumped to \$1.34 billion from \$381 million a year earlier, driven by the ferroalloy and iron-ore divisions, which make products used in steelmaking.

Revenue rose 85% to \$3.44 billion from \$1.86 billion, while costs rose 21% to \$1.44 billion.

The results beat expectations, costs were in line with company forecasts and further earnings growth in the second half "is a given," said Deutsche Bank analyst Rob Clifford.

ENRC has increased its capital expenditure program 92% to \$6.9 bil-

lion to boost ferrochrome, iron ore and electricity production amid expectations of continuing demand for the commodities.

Still, the miner warned of continuing pressure from rising labor and material costs, and Chief Financial Officer Miguel Perry said the company would maintain its forecast of a "high teens to 20%" cost increase for the full year.

Even with rising costs and potentially flat prices for ferrochrome, Chief Executive Johannes Sittard said the company expects strong results in the second half and beyond. "I think we have the fundamentals to remain successful not only in the second half of this year," Mr. Sittard said.

ENRC said it plans to expand production with the construction of six new ferroalloy furnaces, expansion of iron ore operations and construction of an additional 1,200 megawatts in electricity-generating capacity.

CORPORATE NEWS

Start-up sues Nintendo over controllers for Wii

Lab says game giant violated its patents with popular product

BY NICK WINGFIELD

A start-up has taken legal action against Japan's Nintendo Co. for allegedly violating patents with the popular Nintendo Wii videogame system, in a further sign that litigation is heating up in the fast-growing videogame business.

The start-up, Hillcrest Laboratories Inc. of Rockville, Md., filed a complaint Wednesday against Nintendo with the U.S. International Trade Commission, alleging that the Wii's



Hillcrest's motion-sensing remote control for browsing TV programming.

motion-sensing controller and software infringes on Hillcrest patents related to the technologies. The filing asks the commission to halt the import of Wii consoles into the U.S. Hillcrest also filed a lawsuit in federal court in Greenbelt, Md., making similar allegations against Nintendo and seeking financial damages.

Nintendo spokesman Charlie Scibetta said the company hasn't been served with any lawsuit or action by Hillcrest and wouldn't have a comment.

"While Hillcrest Labs has a great deal of respect for Nintendo and the Wii, Hillcrest Labs believes that Nintendo is in clear violation of its patents and has taken this action to protect its intellectual property rights," Hillcrest said in a statement.

The Wii has become the world's best-selling game console, partly because of a novel motion-sensing controller that allows players to engage in sword battles, swing virtual tennis rackets and other activities simply by swinging a hand-held remote control in the air.

Hillcrest makes a motion-sensing controller for use by consumer-electronics companies in set-top boxes and other products. Hillcrest has licensed its technology to Logitech International SA for a computer-mouse-like device and Universal Electronics Inc., a maker of remote controls.

Patent fights in the games business have flourished in recent years, especially lawsuits related to the game controllers that players use to manipulate on-screen action. In May, a jury in federal court in the Eastern District of Texas awarded Anascape Ltd. of Tyler, Texas, \$21 million in a lawsuit against Nintendo, finding that Nintendo violated several patents related to game controllers. Nintendo appealed the verdict in July.

In another battle, Immersion Corp. last year settled a lawsuit with Sony Corp. in which Immersion alleged that Sony's PlayStation console violated Immersion patents with a technology that causes PlayStation controllers to vibrate during the action in games. As part of the settlement, Immersion will receive at least \$152.2 million from Sony, according to Immersion regulatory filings.

Kerkorian denies knowing private investigator's role

BY SARAH McBRIDE

LOS ANGELES—Billionaire Kirk Kerkorian testified in federal court Wednesday that he didn't know that an investigator accused of illegal wiretapping, Anthony Pellicano, was working for Mr. Kerkorian's own lawyer.

Mr. Kerkorian took the witness stand for about a half hour in a trial over whether his longtime lawyer, Terry Christensen, hired Mr. Pellicano to wiretap Mr. Kerkorian's ex-wife. Mr. Christensen, who argues he had no knowledge of the wiretaps, and Mr. Pellicano each face two felony counts of wiretapping and conspiracy.

Mr. Pellicano's legal troubles

have attracted interest because his work as a private investigator brought him into contact with many high-profile Hollywood figures.

Patricia Glaser, who is representing Mr. Christensen and is a partner in his law firm, sought to establish that Mr. Kerkorian wasn't aware of Mr. Pellicano's role. When asked about an April 2002 meeting where Mr. Kerkorian said he first met Mr. Pellicano, Mr. Kerkorian responded that he didn't know whom Mr. Pellicano represented.

"People just walked in" and out, said Mr. Kerkorian of the meeting, which involved a paternity dispute between Mr. Kerkorian, his ex-wife Lisa Bonder Kerkorian, and movie producer Steve Bing, who was also at the meeting. In May 2002, Mr. Kerkorian filed a lawsuit against Mr. Bing, alleging his agents had established Mr. Bing was the father of Ms. Bonder Kerkorian's child.

Earlier this year, Mr. Pellicano was convicted on 76 of 77 counts ranging from wiretapping to conspiracy in a separate case. Sentencing in that case is expected Sept. 24.



Kirk Kerkorian

GLOBAL BUSINESS BRIEFS

Deutsche Telekom AG

Call centers in Germany to be reduced, updated

Deutsche Telekom AG said Thursday it is cutting the number of call-center locations the telecommunications company has in Germany to 24 from 63, and will invest about €70 million (\$1.03 billion) in coming years to modernize the remaining call centers. About 8,000 of the 18,000 full-time and part-time employees will be relocated, Deutsche Telekom said, adding that no jobs will be cut or moved overseas. Germany's biggest union, Ver.di expressed concern over the move. The company said it hopes the restructuring of its service businesses will save a low three-digit-million euro amount annually. The reorganization of the company's call centers should result in savings of about €57 million, Deutsche Telekom added.

Kuoni Reisen Holding AG

Swiss tour operator Kuoni Reisen Holding AG reported a sharp increase in first-half profit, thanks to a gain from a legal dispute and higher bookings during the Euro Cup in Austria and Switzerland. Net profit rose to 22.5 million Swiss francs (\$20.5 million) from 3.4 million francs a year earlier. The bottom line was boosted by a 6.4 million franc release of a provision for a legal dispute with Hogg Robinson Group PLC after the parties reached an agreement earlier this year. A small accounting gain from the sale of Edelweiss Air to Swiss Air also contributed to the increase. Sales rose 9.9% to 2.23 billion francs. Kuoni said bookings as of Aug. 17 were 6% above last year's level, partly driven by the European football championship.

Holcim Ltd.

Swiss cement producer Holcim Ltd. lowered its full-year outlook after reporting a 66% drop in second-quarter net profit, hit by high raw-material costs and a slowdown in the U.S. construction industry. Net fell to 696 million Swiss francs (\$633.4 million) from 2.07 billion francs a year earlier, when the figure was boosted by a 1.3 billion franc divestment. Sales were down 4.8% to 6.93 billion francs. Analysts noted that business in North America was surprisingly weak and that slowing growth in India burdened Asia. The company said it is maintaining its long-term target of 5% annual internal growth in earnings before interest, tax, depreciation and amortization, or Ebitda, but its aim this year is to match last year's operating Ebitda on a like-for-like basis.

Umicore SA

Belgian metals company Umicore SA posted a 14% increase in first-half net profit, driven by strong profit in its precious-metals-services and advanced-materials businesses. Net profit rose to €137.6 million (\$202.8 million) from €120.5 million a year earlier, while revenue was up 19% to €4.95 billion from €4.18 billion. Umicore's results were boosted by strong operating performance at its precious-metals-refining business as well as high prices for precious metals. Shares in the company have fallen 25.5% since the start of the year, but rose 12% following the release of first-half results.

Vienna Insurance Group

Vienna Insurance Group said its net profit rose 29% in the first half amid strong premium growth in Central and Eastern Europe. The Austrian insurer said its net profit rose to €207.7 million (\$306.3 million) from €160.6 million a year earlier. Gross premiums rose 21% to €4.22 billion, driven by growth in Central and Eastern Europe, where premiums were up 41% at €1.98 billion. Premiums outside Central and Eastern Europe rose 7.1% to €2.23 billion. The combined ratio after reinsurance, an industry measure of profitability, fell to 95.9% from 96%. The insurer stuck with its profit forecast. Chief Executive Günter Geyer said the company has retained provisions of €315 million as a buffer against less favorable times and as insurance against volatility in securities and potential cost increases in implementing new information technology.

H.J. Heinz Co.

H.J. Heinz Co. reported a 12% increase in fiscal-first-quarter net income on strong sales growth, particularly in emerging markets. The Pittsburgh-based food maker posted net income of \$228.9 million, or 72 cents a share, up from \$205.3 million, or 63 cents a share, a year earlier. For the quarter ended July 30, sales rose 15% to \$2.58 billion. The company's U.S. food-services revenue slipped 2.8% as volume dropped amid lower ketchup sales. International sales rose at least 20% in every region. Chief Executive William R. Johnson has been striving to expand Heinz into more emerging markets, and saw sales of soy sauce take off in Indonesia, while nutritional beverages sold well in India. The company raised the low end of its fiscal 2009 earnings guidance four cents.

Volkswagen AG

Volkswagen AG said worldwide deliveries of its brand cars were down 1.5% in July amid a wider decline in global markets. Europe's biggest car maker by sales said its core VW brand delivered 305,000 vehicles last month. It said the fall from last July was a result of the general market decline. Over the first seven months of 2008, the company said 2.21 million VW vehicles were delivered—an increase of 4.7% from a year earlier. Wolfsburg-based Volkswagen said it saw healthy growth in its three biggest markets over the January to July period. VW delivered 501,250 cars in China, a 12.9% rise, and 314,500 in Brazil, an increase of 20.4%. For the first time, Volkswagen sold more cars in Brazil than in Germany, where it delivered 312,600 cars—an increase of 6.2%.

Qantas Airways Ltd.

Despite soaring fuel costs, Qantas Airways Ltd. posted record full-year earnings but warned its profit is set to fall this year amid an uncertain outlook for fuel prices and economic conditions. Qantas, Australia's largest airline by revenue and passenger traffic, increased net profit by 44% to 969 million Australian dollars (US\$846.1 million) from a restated A\$672.8 million a year earlier, helped by A\$291 million in payments from aircraft manufacturers to compensate for delays in delivery of ordered aircraft. Profit before tax for the year ended June 30 increased 46% to A\$1.41 billion, above Qantas's forecast of at least 40% growth. Full-year revenue rose 7.5% to A\$16.19 billion from A\$15.06 billion.

Burger King Holdings Inc.

Burger King Holdings Inc. said its fiscal-fourth-quarter earnings rose 42%, though high ingredient costs ate into the company's profit. The Miami-based hamburger chain's results showed signs of how rising prices of beef, cheese and other commodities are straining restaurants. Burger King's restaurant profit margins fell to 13.1% from 14.8% during the quarter ended June 30. Burger King's same-store sales, a key measure of restaurant performance, rose 5.3% world-wide during the period and 5.5% in the U.S. and Canada, helped by longer hours and promotions tied to movies. Net income was \$51 million, or 37 cents a share, in the quarter, up from \$36 million, or 26 cents a share, during the same period a year earlier. Revenue rose 9% to \$646 million.

Live Nation Inc.

In a bid to strengthen its global touring business, Live Nation Inc. has formed a partnership with the biggest concert promoter in Latin America, Corporación Interamericana de Entretenimiento SAB de CV, known as CIE. The deal gives Live Nation the exclusive right to book world tours into CIE venues—nearly all the major concert halls and arenas in Mexico, and a large percentage in Brazil and other big markets. Competitors with acts on world tours wouldn't be able to use CIE venues. Terms weren't disclosed, but CIE is to pay Live Nation a percentage of revenue when acts promoted by Live Nation play at CIE venues. Live Nation, which has spent years bolstering its presence in Europe and Asia, has been less successful gaining a foothold in Latin America.

National Aviation Co. of India

State-run carrier Air India will seek more than 20 billion rupees (\$458.4 million) in financial support from the government to expand its equity capital base and to boost operations. "We are working with the [civil aviation] ministry on a package," said Raghu Menon, chairman and managing director of National Aviation Co. of India Ltd., which runs the airline. Air India currently has an equity capital base of 1.45 billion rupees, Mr. Menon said. He said Air India is expected to record a net loss of about 20 billion rupees in the fiscal year ended March 31. He declined to elaborate. The carrier had a loss of 4.48 billion rupees in the fiscal year ended March 31, 2007, on revenue of 95.9 billion rupees.

Fairfax Media Ltd.

Australia's Fairfax Media Ltd.'s full-year net profit rose 47%, boosted by the acquisition of regional newspaper publisher Rural Press. Fairfax said net in the year ended June 30 rose to 386.9 million Australian dollars (US\$337.8 million) from A\$263.5 million the prior year, while revenue rose 34% to A\$2.92 billion. "Overall, these are a very satisfactory set of results in the face of declining earnings for our Sydney and Melbourne metropolitan newspapers in Australia and tough trading conditions, particularly in New Zealand," Chief Executive David Kirk said. The group didn't give guidance for the current half and said the advertising market has slowed since the start of July amid weaker economic conditions.

—Compiled from staff and wire service reports.

THE WALL STREET JOURNAL.

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Guests and clients of 320 leading hotels and car rental agencies receive The Wall Street Journal Europe daily, courtesy of



ECONOMY & POLITICS

U.K.

July retail sales increased by more than expected



U.K. RETAIL sales rose more than expected in July, an encouraging sign that consumer sentiment may not have been battered as badly as thought by the credit crunch and economic uncertainty.

But analysts cautioned against reading too much into the data, noting that the Bank of England's Monetary Policy Committee is currently placing more weight on anecdotal and survey evidence than official sales figures.

The volume of retail sales grew 0.8% from June and 2.1% from last July, the Office for National Statistics said, beating expectations for a 0.3% monthly rise and 1.7% on a yearly basis. —Natasha Brereton

NORWAY

Data paint mixed picture of economy's performance



GROWTH in oil-rich Norway's mainland economy grew much faster in the second quarter than the rest of Europe, rising 1% from the first quarter and 7.1% from a year earlier.

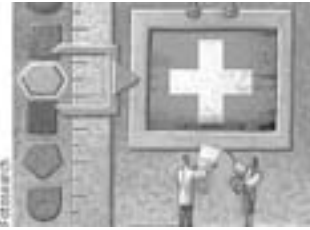
But analysts said downwardly revised first-quarter data and weaker investment showed the economy is slowing.

The market had expected a quarterly growth rate of 0.7% and an annual growth of 4.2% due to onshore oil-sector investment and moderate growth in private consumption. The figures exclude shipping and other activity connected to the offshore energy sector.

Total GDP rose 0.6% from the first quarter and 5.9% on an annual basis. —Elizabeth Cowley

SWITZERLAND

Solid July trade surplus shows economic resilience



SWITZERLAND posted another solid trade surplus in July amid resilient exports and imports, fresh data showed, indicating the economic environment is deteriorating only gradually.

However, a slowdown in trade flows is expected later this year, and declining consumer confidence and inflation continue to weigh on sentiment.

The Swiss trade surplus stood at 2.37 billion francs (\$2.16 billion) in July, unchanged from June.

Other data showed Swiss producer and import prices rose 0.5% in July from June and were 4.9% higher from a year earlier, beating expectations of 0.4% and 4.7%, respectively. —Martin Gelnar

Scarf standoff in Turkey divides women

Head-covering issue in nation goes past religion, secularism

BY FARNAZ FASSIHI
Istanbul

FOR ESRA CIFCI, a 26-year-old Turk, wearing a head scarf isn't only an expression of her Muslim beliefs but also an assertion of her right as a woman to dress as she pleases.

For Canan Arin, a 65-year-old secular feminist and also a Muslim, the scarf is a clear symbol of the oppression of women.

Turkish law bans female citizens from educational and government establishments if they cover their hair for religious reasons. Among Turkish politicians and intellectuals—mostly men—the scarf is frequently at the center of the debate about whether Turkey is Eastern or European, Islamic or secular, traditional or modern. Last month, the simple piece of silky fabric embroiled Turkey in a political standoff that almost toppled the government.

But the scarf is also sharply dividing women's-rights advocates, here and elsewhere in the Muslim world. Islamist feminists like Ms. Cifci (pronounced CHIF-chee) passionately argue against the ban, saying a woman should be free to express her religious devotion as she wishes and wear what she likes. Secularists like Ms. Arin back the ban, saying if women in Turkey start wearing the head scarf anywhere they want, it could usher in a more religious society, hinder modernization and reverse gains made by Turkish women over the years. They scoff at Ms. Cifci and others who have framed the head scarf issue in terms of women's rights.

"This is a very ugly trick they are using," Ms. Arin says, adding their real motivation is to create a strict Islamic society.

In a 2007 Gallup survey, 45% of Turkish women polled said they wore a head scarf in public. In the same poll, 66% of Turks (both men and women) said they associated the head scarf with "being religious," but 38% of respondents also

associated it with "freedom," while 26% saw it as a sign of "oppression."

A legal row over the ban earlier this year triggered the political crisis, destabilizing financial markets and threatening early elections. In February, the popular and conservative ruling AK Party proposed an amendment to the constitution that would lift the ban on head scarves in universities. The opposition accused the party of having a hidden Islamic agenda and mounted a legal attack seeking to ban the party.

Eventually, the country's high court threw out the AKP's proposed amendment and, in a separate hearing last month, cut off part of the party's government funding. It refrained from banning the AKP.

The Islamic holy book Quran says that women should be modestly covered, without specifying how. Differing interpretations of Islamic texts have come up with a wide range of coverings for women. In stricter societies such as Saudi Arabia, the law is on the other side of the head-scarf debate, and women wear a head-to-toe, cloak-



Esra Cifci says a woman should be free to express her religious devotion as she wishes and wear what she likes.

like black slip that covers even their faces. In countries such as Iran, the hair and body are covered while the face remains in plain view.

Turkey's secular laws were enshrined by the founding father of the republic, Mustafa Kemal Ataturk, who believed religion was a hin-

drance to progress and modernization. In 1997, following a military coup, a longstanding ban on head scarves on campus and in government buildings began to be more strictly enforced; ultimately, it took hold nationwide. Conservative Muslim women in great numbers left educational establishments and the work force.

In 1999, Ms. Cifci co-founded a women's rights organization called Ozgur-Der with a group of like-minded female friends. The group advocates allowing conservative women to wear head scarves on campus. Over the past 10 years, scores of similar associations have been set up.

Ms. Cifci was in her second year of graduate studies at the University of Marmara in Istanbul when the school enforced the ban in 2003. An honors student on full scholarship, she had gone through high school and college covering her hair with no problem.

For Ms. Cifci, the ban was an end to many dreams. She was set to become the first female in her family

to obtain an advanced degree. She wanted to become a teacher and be financially independent of her father and husband.

"My mother tried very hard to convince me to take off the scarf and go on with my studies and work, but if I wore a hat or a wig, I would solve my problem, not the issue. I decided to fight," says Ms. Cifci, soft-spoken and pale-skinned. She was ejected.

Today, Ms. Cifci is married, with a 2-year-old son. She writes a monthly column in a political magazine, Hak-soz, and prepares reports and news releases, which she fires off to members of Parliament, local news media and international organizations.

Ozgur-Der has branched out to promote the rights of ethnic minorities and the humane treatment of political prisoners. It has over 1,000 active members and 12 branches around the country. In addition to advocacy, the centers offer continuing-education classes taught by ousted professors to further the intellectual growth of ousted female students, as well as workshops on law and human rights and reading groups.

"Banning women from school and employment is a backward mentality. It will marginalize young women and make them dependent on male figures in the family," Ms. Cifci says. "It's not fair."

Data fuel recession jitters; inflation pressures ease

BY EMMA CHARLTON

LONDON—More evidence of slackening economic activity increased the chance of the euro zone slipping into recession this quarter, while officials warned the downturn could be worse than the 2001 economic slowdown.

But there was also some good news, as initial signs emerged that the stalling economy and the recent decline in oil prices are beginning to curb inflationary pressures.

Business activity in the 15-country euro zone contracted for a third straight month in August, a survey of about 5,000 euro-zone purchasing managers showed Thursday.

The preliminary estimate of the

composite purchasing-managers index for the euro zone rose in August to 48 from 47.8 in July, beating expectations but still signaling a contraction, data from research group Markit Economics showed.

A reading above 50 signifies an expansion in activity, while a level below 50 shows a contraction.

The latest index already suggests that euro-zone gross domestic product will shrink 0.1% in the current quarter after a decline of 0.2% in the second period, said Jonathan Loynes, an economist at Capital Economics.

"With virtually every index below the 50 boom/bust line, it looks like most sectors and countries in the euro zone are contracting," he

said.

Many economists think the euro-zone economy is heading for a technical recession, defined as two consecutive quarters of declining output.

European Central Bank Governing Council member Nout Wellink said in an interview with Dutch financial newspaper Het Financieele Dagblad published Thursday that the current economic crisis is worse than the unwinding of the dot-com boom, which prompted a sharp slowing in European economies in 2001.

"Then it concerned only one sector. Now it touches the heart of the entire financial system," Mr. Wellink was quoted as saying. But he said he was skeptical about lowering interest rates as a way of stimulating the

economy and about providing a U.S.-style budgetary stimulus.

The bank chose not to follow many other major central banks in lowering interest rates as the credit crisis took hold, instead raising rates in July to stem inflationary pressures.

Early signs emerged Thursday that those price pressures might have peaked, with the PMI input- and output-price indicators both easing. Input-price inflation, or what producers pay for materials, slowed markedly in August. Output-price inflation fell to its lowest level since February, as producers competed on prices to win sales amid slack demand.

ECONOMY & POLITICS

Pakistan violence grows

Bombers kill workers at munitions factory as militancy worsens

BY ZAHID HUSSAIN

ISLAMABAD, Pakistan—Two suicide bombers killed at least 59 workers outside Pakistan's main munitions factory about 20 miles from the capital in a sign of how the Islamic militancy is worsening even as Pakistan's military intensifies a campaign against it.

The bombers struck simultaneously at two gates where hundreds of workers were leaving the facility, located in Wah, a garrison town. Some 67 were wounded.

Maulvi Umar, a spokesman for Tehrek-e-Taleban Pakistan, an outlawed militant group that supports al Qaeda, claimed responsibility for the attack in a statement. He said it was revenge for military airstrikes earlier this week in Bajur, a militant stronghold near the Afghan border. According to Pakistani and Western intelligence agencies, the Bajur tribal region has become the main center for al Qaeda and Taliban activities in Pakistan.

Mr. Umar said militants will carry out similar attacks in other major cities, including Islamabad, unless the military halts its operations. Islamabad and other major cities are now on high security alert.

It was the second attack by the Taliban militants this week. More than 35 people were killed Tuesday in a bombing at a government hospital in Dera Ismail Khan, a town in North West Frontier Province.

Security officials say more than 500 militants and around 30 soldiers have been killed during nearly two weeks of fighting in Bajur. Thou-



The violence presents a huge challenge to Pakistan's government, which is in disarray following the resignation of President Pervez Musharraf Monday.

sands of troops backed by helicopter gunships are involved in the operation. Jet fighters bombed suspected militant hideouts in the area on Wednesday. The fighting has forced more than 100,000 people to flee the area for safety.

The escalating violence presents a huge challenge to Pakistan's government, which is in disarray following the resignation of President Pervez Musharraf Monday. The two main parties in the ruling coalition are at odds over whether to restore judges Mr. Musharraf sacked last year. The parties are expected to discuss the issue again Friday. Former Prime Minister Nawaz Sharif, leader of the junior partner in the coalition, has threatened to withdraw support from the government if there is no agreement to reinstate the judges Friday.

The U.S. is watching the situation closely. President George W. Bush called Yousuf Raza Gilani, Pakistan's prime minister, Thursday to

express his sympathies for the victims of the terrorist attacks and affirm U.S. support for the campaign against the extremists, according to a White House statement. Mr. Bush also called Mr. Musharraf to wish him well, it added.

The complex attacked Thursday, near the city of Taxila, is a cluster of about 20 industrial units producing artillery, tank and antiaircraft ammunition for the Pakistan armed forces. It employs around 30,000 workers. A senior police official said the bombers blew themselves up after failing to get inside the gate.

Witnesses said there was a massive explosion. "All around the gate I saw blood and human flesh," said Rana Tanveer, who was working at a bank about 200 meters from one of the gates where a bomber struck.

Police arrested three suspects allegedly involved, including a prospective bomber who was trying to flee.

Pakistan's military chief wants army out of politics

BY ZAHID HUSSAIN AND PETER WONACOTT

ISLAMABAD—With militant violence rising, the Pakistani government in disarray and Pervez Musharraf no longer president, the future of Pakistan rests increasingly on Gen. Ashfaq Kayani, the nation's army chief.

So far, the 56-year-old career soldier, who took over from Mr. Musharraf as head of the military late last year, has struck a fine balance through the political crisis that included Mr. Musharraf's resignation Monday.

Gen. Kayani made it clear that the army didn't want to be dragged into the political fray—which has happened repeatedly during political crises in the past—and he was lauded by the public and politi-



Ashfaq Kayani

cians for staying in the background. Yet after Mr. Musharraf announced his departure, he inspected an honor guard at his residence in Islamabad and is under army protection in Rawalpindi, a garrison town that is the headquarters of Pakistan's military. "It was a 'hands off' signal to the civilian politicians," said one army official.

In coming weeks, Mr. Kayani may have to engage in more balancing

mier spy agency, which spearheads the hunt for al Qaeda militants as well as providing internal security. It also has been accused of having a hand in terrorist attacks abroad, most recently the suicide bombing of the Indian embassy in Kabul last month, which killed dozens. Pakistan denies any involvement.

Gen. Kayani is known for being a man of few words. But on occasion he invites small groups of newspaper editors and columnists for late night discussions on topics ranging from politics to terrorism to extremism. In a recent chat, he made clear his view of the militancy. "We have to defeat them decisively," he said.

The militancy is taking an increasing toll on Pakistan's troops and denting the image of the army. Gen. Kayani has spent much of this year trying to rebuild morale, according to Hasan-Askari Rizvi, author of a book on Pakistan's military. He has improved housing facilities, boosted rations and declared 2008 "The Year of the Soldier," a public-relations campaign meant to highlight the positive role the military plays in Pakistan.

The army's image also is improving as it reduces the political interference it was long known for. Army

The militancy is taking an increasing toll on Pakistan's troops and denting the image of the army. Gen. Kayani has spent much of this year trying to rebuild morale.

acts if he wants the army to remain outside of Pakistani political life.

Pakistan's ruling coalition is on the brink of collapse as the two main parties continue to disagree over whether to reinstate judges fired by Mr. Musharraf last year. Pakistan is facing demands from the North Atlantic Treaty Organization, the Afghan government, and its own people to do more to eliminate militant violence in Pakistan and neighboring Afghanistan. Insurgents claimed more than 70 lives Thursday when two suicide bombers blew themselves up outside a military weapons complex about 32 kilometers from Islamabad. If the situation doesn't improve soon, Gen. Kayani may face extreme pressure to intervene.

"His future role will be in proportion to the performance of the civilian government," said Talaat Masood, a retired general and former secretary of defense production. "The vacuum has to be filled if civilian rule fails."

Neither a military spokesman nor Gen. Kayani could be reached for comment.

The son of a soldier, Gen. Kayani received his commission in the Pakistani army in 1971. His father died while Gen. Kayani was training at the military academy, putting the burden on him to support his family; he is the eldest of four brothers. He received some training with the U.S. army at Fort Leavenworth, Kan., in 1987 and, as a three-star general, was named commander of the prestigious Rawalpindi Corps in 2002.

In 2004, he became head of Inter-Services Intelligence, Pakistan's pre-

intelligence agents in the past sought to manipulate elections, said Asad Durrani, a retired lieutenant general and former ISI chief. As the army gains in popularity by focusing on fighting, "Why would we want to risk that by getting involved again?" Mr. Durrani said.

Pakistan's leading politicians also have little interest in seeing the army reassert itself. "I'm against any army's involvement in political affairs," said Nawaz Sharif, leader of the junior partner in Pakistan's fractious coalition. As prime minister in 1999, he was overthrown in the coup that brought Mr. Musharraf to power.

The army and the ISI retain huge influence over Pakistan's foreign policy and security considerations ripple through diplomacy, economic policy and other government decisions as the country tries to hold itself together. Efforts to suppress the militancy emanating from the border region with Afghanistan, as well as a separatist movement in the province of Baluchistan, are intertwined with basic government initiatives such as poverty alleviation and the allocation of gas and other resources, said retired Brig. Javed Iqbal, former military secretary in Mr. Sharif's government and a classmate of Gen. Kayani's at the Pakistan Military Academy.

Mr. Iqbal said Gen. Kayani is sincere in his desire not to get involved in politics but may be dragged in anyway. "It's going to take time for Pakistan to strengthen its political institutions," he said. "Whether they like it or not, the army is part of the decision making."

U.S. voters back offshore oil drilling

BY STEPHEN POWER

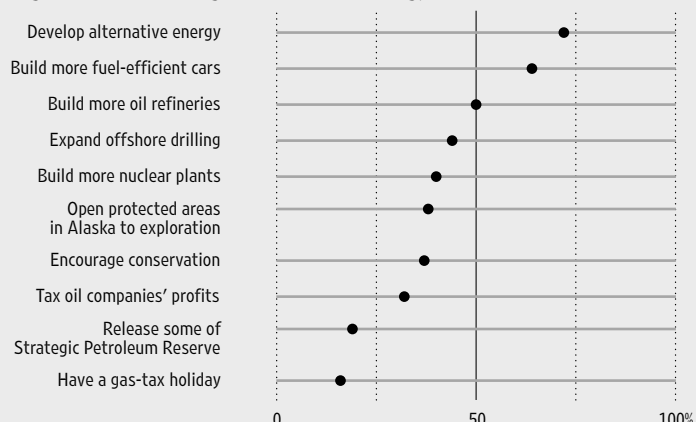
WASHINGTON—U.S. voters are crying out for more solar and wind energy—but that doesn't mean they are opposed to drilling for more oil at the same time, according to a Wall Street Journal-NBC News poll.

The poll's findings suggest any political advantage Democrats or Republicans hope to get from the national debate over energy policy will depend on how skillfully they package their positions. Democrats have opposed expanded offshore drilling and stressed alternatives to oil. Republicans have called for expanding oil exploration to areas currently off limits. Leaders in both parties have begun scrambling for ground somewhere in the middle, where a big chunk of voters appear to stand.

According to the Journal-NBC poll, 72% of the respondents said developing alternative energy sources could "accomplish a great deal." When the question was asked another way, 61% of respondents chose "developing alternative energy sources" as the step that should receive the most emphasis from policy makers. Twenty-five percent responded that "exploring and drilling for oil" in the U.S. should get the most emphasis, and 12% picked "having Americans

Energy strategies

Percentage of voters who say each of the following will accomplish 'a great deal' in dealing with America's energy needs



Source: WSJ/NBC News telephone poll of 503 registered voters conducted Aug. 15-18; margin of error: +/- 4.4 percentage points

conserve and use less oil."

When asked whether expanding areas for drilling for oil off coastal states was a step in the right direction, 63% said it was, with 44% saying it would accomplish "a great deal." Only 27% said that allowing more drilling off coastal states was a step in "the wrong direction."

Asked about building more nuclear plants, 53% said it was a step in the right direction. Thirty-one

percent said it was a step "in the wrong direction."

"Voters are telling us they want everything," said Neil Newhouse, a Republican who conducts the poll with Democrat Peter D. Hart. Mr. Hart said the results indicate that the current energy debate between Republican presidential candidate John McCain and his Democratic rival, Barack Obama, "is not the fight that the American public cares about."

ECONOMY & POLITICS

Red Cross debt puts preparedness in doubt

Charity tends to live 'hand to mouth'; storm season peaks

BY MIKE SPECTOR

As hurricane season nears its peak, the American Red Cross's disaster-relief fund is nearly empty, and it has been borrowing money to help victims.

The Red Cross is still the charity of choice for many Americans when calamity strikes. But its fund-raising model of living from disaster to disaster no longer works well in a world where other charities constantly are competing for donor dollars. In addition, a series of scandals and management changes have created a credibility problem at the 127-year-old institution.

"For the last year in particular, we've been living hand to mouth," says Joseph Becker, the Red Cross's senior vice president for preparedness and response.

The Red Cross is currently running a \$200 million deficit. It may have to borrow \$4 million to help recent victims of Hurricane Dolly, though a spokesman says donations may cover the cost. That is after raising \$30 million in recent months to pay back loans for responses to tornadoes, floods and wildfires. Earlier this year, the charity cut 1,000 jobs.

Gail McGovern, a former top manager at AT&T and Fidelity Investments, took over as the Red Cross's CEO June 23. Her predecessor, Mark Everson, a former Internal Revenue Service commissioner, resigned six months into his term after acknowledging an affair with a subordinate.

In an interview, Ms. McGovern said she has already started visiting wealthy donors. "We just need to do steady fund raising. I believe we're just now getting traction with programs that get us off episodic fund raising," she said.

Previous Red Cross leaders with similar goals have been stymied. The Red Cross caught flak for how it responded to victims of the Sept. 11, 2001, attacks and Hurricane Katrina. For years, the Food and Drug Administration has flagged problems with the charity's blood supply. Since 1999, seven people have led the Red Cross.

Donations fell to \$705.7 million in the year ended June 30, 2007, after reaching \$3.2 billion the previous year because of Katrina. Officials say donation growth in the year ended June 30, 2008, was flat at best.

The broader economic climate isn't helping. Charitable giving in the U.S. in 2007 rose a meager 1%, adjusted for inflation.

Other relief charities, including the Salvation Army, AmeriCares and World Vision, have increased donations by building a large network of regular donors, large and small. Many of these groups do international relief work and can draw U.S. donations during big disasters such as the Myanmar cyclone. The American Red Cross typically doesn't raise money for foreign disasters.

Clara Barton founded the American Red Cross in 1881. Congress chartered the charity in 1905, mandating that it support the U.S. military and provide disaster relief. Over the years, the Red Cross has added blood collection—it controls 43% of the nation's blood supply—and health and safety classes to its activities.

One issue that has dogged the

Red Cross is the relationship between its headquarters and its 741 chapters, many of which act with some autonomy in fund raising and responding to local disasters. In the latter half of 2002, an official at the Red Cross's Atlanta chapter told headquarters to stay away from Coca-Cola Co., a big donor the chapter liked to tap for its own money, according to people familiar with the situation.

Some months later, a local chapter outside New York put only first names on name tags during a fundraiser, fearful that national officials in attendance might raid its donor base, people familiar with the matter said.

"It is not uncommon in large non-profits with many chapter offices for there to be occasional differences as to which office should en-



The Red Cross uses a fund-raising model of living disaster to disaster. Above, a woman talks with a Red Cross worker after an ice storm in Oklahoma last year.

gage in managing donor relationships," Jeffrey Towers, the Red Cross's newly hired fund-raising chief, said in a statement. "But the

Red Cross enthusiastically embraces the importance of stewarding donors cooperatively and collaboratively between all offices."



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DOW JONES

REVIEW & OUTLOOK

London's Terror Bank

In the war on terror, the U.S. has had no greater friend than the United Kingdom. But even as the U.K. stands with the U.S. in rallying the world against doing business with Tehran, an Iranian bank with a history of financing terrorism continues to operate in London.

On September 8, 2006, the U.S. Treasury announced it was cutting off all direct and indirect ties to the U.S. financial system for Iran's Bank Saderat, given the bank's history of financing terrorism. Treasury's press release did not mention the United Kingdom, but an October 2007 Treasury report connected the dots.

From 2001-2006, the London subsidiary of Bank Saderat transferred \$50 million from the Central Bank of Iran via a Bank Saderat branch in Beirut to front groups for Hezbollah. Hezbollah also has used the bank to funnel money to other terrorist organizations such as Hamas. Almost two years after the U.S. cut off Saderat's access to American finance, and close to a year since the Bush Administration diagrammed the electronic money trail from Tehran to terror via London, Bank Saderat PLC continues to do business in the U.K.

In March, the U.N. Security Council im-

posed its third round of sanctions against Iran for its refusal to halt its nuclear weapons program. Included in the sanctions package was a warning to all countries "to exercise vigilance" on transactions with all Iranian banks, but especially Bank Saderat and Bank Melli, due to the risk that such transactions could support illicit nuclear activities. A June 14 statement by the G-8 finance ministers also singled out Saderat and Melli as rogue banks.

Better late than never, on June 23 the European Union imposed tough sanctions, including an asset freeze—but only on Bank Melli. The penalty was richly deserved. Melli is Iran's largest bank, and according to Treasury, "through its role as a financial conduit, Bank Melli has facilitated numerous purchases of sensitive materials for Iran's nuclear and missile programs."

Treasury further notes that Melli is the banker to Iran's Revolutionary Guards Corps and the Qods force. During the period 2002-2006, Bank Melli was the conduit for more than \$100 million sent to the Qods force. This is the outfit,

you'll recall, that provides weapons, money and training to insurgents trying to kill U.S. soldiers in Iraq and Afghanistan. The U.K. has not revoked the license of Bank Melli's London subsidiary, but the EU sanctions have left the bank largely unable to conduct new business.

The same cannot be said for Bank Saderat. The bank's subsidiary continues to operate in London, while Saderat branches exist in France, Germany and Greece. The latter three countries aren't known as the most helpful of America's allies, although France has worked closely with U.S. intelligence agencies.

The U.K. policy is more of a puzzle. Just this month, the Brits joined with U.S. and French officials in sending a letter to the U.N. Security Council warning against "Iran's continued attempts to conduct prohibited proliferation-related activity and terrorist financing." The letter said that Iranian banks were acting to evade financial sanctions. Given that Bank Saderat PLC has been precisely the mechanism to get money to terrorists, it's hard to understand why the rogue finan-

cial institution still enjoys a home in London. Perhaps the Brits are wary of damaging London's reputation as a global financial center, and losing an advantage over New York. If there's another explanation, we haven't heard it; Her Majesty's Treasury in Britain declined comment when we called. In any case, we're told by a senior U.S. source that other countries are beginning to ask why they should cut Iranian banking ties if such business can still be conducted in London. Iranian Banks Sepah and Persia International, which have also been the target of U.S. sanctions, are also still operating in the U.K.

British action could be particularly beneficial now, as the policy of isolating Iran from the international banking system appears to be putting genuine stress on Mahmoud Ahmadinejad's government. Almost all of the world's commercial banks have ceased doing business with Iran, making even routine trade a logistical challenge. It's not a coincidence that Iran's economy has been struggling even amid an oil boom, or that internal dissent against the Iranian government is increasing.

Further help from America's best anti-terror ally could be critical in forcing needed change in Tehran.

Our British friends let the Iranians stay in business.

Beijing, the Olympics and Our Writer

As China puts on a great Olympic show for the world, the realities of everyday Chinese life have received little public attention. China promised free access for foreign reporters during the Games. But journalists who report on issues that Beijing would prefer to bury can meet resistance, as our Leslie Hook found out this week while reporting on land disputes.

On Wednesday, the day her op-ed ran in the Journal Asia, Ms. Hook received threatening phone calls from a man who refused to identify himself and asked repeatedly where she lived. "My name is Tang," he said, giving only his last name. "I

tried calling you yesterday but your phone was off. Where do you live?" Ms. Hook asked whether she had met him. "You haven't met me, but you know what I do."

He then asked about Wang Yuying and Wang Yuping, two women profiled in her article. He called again several hours later demanding to know whether Ms. Hook had met them. "Tang's" purpose was clearly intimidation.

Such incidents are not uncommon, and the phone calls to Ms. Hook are minor compared to the harassment that other foreign journalists have experienced. They pale beside the treatment accorded Chinese journalists, who can lose their jobs, and their liberty. Local media often won't touch land-

dispute cases for fear of reprisal.

The Foreign Correspondents Club of China has recorded numerous examples of intimidation during the Olympics: A reporter and two photographers were detained in Xinjiang; two Scandinavian journalists were followed in Beijing; a photographer trying to take pictures of a Tibet protest in Beijing had his camera damaged.

Most at risk, though, are the Chinese who cooperate with reporters. As in Ms. Hook's article, these are often ordinary people like the Wang sisters who dare to come forward with charges of official corruption. The sisters have been under 24-hour surveillance since July 20, and as Ms. Hook interviewed them in a public

space, several men who appeared to be plainclothes police walked by.

The Associated Press reports this week that two elderly women who applied for permission to express their grievances in an official protest zone were detained and sentenced without trial to reeducation through labor for one year. Like the Wang sisters, their complaint was that they had been forcibly evicted from their homes.

During the Olympics, Beijing has gone to great pains to show its best face to the world. But as Ms. Hook's experience shows, it's hard to unearth the real face of China without risk—to both reporters and the people whose stories they seek to tell.

Mess in Mindanao

In Southeast Asia's battle against terrorism, a flub in one country can have repercussions around the region. That's the danger in the Philippines, where Manila's strategy of negotiating with terrorists has come a cropper.

The Moro Islamic Liberation Front is a violent group that claims large swathes of the southern island of Mindanao as its Muslim homeland. Late last month, President Gloria Macapagal Arroyo announced a peace agreement that promised autonomy. But the deal started falling apart when the Supreme Court blocked it. The rebels responded by hacking or shooting 37 people to

death and forcing 44,000 more to flee their homes. Instability in Mindanao, with its sizable Muslim population and geographic proximity to Malaysia and Indonesia—along with Manila's sometimes loose military grip—make it an appealing destination for terrorists. Abu Sayyaf, which has links to al Qaeda, has a strong base there. Turmoil in Mindanao diverts military resources from other parts of the country, where Abu Sayyaf is also active.

Ms. Arroyo nevertheless conceded to the MILF's main demand: a large, largely autonomous "ancestral domain" encompassing broad swathes of Mindanao and including as many as 700 villages. If implemented, this reward for violent intimidation might well have stoked Muslim-Christian tensions by displacing Christians who have been living in the area, in some cases for generations.

Ms. Arroyo also botched the politics,

negotiating behind closed doors and surprising her countrymen with the autonomy agreement. When the final deal was announced, Catholic politicians challenged its legality before the Supreme Court, arguing that it is unconstitutional

What happens when pols negotiate with terrorists.

to carve out a new autonomous territory in this way. Ms. Arroyo said Wednesday the government will seek to renegotiate the deal.

By engaging in talks with the MILF, Manila has lost valuable time to beef up its policing in Mindanao to protect residents from what's effectively an unreformed gang. Even more seriously, the peace talks have lent the MILF the legitimacy it craves on the world stage. U.S. Ambassador Kristie Kenney, for instance, flew to Kuala Lumpur to witness the signing of the agreement, giving the appearance of a U.S. imprimatur on this peace process.

It's good news that Manila is finally re-deploying police and soldiers to Mind-

anao to tackle the immediate law-and-order problem. The violence is a tragedy for the people of Mindanao—and a danger for neighboring countries that may have to pick up the terrorist pieces in their own backyards.

Pepper . . . and Salt

THE WALL STREET JOURNAL



"Another unemployed English major."

On Taste

W14

■ The chef who spied. Noël Riley Fitch on Julia Child's OSS years.