Leading the News: Reports of fraud and intimidation undermine Afghan vote

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What's News

Lockerbie snags Britain

Questions arise over extent of U.K. government's role in bomber's release

By Alistair MacDonald And Spencer Swartz

LONDON—The political fallout from Scotland's release of the convicted Lockerbie bomber has spread through Britain, as questions arise about whether the U.K. government played a bigger role in the decision than it has publicly acknowledged.

The political stakes for U.K. Prime Minister Gordon Brown mounted after a son of Libyan leader Col. Moammar Gadhafi issued a statement this weekend thanking Mr. Brown's government for the "important role" it had played in the release of Abdel Basset al-Megrahi, and U.S. criticism of the decision took on a more strident tone, with one senior official saying it "makes a mockery of the rule of law."

Both Mr. Brown and the Scottish government have maintained that the decision to free Mr. al-Megrahi, the only man convicted in the 1988 bombing that claimed 270 lives, rested entirely with Scottish Justice Minister Kenny MacAskill. Mr. al-Megrahi, who has terminal prostate cancer, flew home Thursday to a hero's welcome after Mr. MacAskill released him on "compassionate grounds."

But in a statement on Saturday, Col. Gadhafi's son, Saif al-Islam Gadhafi, thanked "our friends in the British government who played an important role in reaching this day," saying he believed the decision would further improve relations between the U.K. and the oil-rich North African nation. A spokesman for the U.K. Foreign Office said the decision was Scotland's alone and had nothing to do with any trade deals between Britain and Libya.

Once a pariah state, Libya has in recent years improved its relations with the West, abandoning its pursuit of weapons of mass destruction and opening its oil reserves to exploration by companies from the U.K. and elsewhere. But its exuberant and widely televised welcome of Mr. al-

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Massive wildfires outside Athens threaten the capital

European Pressphoto Agency

GREEK FIRE: Volunteers battle blazes in Pallini, 10 kilometers north of Athens, on Sunday. Athenians worked with firefighters to control fires that raged for a second day and threatened to spread to heavily populated areas.

Fed talks take aim at threat of deficits

By Jon Hilsenrath

JACKSON HOLE, Wyo.—Central bankers don't make decisions on taxes and government spending, but fiscal policy was a major focus of this year's U.S. Federal Reserve conference here in the Grand Tetons.

Three questions drew attention at a Saturday session at the conference, which drew central bankers from around the world, Wall Street economists and academics: Are deficits a threat that needs more attention? How well is the Obama administration's fiscal stimulus plan working? And is more stimulus warranted?

Money matters

Large long-term deficits could cause "serious economic disruptions," said economist Alan Auerbach of the University of California at Berkeley, who co-wrote a paper presented here with William Gale of the Brookings Institution, a Washington think tank largely populated by Democrats.

Over the next decade, they estimated, the U.S. budget deficit will add up to $10 trillion, and possibly more. Credit mar-

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Early bulls turn tail on U.S. stocks' value

By Mark Gongloff

It feels good to be right. But the few analysts who accurately called the U.S. market's bottom in early March aren't feeling so great about where stocks are headed.

One of the most famous of this group, Jeremy Grantham, penned a note on March 10 entitled "Reinvesting When Terrified" that encouraged investors to buy, suggesting that stocks were 30% undervalued.

Since then, the market has roared ahead, without stopping for a correction of 10% or more. The Standard & Poor's 500-share index ended last week at 1026.13, up nearly 52% from its 12½-year low on March 9 and its highest close since Oct. 6. The Dow Jones Industrial Average is at 9505.96, up 45% since its March low.

Now, the chairman of Boston asset-management firm GMO and his colleagues say the S&P 500 has zoomed right past what they consider fair value of about 880, based on earnings estimates and historical price-to-earnings ratios.

Mr. Grantham sees "seven lean years" of a sluggish market ahead, to atone for what the firm believes was a long era of overpriced stocks, according to his newsletter.

"The past 12 years have seen two bubbles that were really good for corporate profits," says Ben Inker, GMO's director of asset allocation. "Now things are unlikely to be anywhere near as good as people

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Inside

Spy tale

Authorities probe a web of intrigue at Deutsche Bank
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Markets

	CLOSE	PCT CHG
DJIA	9505.96	+1.67
Nasdaq	2020.90	+1.59
DJ Stoxx 600	234.85	+2.26
FTSE 100	4850.89	+1.98
DAX	5462.74	+2.86
CAC 40	3615.81	+3.15
Euro	$1.4299	+0.44
Nymex crude	$73.89	+1.34

THE WALL STREET JOURNAL.

LEADING THE NEWS

North Korea shifts course

Conciliatory steps taken as officials extend stay in Seoul

North Korean dictator Kim Jong Il sent a conciliatory message to South Korean President Lee Myung-bak on Sunday, in the latest action by North Korea that appears to reverse months of antagonistic behavior.

*By **Evan Ramstad** in Seoul and **Jay Solomon** in Washington*

The message, conveyed orally by senior North Korean officials visiting Seoul for memorial ceremonies for former South Korean President Kim Dae-jung, concerned cooperation between the two Koreas, a spokesman for Mr. Lee said.

The North Korean delegation surprised South Korean officials by extending their planned one-night stay by a night and asking to meet top government officials. For more than a year, North Korea has refused most contact with the South's government. Even in preparing for the delegation's trip, it initially negotiated with associates of former President Kim—the author of the "Sunshine Policy" that resulted in billions of dollars in unconditional aid going to the North—before involving current government officials.

The outreach marked Kim Jong Il's first official recognition of Mr. Lee, whom North Korea has disparaged and shunned since he took office 18 months ago. North Korea has been upset that Mr. Lee placed a major condition on several hundred million dollars worth of economic assistance from the South: that the North show progress in ending its nuclear-weapons program.

Mr. Kim's message came after several other steps this month, including the release of two U.S. journalists and a South Korean businessman detained in the North since March, that reduced the perception of tension and animosity emanating from Pyongyang.

Diplomats from the U.S., the United Nations and elsewhere have praised North Korea's recent steps. But they also say the North's need for money is behind them, and they're trying to figure out how strong a hand it has.

On one hand, North Korea might now be in a defensive position, feeling pressure from economic penalties that the U.N. Security Council and many countries imposed in the wake of its weapons tests earlier this year.

But another possibility is that North Korea may be repeating a pattern of provocation and negotiation it has used to get money since the collapse of its longtime benefactor, the Soviet Union, 20 years ago. North Korea has often used the start of a new presidential administration in the U.S. or South Korea to launch a period of bad behavior, followed by calls for talks and the solicitation of rewards for ending the provocations.

An added complication is the prospect that Kim Jong Il's health is playing a role in North Korea's actions. The North Korean leader is widely believed to have suffered a stroke a year ago; negotiations over the country's nuclear-weapons program broke down shortly thereafter.

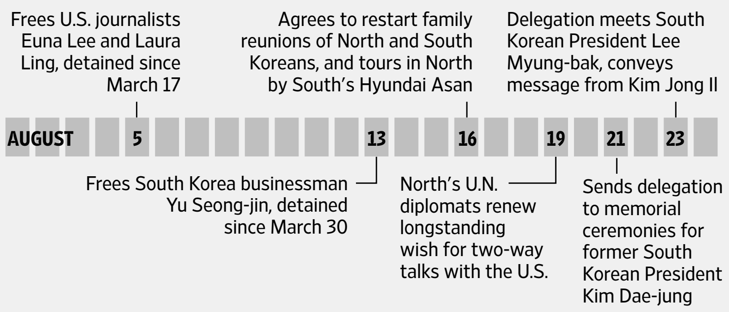
In the succeeding months, North Korea pursued an increasingly hard-line stance toward the international community, testing a nuclear device and a string of long-range missiles.

More recently, diplomats have come to believe Mr. Kim is firmly back in control of Pyongyang's decision-making apparatus.

Some also say Mr. Kim is seeking to rebuild Pyongyang's relationship with the U.S.

August relaxation

North Korea has taken steps this month to defuse tensions created by its weapons tests earlier this year.



South Korean President Lee Myung-bak (right) with North Korean envoys on Sunday.

Iraqi officials showcase new oil fields for auction

By Chip Cummins And Hassan Hafidh

Iraqi officials, smarting from a disappointing oil-license auction in June, will showcase this week a second set of fields that they hope will garner more interest from international companies.

While oil executives have wanted to enter Iraq's giant and relatively unexplored fields since the U.S.-led invasion in 2003, they mostly passed on the first opportunity earlier this summer.

In late June, Iraqi officials attempted to auction rights to boost output at a number of fields that were already producing. Oil companies complained the terms Iraq's oil ministry demanded were too tough, and mostly walked away. Only one field was awarded, to a consortium headed by **BP** PLC and **China National Petroleum** Co.

This time, Iraqi officials are dangling the opportunity to work in undeveloped fields, a potentially more attractive offer. Iraqi officials said Sunday that 45 companies have prequalified to bid on the contracts.

Iraqi Oil Minister Hussain al-Shahristani and other top oil officials plan to meet executives on Tuesday in Istanbul, for a road show of the fields expected to be part of the auction. Iraqi officials have prepared presentations on the fields and are expected to meet prospective bidders. Mr. Shahristani plans to hold a news conference in Istanbul after the event.

Contracts are expected to be structured as 20-year deals, in which companies agree to produce oil from the fields in exchange for a per-barrel fee. Those aren't typically attractive terms for international oil companies, which generally prefer to take ownership of some of the oil they produce. But Iraq's parliament still hasn't passed a petroleum law that would establish the legal groundwork for such deals.

In the next auctions, which the oil ministry said will take place before the end of the year, Baghdad is offering a number of potentially giant, untapped fields.

A new challenge has emerged for Iraqi oil officials: convincing executives that security has improved, despite a spate of recent bombings, including attacks in Baghdad that left more than 100 dead last week.

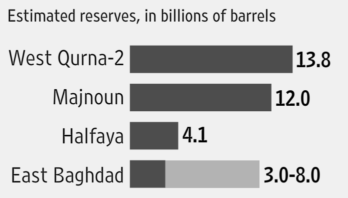
"The security issue was a major factor in why we demanded a higher compensation threshold for our work" in the first round, said an executive from a large international oil company. "And the ministry was deaf to this."

Iraqi officials said Sunday that in addition to providing details of the 10 new groups of fields on offer at their Istanbul road show, they may also shed light on what they plan to do with the fields that weren't awarded in June.

—Spencer Swartz in London contributed to this article.

On tap

Iraqi officials are previewing 10 groups of oil fields they would like to bid out by the end of the year. Here is a look at some of the biggest:



CORRECTIONS & AMPLIFICATIONS

Under a new pricing plan, Bats Europe would give traders £4 for every £100,000 of business they send into the exchange's system. A Money & Investing article Thursday incorrectly said the rebate would be £4 for every £1,000.

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.

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INDEX TO PEOPLE

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

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

LEADING THE NEWS

Afghan election results face challenges

Monitors and rivals are reporting fraud; 'success' reconsidered

KABUL—Reports of fraud and intimidation from election-monitoring groups are mounting, undermining the legitimacy of Afghanistan's presidential vote and posing a challenge for the U.S. and its Western allies, who initially declared the vote a success.

By *Yaroslav Trofimov, Matthew Rosenberg* and *Anand Gopal*

Reuters

Afghans work amid stacks of ballot boxes at the Independent Election Commission in Kabul on Sunday.

A linchpin of the international community's strategy here, Thursday's election was supposed to shore up the credibility of the Western-backed Afghan government threatened by a spreading Taliban insurgency. Rolling back Taliban advances and reinvigorating Afghanistan's development are the key goals of President Barack Obama's administration, which has poured tens of thousands of additional U.S. troops into the country in recent months.

But now, as rivals of President Hamid Karzai allege widespread ballot-stuffing in his favor, the poll may have produced some unintended consequences. Allegations of fraud could end up eroding Afghanistan's stability, fracturing the part of the Afghan society that is opposed to the Taliban—and making it even more difficult to contain the insurgency, say those tracking the election.

"The Obama administration's policy hinges on whether a legitimate leader emerges from this election," says Brian Katulis, a senior fellow at the Center for American Progress, a Washington-based think tank, who observed the Afghan vote. "Without a legitimate civilian leadership here you'll have a shaky foundation for the whole policy."

A partial preliminary vote count is expected Tuesday at the earliest, and it will be weeks before the final result is known.

Both President Karzai and his main rival, former foreign minister Abdullah Abdullah, have staked conflicting claims of victory. Both maintain they have won an absolute majority of votes in an election contested by dozens of candidates.

Afghanistan's electoral commission, which Dr. Abdullah accuses of siding with the incumbent, President Karzai, has refused to release partial results. Should any of the candidates fail to win an outright majority, a runoff is supposed to be held sometime in October.

Shortly after Afghan polls closed last week, President Obama hailed "what appears to be a successful election in Afghanistan despite the Taliban's effort to disrupt it." However, international observers inside Afghanistan have since provided a much more guarded endorsement, as reports of irregularities have arrived from the field.

The National Democratic Institute, which had more than 100 observers in Afghanistan, has highlighted "serious flaws" and said that only "aspects" of the election were in accordance with democratic principles.

Democracy International, another American observer group, cautioned that it is too early to judge whether the election is credible, and urged Afghanistan's electoral commission to conduct a "fair and transparent" vote count.

The Free and Fair Elections Foundation of Afghanistan, or FEFA, an independent monitoring group that dispatched nearly 7,000 observers to the polls, has found many instances of ballot-stuffing and of biased election workers across the country, said its director Jandad Spingar.

"Any attempts to deny the full extent of the flaws in this election would only serve to further disenfranchise the Afghan electorate," cautioned Rachel Reid, the Afghanistan-based researcher for Human Rights Watch.

Senior U.S. officials acknowledge that conspiracy theories are already swirling through the country. "There are always rumors in Afghanistan," Richard Holbrooke, the U.S. special representative for Afghanistan and Pakistan, said over the weekend in the Afghan city of Herat. "We've had disputed elections in the United States, and there may be some questions here. That wouldn't surprise me at all."

The criticism is prompting a bout of soul-searching among Western officials whose governments provide the indispensable military and financial backing to President Karzai's administration.

"It was unwise to say 'this was a good election' hours after the voting ended. We were short on facts and figures; there wasn't enough information about fraud," said a senior Western official who helped the Afghan government organize the vote. "We still don't have these answers. So saying it was a good, clean election, is premature."

Complaints about electoral fraud center on the insurgency-wracked south and eastern parts of the country, where many polling stations were empty because of Taliban attacks and threats to punish anyone who dared to vote. Daoud Ali Najafi, the chief electoral officer of Afghanistan's election commission, confirmed Sunday turnout was low in these provinces "with high security threats," and said that a nationwide estimate of 50% participation in the election would be "optimistic."

In the Wardak province south of Kabul, officials said that nearly all polling centers outside of district capitals had to be closed due to the violence. In Uruzgan province, only six out of 36 female polling centers opened, according to FEFA. The group said its observers witnessed the Taliban in the Kandahar province cut off the fingers of two voters. (Voters' fingers in Afghanistan were marked with indelible ink.)

All these areas are predominantly Pashtun, and have traditionally been a stronghold of President Karzai, an ethnic Pashtun himself. Low turnout by the Pashtuns is likely to bolster Dr. Abdullah, who is more popular in the ethnic Tajik northern and western parts of Afghanistan.

Dr. Abdullah said over the weekend that Taliban violence—which has driven voters and international observers away from the polls in the south—has made it easier to stuff ballot boxes with fictitious votes in favor of the incumbent. Dr. Abdullah added in an interview that only "big rigging" could prevent him from securing an absolute majority.

Hamed Elmi, a Karzai spokesperson, denied these allegations and said that the Abdullah campaign was guilty of vote-rigging itself.

Yet, the findings of some independent observers appear in line with Dr. Abdullah's claims. According to a confidential report made by members of one U.S. observer mission, ballot boxes from Kandahar and the Spin Boldak areas in the south—some of the worst insurgency flashpoints—are arriving at the electoral commission offices filled with 500 to 600 ballots each, indications of an exceptionally high turnout that doesn't square with eyewitness accounts of deserted polling stations.

Despite his complaints, Dr. Abdullah said he still has faith in Afghanistan's electoral process, which requires the results to be vetted by the Electoral Complaints Commission, an independent body presided over by a Canadian officer, Grant Kippen.

Mr. Kippen said Sunday his commission received 225 complaints about instances of voter intimidation, violence, ballot-box tampering and interference by Afghan election-commission officials. Among these complaints, 35 have been assigned a "high priority" status, he said, because they were deemed "material to the outcome of the election results."

Killings roil Pakistan Taliban's quest for new leadership

BY ZAHID HUSSAIN

ISLAMABAD — The struggle among the Pakistan Taliban's leadership intensified Sunday, as the militant group killed several people close to slain commander Baitullah Mehsud, Pakistani government officials said.

Among those killed, officials said, were Mawlvi Ikramuddin, the father-in-law of Mr. Mehsud, along with Mr. Ikramuddin's two sons and a brother. Taliban militants accused the slain individuals of tipping off authorities about Mr. Mehsud's whereabouts.

"According to our information they all have been killed," Rehman Malik, the federal interior minister, told reporters Sunday. The Taliban didn't claim responsibility for the deaths.

Several weeks ago, militants killed a driver of Mr. Mehsud, apparently following allegations that the driver had spied for the government. Also slain: Saadullah Mehsud, a medic treating Baitullah Mehsud, who suffered from a kidney ailment.

Baitullah Mehsud headed Tehrik-e-Taliban Pakistan, a disparate alliance of tribal militant factions. He was thought killed in South Waziristan this month, when a missile fired by a U.S. drone struck the house of Mr. Ikramuddin, the father of his second wife. Mr. Mehsud's wife was also believed killed in that attack.

Because the missile hit the house shortly after Mr. Mehsud's medic had departed, the Taliban also accused the medic, Saadullah Mehsud, of passing information to the authorities, according to a government official.

The news of the killing of Mr. Ikramuddin and others came a day after the Taliban announced it nominated Hakimullah Mehsud to succeed Baitullah Mehsud as chief of the TTP.

A TTP spokesman said a 42-member Shura, or tribal council, has elected Hakimullah Mehsud to succeed Baitullah Mehsud, who was described as in failing health. Taliban leaders insist that Baitullah Mehsud is still alive.

Hakimullah Mehsud, thought to be 29 years old, is known as a ferocious fighter. He was reportedly involved in a shootout with his rival, Wali Ur Rehman, during a Shura meeting called earlier this month to elect Baitullah Mehsud's successor. Mr. Rehman, a former spokesman for Baitullah Mehsud, was believed to have been injured in the exchange of gunfire.

Some Pakistan and U.S. officials say they believe Hakimullah Mehsud may have died in the shootout. "There's no question," said a senior U.S. intelligence official in the region, "He's dead. He was killed in the shootout. We've got no reason to doubt the [intelligence] we're seeing."

However, Pakistani journalists who say they recognize the rebel leader's voice say they spoke to Hakimullah Mehsud shortly after he was rumored to have been killed. No public evidence has emerged of his death.

Since Baitullah Mehsud's apparent death, the TTP has struggled to hold together its loosely grouped militancy. As Baitullah Mehsud's deputy, Hakimullah Mehsud earned a reputation as a ruthless enforcer of loyalty. Analysts said the election of the young and impetuous militant could accentuate divisions in the group.

"Hakimullah seems to have overpowered his rivals and managed to get himself elected through intimidation, but the tussle is far from over," said Mahmood Shah, a retired army brigadier and a former security chief in Pakistan's tribal regions. "His nomination could lead to bloody clashes between the rival factions," he added.

Hakimullah Mehsud's men have been blamed for attacking U.S. and NATO supply convoys traveling through northwestern Pakistan en route to Afghanistan. He has also claimed responsibility for the June bombing of the Pearl Continental hotel in Peshawar, and the deadly attack on the Sri Lankan cricket team in Lahore, Pakistan, earlier this year.

There is a $120,000 reward for information leading to Hakimullah Mehsud's capture or death, according to government officials.

A Pakistani security official said the struggle is also about money. The TTP controls millions of dollars, and supports about 3,500 full-time fighters. Part of the funds were managed by the slain Mr. Ikramuddin.

The funds came from domestic and foreign sources, a Pakistani security official said. In recent years, militants have also filled their coffers by robbing banks and kidnapping rich businessmen for ransom.

—Matthew Rosenberg in Kabul contributed to this article.

Bloomberg

GM chief Frederick 'Fritz' Henderson, above, backed a sale to Magna. But directors said an offer from Belgium's RHJ International should be taken more seriously.

Merkel hopes Opel deal will be resolved soon

GM board withholds its support for sale to Magna-led group

A WSJ News Roundup

German Chancellor Angela Merkel said **General Motors** Corp. needs to make a decision soon on the future of its Adam Opel division and that she hopes for progress in the coming week.

GM executives on Friday proposed a majority sale of Opel to Canadian auto supplier **Magna International** Inc. but failed to win the support of GM's newly appointed board, according to people familiar with the board meeting.

The board expressed reservations over the German government's funding plan that would aid Magna in its purchase of a majority stake in GM's European auto business, these people said. Continued ties with Opel, long a crucial player in GM's product development, is a critical cog in GM's plan to remain a global player.

"I very much regret that there hasn't been a final decision at GM," Ms. Merkel told ZDF television. "This would be urgently necessary for the employees and also for the economic situation at Opel."

German Economics Minister Karl-Theodor zu Guttenberg said Saturday that talks will resume this week with the U.S. and GM.

Chief Executive Frederick "Fritz" Henderson and top lieutenants had backed the Magna-led consortium, but Chairman Edward E. Whitacre Jr. and other board members argued that a competing offer from Belgian investment group **RHJ International** SA should be taken more seriously, the people familiar with the board meeting said.

Mr. Henderson's management team agreed to revisit the terms of any deal for Opel, including RHJ's bid, the people said. The split between the executives and GM's board highlights the greater scrutiny being employed by GM's directors, which had been considered a rubber stamp for GM's management prior to its June 1 bankruptcy filing.

The board is looking for more clarity on what the auto maker's strategy will be once control of Opel is ceded, the people familiar with the board meeting said. The board also wants specific details of Germany's commitment to financing Opel once it is separated from GM, they said.

GM and its European operation released statements saying a decision hasn't been made on Opel. Magna declined to comment.

The Magna-led consortium, which includes Russian savings bank OAO **Sberbank**, received backing from German politicians, who see the bid as more likely to keep jobs in Germany.

"All factual matters between GM and Magna were cleared up, and there is no justification for a postponement of the decision," Roland Koch, state premier of the central German state of Hesse, where Opel is based, said in a prepared statement.

German authorities would provide as much as €4.5 billion, or about $6.5 billion, in guarantees to fund any deal.

GM's European operations incurred a first-quarter loss of $2 billion and are being overseen by an independent trust with €1.5 billion in German government loans. A final decision on any sale will be taken by the trust in coordination with European and U.S. authorities.

'Zombie credits' rise in Europe

By Catherine Craig

The rise of "zombie credits"—highly leveraged companies left to operate in default by lenders—is raising concerns among analysts about the risk of another liquidity crisis when those loans come due.

In previous downturns, European banks were more likely to enforce lending terms, known as covenants, and forced leveraged-buyout companies to repay debt early, in some cases through a break-up of the business. Lenders wrote off debt in exchange for an equity stake or a fresh investment from a new or existing investor. This time, a shortage of inexpensive third-party capital and the potential for big losses when writing off debt is putting lenders off.

Instead, many are preferring to "waive covenants" and allow borrowers to continue operating with debt they can't service. "This is a big worry because no one has full transparency on lenders' exposures," said Neel Sachdev, a partner specializing in leveraged finance at law firm Kirkland & Ellis.

"Zombie credits occur where the business is operating in default, but the lenders are not enforcing covenants," Mr. Sachdev said. "At covenant-waiver meetings, it's as though there's a massive elephant in the room and everyone's ignoring it because they don't want to address the real issue of repairing company balance sheets."

Banks have no incentive to act because the only options are to either demand payment and make the company insolvent or to write down the value of the debt and crystallize their loss, he said.

Moreover, Basel II regulations require banks to hold capital based on the level of risk they ascribe to the loans they make. So declaring the loans less safe means banks must hold larger amounts of capital as security against them.

But by not restructuring the loans, banks may be putting off problems that could resurface simultaneously in a few years, analysts say.

"Most LBOs arranged in 2006 and 2007 at the peak of the market have loans which mature in 2013 to 2015," said Ed Eyerman, managing director for European leveraged finance at Fitch Ratings. "A lot of businesses are generating just enough operating profits to meet interest payments at the moment. But they won't have enough to pay off their debt when it comes due, so they will have to refinance."

Unlike the 2001-2002 downturn, when junior forms of debt typically suffered the most, the risk is growing this time that senior lenders, who take priority over other lenders when it comes to repayment, will lose part of their principal.

According to Fitch's estimates, recovery rates, or how much value can be salvaged from companies overloaded by debt, have fallen for the last nine quarters as the value of companies has fallen. The percentage of all senior debt rated by the agency that stood to lose at least 30% of its principal rose to 53% by June, it said.

Rising default rates among businesses frequently aren't being addressed through restructurings, weakening businesses' ability to grow and eventually meet loan repayments.

The percentage of triple-C rated leveraged buyouts, or businesses that are most likely to default on their loan interest and repayment obligations over the next 12 to 18 months, rose from 8% to 20% between December and July, according to Fitch, which covers about 75% of the European LBO market.

The figure rises to 37% if businesses rated single-B-minus, where the risk of default is present but a limited margin of safety remains, are included. This is equal to about 105 companies, valued at approximately €65 billion ($92.67 billion).

Jon Moulton, founder of U.K. private-equity group **Alchemy Partners** LLP, said accounting methods introduced since the 1990s have altered the way most European banks value their leveraged-loan portfolios, in a way that discourages them from restructuring the businesses.

In the 1990s, bank loans generally were held at "net realizable value," or the amount they would fetch in the prevailing market. That meant that restructurings resulted in a relatively small amount of pain for the banks in accounting terms, Mr. Moulton said.

Today, loans could legitimately be held on a bank's books "at cost," or their original value. Mr. Moulton said the difference between the realizable value of LBO loans held by European banks and their book value could be anything from £10 billion ($16.51 billion) to £30 billion.

As long as interest rates remain low, businesses can continue to operate and service their debts with relatively small amounts of cash, he said. Banks can keep businesses afloat by writing off small amounts of debt and waiving financial covenants.

The problem will come as interest rates start to rise, he said. Businesses already weakened by stifled commercial activity will face cash-flow crises.

—From Financial News

Criticism mounts of Iran cabinet picks

By Farnaz Fassihi

Iranian President Mahmoud Ahmadinejad is facing criticism of his cabinet nominees both at home and abroad, as the political turmoil in the country deepens less than a month into his second term.

Mr. Ahmadinejad introduced 21 cabinet nominees last week and, as the law stipulates, submitted the list to Parliament for a vote of confidence. Parliament said Sunday that it would review and vote on the cabinet over a three-day period starting Aug. 30.

The names drew harsh criticism, even from his allies, as soon as they surfaced. Some lawmakers said they were reluctant to approve the candidates because many lacked the appropriate skills and experience.

"It appears his choices for a cabinet are even weaker than the previous government. We are not obliged to vote for the president's list," cleric and lawmaker Mehdi Pour Fatemi told a semiofficial parliamentary news agency.

Mr. Ahmadinejad's pick of three women ministers—for the health, education and welfare, and social security portfolios—scandalized clerics in the holy city of Qum, who warned that there are limits to women's abilities. Women activists questioned the hard-line president's motives and charged that these female candidates would only push his agenda.

His choice for defense minister, Gen. Ahmad Vahidi, drew international condemnation. Mr. VahidI, who served as the commander in chief of the Quds Force unit of Iran's Revolutionary Guards, is one of five prominent Iranians wanted by Interpol for the bombing of a Jewish cultural center in Argentina in 1994. The attack killed 85 people.

Alaeddin Boroujerdi, an ally of the president who heads an influential committee in Parliament, told Iran's official news agency IRNA on Sunday that international pressure and accusations linking Mr. Vahidi to the Argentina attack would have no bearing on Parliament's decision to approve his nomination. Mr. Boroujerdi rejected accusations that Mr. Vahidi was involved in the bombing.

The choices for key ministries such as interior, intelligence, culture, oil and foreign drew criticism even from members of the president's own party, who said the picks indicated that Mr. Ahamdinejad wants ministers who completely submit to him, according agencies.

"The president wants to be the ruler in sensitive ministries. So he has introduced people whose major quality is that they are 'yes-men,' " conservative lawmaker Ali Motahari told Mehr News Agency on Friday.

Mr. Ahmadinejad's re-election in June has been shadowed by allegations of fraud. He now faces the most formidable grass-roots opposition movement the Islamic Republic's regime has yet seen.

Public anger has risen amid reports on opposition Web sites and in letters written by opposition leaders Mir Hossein Mousavi and Mahdi Karroubi of human-rights abuses at the hands of the government, including torture, rape, murder and mass burials of opponents allegedly killed by the government, either during protests or while in prison.

The government at first denied the accusations, but the widespread reports eventually forced Parliament to name a committee to investigate the charges.

According to reformist Web site nooroznews.ir, citing cemetery workers and some alleged victims' families, 44 unidentified corpses were buried on July 12 and 15 amid heavy security in unmarked graves in Tehran's Beheshte Zahra cemetery. The government has denied that, but as outrage mounts, lawmakers have asked for evidence to be submitted to them for investigation.

Mr. Ahmadinejad took the unusual step of appearing live on state-owned television last Thursday to defend his cabinet choices in a lengthy broadcast. As the screen showed pictures of each proposed cabinet member with bullet points listing his or her qualifications, the president reiterated the nominee's devout religious credentials and commitment to the Islamic Revolution.

On Saturday, Mr. Ahmadinejad didn't attend a meeting of the Expediency Council, a political arbitration body. His absence suggests a rift with the high-powered clerics on the council. The council is headed by one of Mr. Ahmadinejad's harshest critics, former President Ali Akbar Hashemi Rafsanjani, who stunned opposition supporters when he called for unity and harmony after the disputed June presidential election and urged Iranians to follow the orders of Supreme Leader Ayatollah Ali Khamenei.

CORPORATE NEWS

Toxic assets vex Natixis and its parent

Expected large second-quarter loss should make disposition of problem investments a priority, analysts say

By Jethro Mullen

PARIS—As toxic assets likely will force French bank **Natixis** SA to report a second-quarter loss, analysts say Chief Executive Laurent Mignon's first earnings report on Thursday would be an ideal time to announce measures to purge them from the balance sheet.

If he fails to do so, the bank will keep struggling to stanch losses that have driven it into the red in five of the last six quarters, making it one of the French banks hardest hit by the global financial crisis.

"The magnitude of Natixis' toxic and risky assets and the change of management at both Natixis and [parent bank] **BPCE** represent the opportunity to rid the group of its biggest risks," Credit Suisse analysts said in a note to investors.

There are a few ways Natixis could do that. One would be to carve out the most noxious elements and transfer them to BPCE, France's second-largest retail bank and the owner of 71.54% of Natixis. A second way would be to entrust the handling of some of the assets to external managers.

Some analysts have suggested Natixis could go further by seeking government help in a move reminiscent of the clean-up of the bad loans at Crédit Lyonnais SA 15 years ago. Analysts at Société Générale called it "an ideal solution." However, the French government appears reluctant to step in after already having pumped more than €7 billion ($10.04 billion) into BPCE and Natixis.

The most dangerous course would be for Natixis to soldier on without tackling the assets, analysts warn.

BPCE said in a filing with the French financial market regulator earlier this month that it may consider transferring some Natixis assets. A BPCE spokesman and a Natixis spokeswoman declined to elaborate on the subject ahead of the banks' joint press conference Thursday.

At the end of March, Natixis valued risk-weighted assets in a special portfolio of its least-appealing activities at €33.7 billion. The portfolio is intended to manage and sell off many of the synthetic products that became notorious during the financial crisis, including collateralized debt obligations, residential mortgage-backed securities, and complex derivatives.

Shifting the assets to BPCE, either by selling them at a discount or having BPCE guarantee them, would cost Natixis in the short-term, but leave it adequately capitalized for the future, the Credit Suisse analysts say.

That would allow Natixis to concentrate on developing its core businesses as determined by Mr. Mignon's strategic review, which he is to announce Thursday.

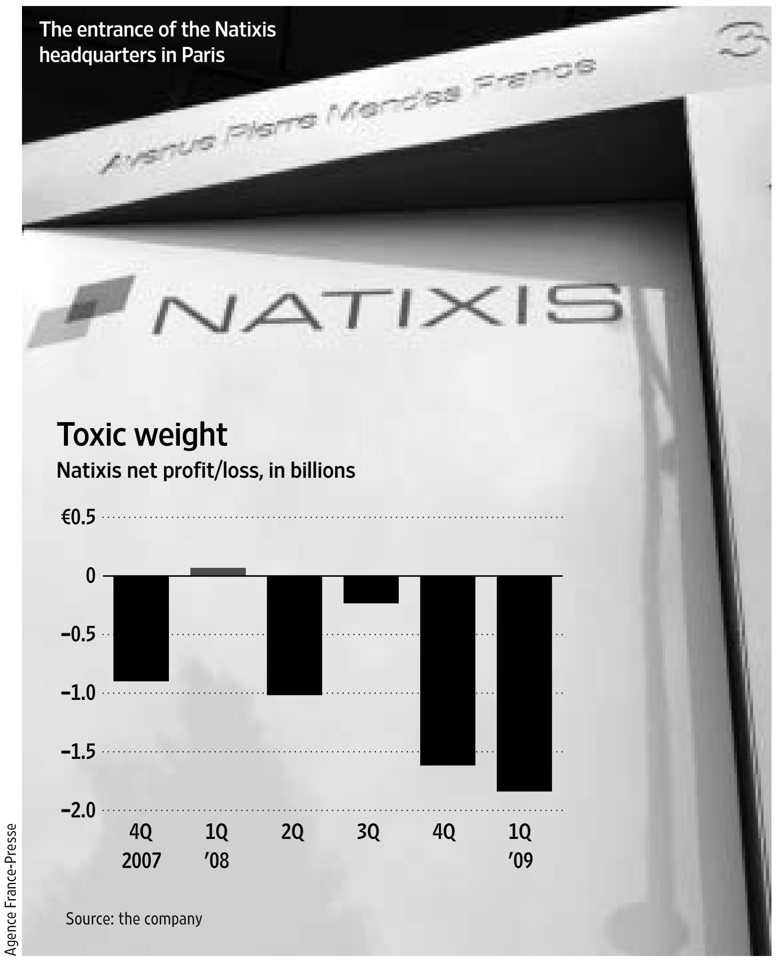
His strategy for the healthier part of the bank is likely to involve a closer integration of Natixis's activities with those of BPCE, a focus on businesses offering steady returns without excessive risk-taking, and further restructuring and cost cutting, analysts at Keefe, Bruyette & Woods said in a note to investors.

Natixis is expected to announce a net loss of €446 million for the second quarter, compared with a €69 million profit a year earlier, according to a poll of four analysts by Dow Jones Newswires.

The bank is the result of a 2006 merger of the investment-banking operations of Caisse d'Epargne and Banque Populaire with the intent of creating a European giant.

The French government has taken a deeper role in running Natixis and BPCE than it has with other French banks. François Perol, previously an advisor to President Nicolas Sarkozy, was parachuted in to handle the merger of Banque Populaire and Caisse d'Epargne into BPCE. He is now CEO of BPCE and chairman of Natixis. Mr. Mignon took up his post at Natixis in May.

The government holds 19.84% of BPCE's capital, has two representatives on the bank's supervisory board and in addition named two independent board members.



The entrance of the Natixis headquarters in Paris

Agence France-Presse

P&G to sell prescription-drug arm

By Jeffrey McCracken

Specialty drug maker **Warner Chilcott** Ltd. is expected to announce as early as Monday the acquisition of **Procter & Gamble** Co.'s prescription-drug business for more than $3 billion, say people familiar with the matter, a sign that the market for loans on more highly levered deals may be loosening.

Six banks, led by **J.P. Morgan Chase** & Co. and **Bank of America** Corp. and including **Credit Suisse Group** AG, **Citigroup** Inc., **Barclays** PLC and **Morgan Stanley**, are expected to put up as much as $4 billion in financing for the transaction. Roughly $3 billion will go toward the acquisition, with the remainder refinancing $1 billion in existing Warner Chilcott debt.

This would be the fourth-largest "leveraged loan" of 2009 in the U.S. and the largest globally for an acquisition, according to data provided by Dealogic. The last leveraged loan of this size for a deal in the U.S. was in April 2008, when Mars Inc. announced its planned purchased of Wrigley.

A leveraged loan is typically defined as a loan made to a borrower with a credit rating below investment grade or that already carries a good amount of debt.

The deal is one of the larger transactions in a weak summer market for acquisitions. But perhaps its biggest impact will be on the dormant markets for deal financing, which have been largely shut since the mid-September 2008 collapse of Lehman Brothers Holdings Inc. Financing for deals have lately been mostly limited to big companies with strong credit ratings.

None of the banks wanted to underwrite this deal alone, but "no bank wanted to miss out," said one person familiar with the matter.

The banks are in part attracted to the transaction because they are able to demand higher underwriting fees than during the last big deal-making cycle in the middle of the decade, said one person familiar with the deal.

Warner Chilcott is able to absorb those fees because interest rates remain historically low, which keeps the company's overall borrowing costs down despite the banks' additional charges.

Cerberus Capital Management LP and rival drug-maker **Forest Laboratories** Inc. also were interested in the business, said the people familiar with the matter. But Warner was able to produce the best bid for the Ohio-based unit, which will be run as a wholly owned subsidiary of New Jersey-based Warner.

A key issue in the talks, said these people, was a patent-dispute lawsuit between P&G and generic-drug maker Roxane Laboratories Inc., an Ohio-based subsidiary of Germany's Boehringer Ingelheim.

P&G sued Roxane in October 2007 over the P&G drug Asacol, an ulcerative colitis drug. The suit came after Roxane earlier sought approval from the U.S. Food and Drug Administration to product a generic version of Asacol. The suit is pending.

P&G was confident in its defense and has won similar cases in the past, including one against Israeli drug maker Teva Pharmaceutical Industries Inc. over Actonel, the osteoporosis treatment for women that is the division's best-selling product.

Nonetheless, Warner Chilcott and Forest wanted the matter settled before inking a deal, said these people, while Cerberus offered a lower price but was willing to take on the potential liability. The status of the matter was unclear Sunday.

A P&G spokesman declined to comment on the deal. The company made clear last year it "would look at all options" for the division, said spokesman Tom Millikin.

The deal should boost the profile of Warner Chilcott, which focuses on women's health care and dermatology products. Folding in the division would triple Warner's revenue and give it access to drugs that focus on a wide range of women's health concerns.

The company recently reported second-quarter profits of $56 million on sales around $251 million. Its shares trade around 2009 highs of $16.

The P&G unit, which makes roughly $800 million in operating profit, was put on the auction block late last year, in a sales process led by Goldman Sachs Group Inc. It has annual sales of about $2 billion.

P&G has struggled for years to gain a foothold in the pharmaceutical industry, having aborted a 2000 plan to swallow drug makers Warner-Lambert Co. and American Home Products in a three-way deal. The failed takeover eventually led to the ouster of P&G's chief executive at the time. By 2006, the company announced plans to end most of its in-house work on drug discovery, investing instead in forging pacts with small biotech companies and universities.

—Ellen Byron contributed to this article.

Chrysler deputy chief Press will leave before year-end

By Kate Linebaugh

DETROIT—**Chrysler Group** LLC Deputy Chief Executive Jim Press is planning to leave the auto maker before the end of the year, according to people who have been informed of the plan, as **Fiat** SpA seeks to revive the car company that two months ago emerged from bankruptcy.

Mr. Press, a former star at **Toyota Motor** Corp., was the only one of Chrysler's top executives retained after the company's bailout. He was kept on as a special adviser to Sergio Marchionne, who now serves as CEO of Chrysler and Fiat.


Jim Press

But Mr. Press has been stripped of many of his responsibilities, and recent missteps have strained his relationship with Chrysler dealers.

Mr. Press, 62 years old, is expected to leave Chrysler by the end of November, according to one of the people informed of the plan.

"I don't think anything has been released about management changes," he said, declining further comment. A Chrysler spokesman declined to comment.

The departure comes two months after Mr. Marchionne's initial management shake-up, which created a flatter structure of 23 executives, including Mr. Press, reporting directly to him.

In his current position, Mr. Press—unlike the three executives in charge of the Chrysler, Dodge and Jeep brands—doesn't have any direct operational control over departments that Mr. Marchionne is concentrating on to lead the turnaround.

Mr. Press's exit will end a tough two-year run at Chrysler. Hired by Chrysler's former owner **Cerberus Capital Management** LP in September 2007, Mr. Press came in with high expectations as one of the top auto executives.

In his 37-year career at Toyota, the Kansas native became a powerful figure, exerting influence over all aspects of Toyota's U.S. sales unit and building a strong reputation among auto dealers. Eventually, he became the first non-Japanese elected to the company's board of directors.

At Chrysler, Mr. Press started working to revamp the way the company developed new models, but after only a few months his relationship with then-CEO Robert Nardelli became strained, said people familiar with the matter.

Mr. Press lost credibility among dealers after he went out in January and February to rally dealers to order more cars and trucks, saying that would help the company survive. Many did, but Chrysler still filed for bankruptcy, leaving dealers who loaded up their lots with cars and trucks that became difficult to sell.

Mr. Press ran afoul of dealers again in June when Chrysler dropped 789 of them from its retail network as part of its bankruptcy organization. At that time, he called the dealership cuts the "most difficult business decision" of his career.

Maersk swings to a loss

Shipping giant sees sluggish rest of year as freight rates drop

By Ola Kinnander
And Elizabeth Adams

Container-shipping giant **A.P. Moller Maersk** AS said Friday it expects weak business to continue the rest of this year as it swung to a first-half loss on plunging freight rates.

Maersk, whose results are a key indicator of the health of global trade, said that although the world economy appears to be improving, a pickup in the shipping sector will lag behind any economic recovery because freight rates will rise only when ships are full again.

"But we feel relatively optimistic for the group long term. When markets return to normal we will be among those making money," said Chief Executive Nils Smedegaard Andersen.

Still, the Denmark-based company warned about "considerable uncertainty" for the rest of 2009, especially on container freight rates, transported volumes, the dollar exchange rate and oil prices.

"That's a pretty bleak and disappointing comment from the management," said Jyske Bank analyst Karsten Sloth. "That indicates there will be a huge loss for the full year."

World-trade flows plummeted in the final months of last year, as demand slowed and banks shied away from financing cross-border transactions. The collapse in trade hit the world's largest exporting economies, such as Japan and Germany, particularly hard. Many container-shipping operators took parts of their fleets out of operation as freight rates dropped.

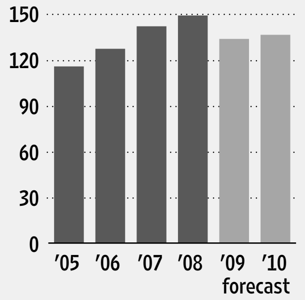
But in recent months there have been signs that the decline in trade is coming to an end, and with trade steadying, so are the big exporting economies. The economies of Germany and Japan grew in the second quarter as exports revived.

Maersk, which also has an oil-and-gas producing unit, recorded a first-half loss of 3.67 billion Danish kroner ($702.8 million), compared with a profit of 11.59 billion kroner a year earlier and analysts' expectations of a 3.13 billion kroner loss.

Revenue for the six months fell 14% to 127.39 billion kroner from 148.37 billion kroner, as freight rates fell 30% and volumes fell 7%.

Low tide

Global container volumes, in millions of TEU*



*Twenty-foot equivalent unit (TEU) is based on 20-foot-long cargo container capacity.
Source: Drewry

The company also blamed lower oil prices, with the average price of Brent crude oil 52% lower than in the first half of 2008.

Maersk also booked 1.25 billion kroner in impairments.

—Paul Hannon contributed to this article.

Sinopec profit climbs sharply as fuel prices rise

By Yvonne Lee

HONG KONG—**China Petroleum & Chemical** Corp., Asia's largest refiner by capacity, said Sunday that its first-half net profit more than quadrupled, driven by higher fuel prices amid China's more market-oriented fuel-pricing system.

The company, known as Sinopec, also said it expects its net profit for the first three quarters ending Sept. 30 to rise at least 50% from a year earlier.

"Looking into the second half of this year, the state will continue implementing the proactive fiscal policy and relatively easy monetary policy, further improving and materializing the integrated economic stimulus package, and increasing domestic demand," Chairman Su Shulin said in a statement.

Sinopec spokesman Evan Jia said the company would unveil its 2009-2011 development plan at a news conference in Hong Kong on Monday.

The oil company said its net profit for the six months ended June 30 was 33.25 billion yuan (US$4.87 billion), up sharply from 7.68 billion yuan a year earlier. That was higher than the average of 26.5 billion yuan forecast by seven analysts polled by Dow Jones Newswires.

Revenue, though, fell 27% to 534 billion yuan amid lower contributions from the upstream exploration-and-production segment.

Sinopec's oil- and gas-producing operation posted an operating profit of 5.5 billion yuan, down from 27.1 billion yuan, because of lower oil prices. Sinopec said the average selling price of its crude oil fell 60% to 1,699 yuan a ton.

The company's refining business, however, swung to an operating profit of 19.9 billion yuan, from an operating loss of 46.55 billion yuan, aided by Beijing's move to ease price controls.

The government adjusted domestic fuel prices several times during the first half. It cut gasoline and diesel prices by 3% in July, after raising them 8%-10% in June in response to a rebound in crude-oil prices during the second quarter.

Under China's new resources pricing system, introduced in January, refiners are guaranteed a 5% profit margin as long as the price of international crude is below $80 a barrel.

Benchmark crude-oil futures on the New York Mercantile Exchange started the second quarter around $53 a barrel and ended the period at $69 a barrel.

Mr. Su said Sinopec for now would keep its full-year target of refining 184 million metric tons of crude oil, of which it will refine 97.1 million tons in the second half. Sinopec refined 86.9 million metric tons of crude oil in the first half, up 1.8% from 85.35 million tons a year earlier.

It sold 57.71 million tons of fuel in the domestic market during the first half, down 8.4% from 63.02 million tons, because of a drop in fuel demand.

Sinopec's capital expenditure for the first six months totaled 38.98 billion yuan, up 6.1% from 36.73 billion yuan. Capex was about a third of the full-year budget of 111.8 billion yuan the company disclosed in March. Sinopec didn't comment on its second-half budget.

Sinopec is expected to post a 70% jump in net profit this year to 50.68 billion yuan from 29.77 billion yuan last year, according to the average estimate of 14 analysts polled by Thomson Reuters.

CORPORATE NEWS

Air France-KLM shows turbulence

Carrier's decision to scrap bid for CSA reflects its struggles

BY DAVID PEARSON

PARIS—**Air France-KLM** SA's decision last week to walk away from a potential takeover of Czech Airlines JSC highlights the fragile financial health of the Franco-Dutch airline as it struggles with declining traffic and shaves margins to attract passengers and cargo, analysts say.

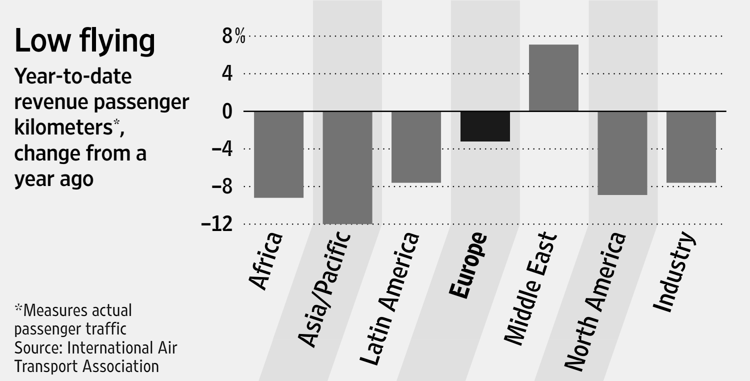
The Franco-Dutch airline announced Wednesday it was no longer interested in taking up the Czech government's 91.5% stake in the carrier, known as CSA, a move that industry analysts say could have obliged Air France-KLM to pay out about $270 million at a time when it is reporting losses and there's no sign of an industry upturn in the near term.

"When Air France-KLM entered into the CSA privatization process, it made perfect sense to be investigating that opportunity," said Andrew Lobbenberg, an airlines analyst at Royal Bank of Scotland Group PLC. But the decision to walk away from CSA "isn't surprising," he said, given the deterioration in the airline industry's business environment.

"Air France-KLM's cash position is under greater strain, and the relative strategic value of having cash in your pocket has increased" since the CSA privatization process began in February, Mr. Lobbenberg said.

Explaining its decision over CSA, Air France-KLM said Wednesday: "The current economic environment has significantly impacted the airline business. Under such circumstances, Air France-KLM believes that CSA might focus on developing and implementing a standalone recovery plan aimed at restoring its profitability."

Air France-KLM, Europe's largest airline, has issued a series of profit warnings over the past year, and last month surprised investors again by releasing results for the three months through June 30 that were far worse than expected. The airline posted a net loss of €426 million ($610 million), compared with a year-earlier net profit of €168 million.



The lackluster earnings led to a string of recommendation downgrades as analysts penciled in projections for more red ink through the 2010-2011 financial year.

Like its industry peers, the airline is struggling with collapsing passenger and cargo revenue, and most analysts don't see a pickup in traffic before the second quarter of 2010, even if economic activity starts to show signs of reviving before then.

Airlines such as Air France-KLM have had difficulty adapting their capacity to the sharp decline in traffic. Its revenue is falling faster than it can cut capacity, and it can't reduce operating overheads—particularly labor costs—fast enough. The carrier is trying to reduce headcount by 3,000 through attrition this year. At the same time, its net debt is rising.

Air France-KLM predicted last month that its passenger revenue will continue to deteriorate in the quarter ending Sept. 30 and stabilize over the next six months, provided the global economy starts recovering toward the end of the year.

Fraport cleared to expand Frankfurt airport

BY ALLISON CONNOLLY AND NATALI SCHWAB

FRANKFURT—German airport operator **Fraport** AG said a court has cleared its €4 billion ($5.7 billion) plan to expand Frankfurt's main international airport, the final step allowing a fourth runway and third terminal to be built at **Deutsche Lufthansa** AG's main hub.

The plan, which was approved by the administrative court of the state of Hesse, will allow Fraport to build Runway Northwest, the new runway it hopes to open in the winter of 2011. The new runway will allow 120 aircraft movements per hour and the new terminal, with 75 new aircraft positions, will have the capacity to handle 25 million passengers. The airport handled nearly 53.5 million passengers in 2008.

The move comes as other large European airports are also considering expansion plans, even though the industry is undergoing one of its worst-ever downturns as economic woes have slashed passenger numbers and cargo volumes. With 40,462 takeoffs and landings, Fraport recorded a 5.3% fall in aircraft movements from a year earlier in July.

In each case, expansion plans have polarized opinion, with businesses saying expansion is key to the growth of the economy, and local and environmental campaigners complaining about noise levels and the environmental impact.

The U.K. government earlier this year approved plans for a third runway at London's Heathrow airport, Frankfurt's larger competitor as one of Europe's major hub airports. The decision came after intense lobbying by businesses and the airport operator BAA, who said Heathrow's expansion was key to maintaining the competitiveness of the airport and to future growth of the U.K. economy.

However, the U.K.'s main opposition party has pledged to reverse the decision if it wins an election that must be called by next May, backing local residents and the environmental campaigners. Under current plans, Heathrow's new runway would start being built in 2015 and is slated for completion in 2019.

The expansion in Frankfurt is causing a battle over night flights.

The state of Hesse's local zoning authority recently reduced the number of flights allowed at Frankfurt airport between 11 p.m. and 5 a.m. to 17, from about 40, and local campaigners had called for an outright ban.

However, Fraport and Lufthansa, who want more night flights allowed, had asked the court to rule. But the court effectively deflected a decision, saying that the state of Hesse must come up with new rules.

"Ultimately, the issue will presumably be decided at the highest court level," said Stefan Schulte, Fraport's executive board vice chairman, who heads up the expansion project.

"We regret that the court didn't listen to our argument," a Lufthansa spokesman said.

Lufthansa has said a ban or reduction in night flights will further hurt its cargo operations, which have already seen volumes decline sharply due to the downturn in world trade. Airlines run most of their cargo operations overnight.

The Lufthansa spokesman said that without night flights, Frankfurt Airport would be cut off from global cargo flight traffic and left on the sidelines.

Lufthansa will wait for the court to publish its written decision and opinions before deciding how best to proceed, the spokesman said.

U.K. car output drops, but sales incentives ease fall

BY STEVE MCGRATH

LONDON—The number of new cars made in the U.K. dropped 17.9% in July from a year earlier, though the government's scrapping incentives have slowed the pace of decline seen in recent months.

The U.K. produced 107,635 cars in July, according to the Society of Motor Manufacturers and Traders, down from 131,079 cars a year earlier—the shallowest decline in car output since September of last year.

"The slowdown in the rate of decline of U.K. car production reflects the impact of the scrappage incentive schemes in place across Europe," said Paul Everitt, SMMT chief executive.

The U.K.'s major automobile producers—including the U.K. units of global companies such as **Toyota Motor** Corp., **General Motors** Co., **Nissan Motor** Co. and **Honda Motor** Co.—have slashed production as the industry has been hit by the worst downturn since World War II.

However, production slowly has been ramped up again in response to scrapping programs put in place in several European Union countries, including the U.K., in recent months. The programs, which offer consumers incentives for trading in older cars for new cars that produce lower carbon-dioxide emissions, have mostly boosted sales of small cars.

U.K. car production is still down 45.8% from a year earlier for the first seven months of 2009. The number of cars produced for export—the U.K. exports about 80% of the vehicles it produces—is down 44.6% and the number for domestic sale is down 49.6%.

Showing the continued impact of the economic downturn on the industry, production of commercial vans was off 63.8% in the U.K. in July from a year before.

BYD of China aims to sell electric car in U.S. next year

BY NORIHIKO SHIROUZU

XIAN, China—Chinese auto maker **BYD** Co. is finalizing plans for an all-electric battery car that would be sold in the U.S. next year.

Chairman Wang Chuanfu Wang said BYD aims to use money from a planned new-share sale in China to help pay for the U.S. push, as well as for a second production line for automotive lithium-ion batteries near its Shenzhen headquarters.

He said BYD wants to build up its brand name in the U.S. by offering one of its most advanced cars, the five-seat e6, before eventually expanding its offerings.

Mr. Wang said the company plans to pick a specific region within the U.S. and initially market "a few hundred" e6s, priced at slightly more than $40,000, through a small number of dealers. Mr. Wang said BYD hopes to enter Europe with a similar strategy in 2011 or later.

BYD, which lists shares in Hong Kong, plans to sell as many as 100 million new shares in mainland China ahead of a listing on the Shenzhen Stock Exchange as early as next year. The offering, which still needs government approval, could raise as much as $500 million based on current prices.

GLOBAL BUSINESS BRIEFS

Sky Network Television Ltd.

Net profit declines 10% amid drop in ad revenue

Sky Network Television Ltd. said its full-year net profit fell 10% because of a rise in costs and a decline in advertising revenue, which shows no signs of picking up. The New Zealand-based company—half-owned by **News** Corp., which also owns The Wall Street Journal—said net profit was 88.4 million New Zealand dollars (US$60.3 million) in the year ended June 30, compared with NZ$97.7 million in the previous year. Sky TV, which is the dominant player in New Zealand's pay-television market, said advertising revenue fell 13% to NZ$57.8 million, led by pay-TV advertising sales, which were down 4% over the year. Annual revenue rose 5% to NZ$692 million.

Toyota Motor Corp.

Toyota Motor Corp. plans to increase North American production of four-cylinder engines by adding capacity at its Huntsville, Ala., plant. The engines will be used in Camry and RAV4 models that Toyota assembles in Lafayette, Ind., and Woodstock, Ontario, respectively. Four-cylinder engines for those operations currently come from Japan. The company expects to hire at least 240workers and invest about $147 million in the expansion plan. Production is set to begin in the summer of 2011. The move comes as slumping U.S. auto sales have shown signs of life as government incentives boosted demand for fuel-efficient vehicles. Declines narrowed for Toyota in July. Toyota's Huntsville plant currently builds six- and eight-cylinder engines.

Hyundai Motor Co.

The son of **Hyundai Motor** Co. Chairman Chung Mong-koo was promoted to vice chairman at the auto maker as part of a strategy to boost sales in overseas markets, Hyundai said Friday. Chung Eui-sun, formerly a president at Hyundai Motor affiliate Kia Motors Corp., succeeds Choi Jae-kook, who retired earlier this year. Mr. Chung, who is 38 years old and the only son of the chairman, becomes one of six vice chairmen at Hyundai, South sKorea's largest auto maker. In his new post, Mr. Chung will be in charge of sales and planning. Hyundai Motor owns 39% of Kia and together the two companies form the world's fifth-largest car maker by sales.

Japan Airlines Corp.

Japan Airlines Corp. is looking to revamp its unprofitable cargo business by teaming up with shipping company **Nippon Yusen** KK. JAL and Nippon Yusen said Friday they will begin talks to integrate their air-cargo operations as demand for such services dwindles amid the economic slowdown. The companies will discuss the establishment of a joint venture to merge operations at subsidiaries Japan Airlines International and Nippon Cargo Airlines, aiming for the entity to start business on April 1. The economic crisis has depressed freight-service demand since last autumn.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

Fears of double dip drive U.S. officials

Stalled comeback in 1937 informs Obama administration's debate on winding down Fed's emergency measures

BY MICHAEL M. PHILLIPS

THE OUTLOOK

WASHINGTON—A few months ago, Obama administration officials were sounding the alarm about another 1929. These days, it's 1937 that has them in a sweat.

The Great Depression was W-shaped. The stock-market collapse led to a steep economic decline. But by 1933, the economy had rebounded. Then a series of monetary and fiscal blunders drove the country back into a deep recession at the end of 1937.

That episode is at the heart of the debate over how quickly the government and the U.S. Federal Reserve should unwind the emergency measures they have taken to fend off a Depression-like contraction.

For the administration, the answer is clear: Err on the side of continued expansionary policies. "What you learned from that episode in 1937 is that it's not enough to be recovering," says Christina Romer, chairman of the president's Council of Economic Advisers and an expert on the Great Depression. "You don't want to do anything when you start recovering that nips it off too soon."

For fiscal conservatives, the answer is equally clear: Start cutting the federal deficit and slowing the growth in the money supply now, before the binge generates a burst of inflation.

Ms. Romer is "sending the absolutely wrong message—that we can't do anything to worry about inflation until the recovery is locked in because of concern for unemployment," says Allan H. Meltzer, a political economist at Carnegie Mellon University. "The reason economists and central bankers have two eyes is so they can do two things at once."

The economy was recovering briskly during Franklin D. Roosevelt's first term in the White House. The jobless rate, which had peaked at 25% in 1933, fell to 14% in 1937—not exactly cause for celebration but a relief nonetheless.

The comeback stalled in 1937. Banks, nervous about the fragile recovery, were holding huge amounts of cash in reserve at the Fed. Fearing an inflationary surge should the banks decide to lend that money out to businesses and individuals, the Fed—which had made the mistake of tightening monetary policy soon after the 1929 stock-market crash—miscalculated again. The Fed ratcheted up banks' reserve requirements three times, starting in 1936. The banks reacted by cutting lending even further.

"There's no doubt that [Fed Chairman Ben] Bernanke is heavily influenced by these two mistakes of the Fed during the Depression and is absolutely intent on not repeating them," says Alex J. Pollock of the American Enterprise Institute, a free-market think tank in Washington.

Compounding the Fed's errors, the federal government tightened fiscal policy. Congress approved a big bonus for World War I veterans in 1936, providing a spark of consumer spending. But lawmakers allowed the subsidy to lapse in 1937. At the same time, the government began collecting the first Social Security taxes, on top of income and capital-gains tax increases that Mr. Roosevelt approved in 1934-35.

Tightening the monetary and fiscal screws sent the economy into free fall again—the second trough of the W. Unemployment shot up to 19%, prolonging the nation's suffering.

Fast-forward to 2009. Most economists surveyed by The Wall Street Journal this month believe that the recession is over. On average, they expect to see a 2.4% increase in output in the third quarter, at a seasonally adjusted annual rate. Construction of new single-family homes has started to climb. Auto sales are up.

But administration officials and their allies fear a second dip if the government pulls back the $787 billion stimulus or if the Fed clamps down too soon.

"I think it's a fringe view to say we should get rid of the stimulus," says Ms. Romer. Economists who say the economy is on the upswing do so because they assume a continued fiscal boost through 2010, she says.

"Even though the Fed is talking about and obviously doing internal planning for the exit strategy, nobody should think it's imminent," says Princeton University economist Alan Blinder, a former Fed vice chairman and economic adviser to the Clinton White House. "And it shouldn't be imminent; the Fed has got to have its pedal to the metal for some time yet."

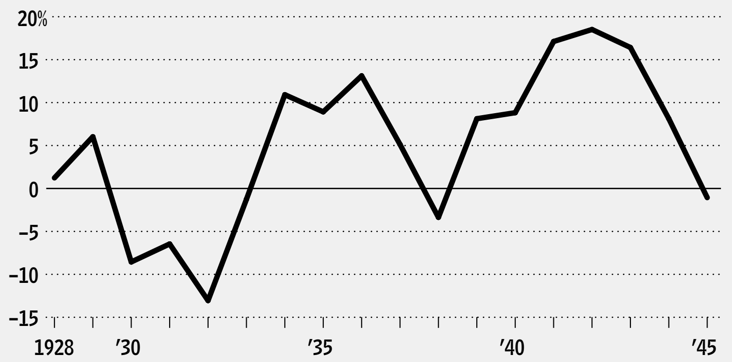
Mr. Meltzer says the risk lies not in pulling back too soon but dithering too long. And he would scrap the stimulus program immediately and replace it with cuts in marginal tax rates for individuals and businesses. "It's certainly not a bad idea to get rid of a policy that isn't working," he says. "It takes courage, but that's what we pay these people to do." And, he says, the Fed should now slow the growth of the money supply.

Conservative voices in Congress are sending the same message. Last week, Sen. Jon Kyl, an Arizona Republican, reiterated his view that the rebounding economy renders further stimulus spending superfluous.

This week the Obama administration and Congressional Budget Office are to release new federal deficit forecasts. The White House projection is expected to be a record $1.58 trillion for the year ending Sept. 30, and the congressional forecast could be even larger. Expect the news to prompt an outcry from those who believe that the inflation of the 1970s is now a bigger risk than the deflation of the 1930s.

History lessons

Economists are studying the double-dip contraction of the 1930s for clues on the path forward now. Real U.S. GDP, change from a year earlier:



Source: MeasuringWorth.org

Support voiced for Bernanke reappointment

BY JON HILSENRATH

JACKSON HOLE, Wyo.—The prospect of a second term for Federal Reserve Chairman Ben Bernanke wasn't discussed from the podium at the U.S. central bank's annual retreat here. But on the sidelines of the meeting, many said Mr. Bernanke should get to keep his job, and believe he will.

With Mr. Bernanke's term expiring in January, President Barack Obama must decide in the weeks ahead whether to offer him a second one. The vote of confidence at the Jackson Hole meetings amounts to a thumbs-up from his peers.

The economists and officials from around the world who met in the Grand Tetons are a naturally sympathetic audience. "This is a group of people who like the Fed," said Harvard economist Martin Feldstein, once mentioned as a potential Fed chairman himself.

The group largely admires the aggressive, outside-of-the-textbook steps Mr. Bernanke took last fall after Lehman Brothers Holdings Inc. collapsed. "Ben came to the Fed as an expert's expert on fundamental monetary policy and went far beyond that with all of his creative policies," Mr. Feldstein said.

Mr. Bernanke has widespread support on Wall Street, too: 42 out of 43 economists surveyed by The Wall Street Journal this month said he should be reappointed, and betting markets give him strong odds of getting a second term.

Still, he isn't a shoo-in. Mr. Bernanke faces significant criticism on Capitol Hill, which could sway Mr. Obama. Support for Mr. Bernanke isn't uniform among central-banking insiders, either. Some conference participants criticized Mr. Bernanke for flooding the financial system with too much money, which could cause inflation later. Others worry he has jeopardized the Fed's independence by working so closely with the Treasury Department to rescue firms including American International Group Inc. and Bear Stearns.

And European Central Bank President Jean-Claude Trichet took a subtle jab at the Fed Saturday, arguing that inflation expectations and inflation-adjusted interest rates have been more stable in Europe since the crisis started than in the U.S.

But others among the Jackson Hole crowd offered two reasons for backing another term for Mr. Bernanke.

First, many said, Mr. Bernanke's aggressive efforts to revive markets and the economy after Lehman's collapse helped to avert a greater economic disaster. "We've had an incredible display of pyrotechnics out of the Federal Reserve," said Allen Sinai, a meeting participant and founder of forecasting firm Decision Economics Inc.

Second, said others, with the economy still weak, markets fragile and the Fed making complicated choices about when and how to pull back its stimulus, it would be too disruptive to markets and to the Fed to change leadership now.

"I can't imagine that the president wouldn't reappoint Ben," said John Makin, a meeting participant and principal at money-manager Caxton Associates. "Why would you start with somebody new who is unproven?"

But popular and congressional resistance to Mr. Bernanke could be an impediment to reappointment. "Ultimately, these aren't decisions made by economists. They're made by politicians," said Mr. Sinai.

Reuters

Federal Reserve Chairman Ben Bernanke leaves the Jackson Hole Economic Symposium in Grand Teton National Park, Wyoming, on Saturday.

Israel, Sweden escalate dispute over news article

ASSOCIATED PRESS

JERUSALEM—Israeli Prime Minister Benjamin Netanyahu on Sunday called for the Swedish government to condemn an article in a Stockholm newspaper suggesting Israeli troops harvested the organs of Palestinians they killed.

An official present at the weekly session of the Israeli cabinet said Mr. Netanyahu told his ministers he didn't expect the Swedish government to apologize for the article in the tabloid Aftonbladet but he did expect it to take a stand.

Swedish Foreign Minister Carl Bildt rejected Israeli calls for an official condemnation.

The article implied without evidence that there was a link between charges of organ theft from Palestinians and the recent arrest in the U.S. of an American Jew suspected of illicit organ trafficking.

Finance Minister Yuval Steinitz said if Sweden continued its refusal to condemn the Aftonbladet story, Israel might cancel a visit by Mr. Bildt scheduled for next month.

"Whoever doesn't distance himself from this kind of blood libel might not be a welcome guest in Israel at this time," Mr. Steinitz told Israel Radio. The Israeli Government Press Office said it was delaying approval for an Aftonbladet correspondent and photographer seeking permission to enter the Gaza Strip by the maximum 90 days allowed by regulations.

Russia's pride could diminish its power

Air of aggressiveness holds country back; the call of the West

By Richard Pipes

Russia is obsessed with being recognized as a "Great Power." She has felt as one since the 17th century, after having conquered Siberia, but especially since her victory in World War II over Germany and the success in sending the first human into space. It costs nothing to defer to her claims to such exalted status, to show her respect, to listen to her wishes. From this point of view, the recent remarks about Russia by Vice President Joe Biden in an interview with this newspaper were both gratuitous and harmful. "Russia has to make some very difficult calculated decisions," he said. "They have a shrinking population base, they have a withering economy, they have a banking sector that is not likely to be able to withstand the next 15 years."

These remarks are not inaccurate, but stating them publicly serves no purpose other than to humiliate Russia. The trends the vice president described will likely make Russia more open to cooperating with the West, Mr. Biden suggested. It is significant that when our secretary of state tried promptly to repair the damage which Mr. Biden's words had caused, Izvestiia, a leading Russian daily, proudly announced in a headline, "Hillary Clinton acknowledges Russia as a Great Power."

Russia's influence on world affairs derives not from her economic power or cultural authority but her unique geopolitical location. She is not only the world's largest state with the world's longest frontier, but she dominates the Eurasian land mass, touching directly on three major regions: Europe, the Middle East and the Far East. This situation enables her to exploit to her advantage crises that occur in the most populous and strategic areas of the globe. For this reason, she is and will remain a major player in world politics.

Opinion polls indicate that most Russians regret the passing of the Soviet Union and feel nostalgia for Stalin. Of course, they miss not the repression of human rights which occurred under Communism nor the miserable standards of living but the status of their country as a force to be reckoned with: a country to be respected and feared. Under present conditions, the easiest way for them to achieve this objective is to say

Polaris

Russian President Dmitry Medvedev, right, and Prime Minister Vladimir Putin mark the World War II defeat of Nazi Germany.

"no" to the one undeniable superpower, the United States. This accounts for their refusal to deal more effectively with Iran, for example, or their outrage at America's proposal to install rocket defenses in Poland and the Czech Republic. Their media delight in reporting any negative news about the United States, especially the dollar, which they predict will soon be worthless (even as their central bank holds $120 billion or 30% of its reserves in dollar-denominated U.S. securities).

One unfortunate consequence of the obsession with "great power" status is that it leads Russians to neglect the internal conditions in their country. And here there is much to be done. To begin with: the economy. The Russian aggression against Georgia has cost it dearly in terms of capital flight. Due to the decline in the global prices of energy, which constitute around 70% of Russian exports, exports in the first half of 2009 have fallen by 47%. The stock market, which suffered a disastrous decline in 2008, has recovered, and the ruble has held steady, but the hard currency reserves are melting and the future does not look promising: The latest statistics indicate that Russia's GDP this year will fall by 7%. It is this that has prompted President Dmitry Medvedev recently to demand that Russia carry out a major restructuring of her economy and end her heavy reliance on energy exports. "Russia needs to move forward," he told a gathering of parliamentary party leaders, "and this movement so far does not exist. We are marking time and this was clearly demonstrated by the crisis...as soon as the crisis occurred, we collapsed. And we collapsed more than many other countries."

One of the major obstacles to conducting business in Russia is the all-pervasive corruption. Because the government plays such an immense role in the country's economy, controlling some of its most important sectors, little can be done without bribing officials. A recent survey by Russia's Ministry of the Interior revealed, without any apparent embarrassment, that the average amount of a bribe this year has nearly tripled compared to the previous year, amounting to more than 27,000 rubles or nearly $1,000. To make matters worse, businesses cannot rely on courts to settle their claims and disputes, and in extreme cases resort to arbitration.

The political situation may appear to a foreigner inculcated with Western values as incomprehensible. Democratic institutions, while not totally suppressed, play little role in the conduct of affairs defined by the leading ideologist of the regime as "sovereign democracy." Indeed, President Medvedev has publicly declared his opposition to "parliamentary democracy" on the grounds that it would destroy Russia.

A single party, One Russia, virtually monopolizes power, assisted by the Communists and a couple of minor affiliates. Parliamentary bodies duly pass all bills presented to them by the government. Television, the main source of news for the vast country, is monopolized by the state. One lonely radio station and a few low-circulation newspapers are allowed freedom of expression in order to silence dissident intellectuals. And yet, the population at large seems not to mind this political arrangement-an acquiescence which runs contrary to the Western belief that all people crave the right to choose and direct their government.

The solution of the puzzle lies in the fact that during their 1,000-year old history of statehood, the Russians have virtually never been given the opportunity to elect their government or to influence its actions. As a result of this experience, they have become thoroughly depoliticized. They do not see what positive influence the government can have on their lives: They believe that they have to fend for themselves. Yes, they will gladly accept social services if offered, as they had been under the Soviet government, but they do not expect them. They hardly feel themselves to be citizens of a great state, but confine their loyalties to their immediate families and friends and the locality which they inhabit. From opinion polls it emerges that they believe democracy everywhere to be a sham, that all governments are run by crooks who use their power to enrich themselves. What they demand of the authorities is that they maintain order: when asked what is more important to them-"order" or "freedom"-the inhabitants of the province of Voronezh overwhelmingly expressed preference for "order." Indeed, they identify political freedom, i.e., democracy, with anarchy and crime. Which explains why the population at large, except for the well-educated, urban minority, expresses no dismay at the repression of its political rights.

One aspect of the "great power" syndrome is imperialism. In 1991, Russia lost her empire, the last remaining in the world, as all her colonies, previously disguised as "union republics" separated themselves to form sovereign states. This imperial collapse was a traumatic experience to which most Russians still cannot adjust themselves. The reason for this lies in their history. England, France, Spain and the other European imperial powers formed their empires overseas and did so after creating national states: As a result, they never confused their imperial possessions with the mother country. Hence, the departure of the colonies was for them relatively easy to bear. Not so in the case of Russia. Here, the conquest of the empire occurred concurrently with the formation of the nation-state: Furthermore, there was no ocean to separate the colonies. As a result, the loss of empire caused confusion in the Russians' sense of national identity. They have great difficulty acknowledging that the Ukraine, the cradle of their state, is now a sovereign republic and fantasize about the day when it will reunite with Mother Russia. They find it only slightly less difficult to acknowledge the sovereign status of Georgia, a small state that has been Russian for over two centuries. The imperial complex underpins much of Russia's foreign policy.

These imperial ambitions have received fresh expression from a bill which President Medvedev has submitted in mid-August to parliament. It would revise the existing Law of Defense which authorizes the Russian military to act only in response to foreign aggression. The new law would allow them to act also "to return or prevent aggression against another state" and "to protect citizens of the Russian Federation abroad." It is easy to see how incidents could be provoked under this law that would allow Russian forces to intervene outside their borders.

How does one deal with such a difficult yet weighty neighbor, a neighbor who can cause no end of mischief if it becomes truly obstreperous? It seems to me that foreign powers ought to treat Russia on two distinct levels: one, which takes into consideration her sensitivities; the other, which responds to her aggressiveness.

We are right in objecting strenuously to Russia treating her onetime colonial possessions not as sovereign countries but dependencies lying in her "privileged zone of influence." Even so, we should be aware of their sensitivity to introducing Western military forces so close to her borders. The Russian government and the majority of its citizens regard NATO as a hostile alliance. One should, therefore, be exceedingly careful in avoiding any measures that would convey the impression that we are trying militarily to "encircle" the Russian Federation. After all, we Americans, with our Monroe Doctrine and violent reaction to Russian military penetration into Cuba or any other region of the American continent, should well understand Moscow's reaction to NATO initiatives along its borders.

This said, a line must be drawn between gentle manners and the hard realities of politics. We should not acquiesce in Russia treating the countries of her "near abroad" as satellites and we acted correctly in protesting last year's invasion of Georgia. We should not allow Moscow a veto over the projected installation of our anti-rocket defenses in Poland the Czech Republic, done with the consent of their governments and meant to protect us against a future Iranian threat. These interceptors and radar systems present not the slightest threat to Russia, as confirmed publicly by Russian general Vladimir Dvorkin, an officer with long service in his country's strategic forces. The only reason Moscow objects to them is that it considers Poland and the Czech Republic to lie within its "sphere of influence."

Today's Russians are disoriented: they do not quite know who they are and where they belong. They are not European: This is attested to by Russian citizens who, when asked. "Do you feel European?" by a majority of 56% to 12% respond "practically never." Since they are clearly not Asian either, they find themselves in a psychological limbo, isolated from the rest of the world and uncertain what model to adopt for themselves. They try to make up for this confusion with tough talk and tough actions. For this reason, it is incumbent on the Western powers patiently to convince Russians that they belong to the West and should adopt Western institutions and values: democracy, multiparty system, rule of law, freedom of speech and press, respect for private property. This will be a painful process, especially if the Russian government refuses to cooperate. But, in the long run, it is the only way to curb Russia's aggressiveness and integrate her into the global community.

—Richard Pipes is Frank B. Baird Jr. professor of history, emeritus, at Harvard University. In 1981 and 1982 he served as Director of East European and Soviet Affairs in President Ronald Reagan's National Security Council.

Money & Investing

Elusive oasis

Business spat threatens Riyadh's bid to be a Middle East boomtown > **Page 19**

Beijing puts limits on petitioners

In end to tradition, those with issues first seek local redress

By Loretta Chao

Associated Press

Chinese petitioners toss handbills from the rooftop of a Beijing hotel during a May protest against corruption.

BEIJING—Authorities in China are moving to snuff out petitioning, a centuries-old form of protest that brings thousands of aggrieved people to the capital each year seeking justice.

The new rules come as authorities are seeking to keep a lid on protests ahead of the 60th anniversary of the People's Republic of China in October. One official from the legislative affairs committee said recently that an "improvement" of the petitioning situation was needed to ensure "a harmonious and stable social environment for the celebratory events of the 60th anniversary of new China."

The regulations haven't been published, but the party's Political and Legislative Affairs Committee posted a notice on its Web site Wednesday giving details: Petitioners should "not seek solutions by visiting Beijing"; instead, they should seek redress locally, and if the case is rejected then central authorities may initiate a review. But bringing cases directly to the capital, the notice implied, would be considered illegal.

"No illegal petitioning is allowed, whether the cases are reasonable or not," the notice said, adding that people who represent or instigate others to appeal will get "criticism and education."

The new rules could end a form of protest with a long history in China. In imperial times, people with wrongs sought redress at the emperor's court, and Chinese history books are filled with stories of upright Confucian officials traveling thousands of miles to the capital hoping to have unjust opinions overturned.

The system of petitions was kept on by the communists as an important safety valve for a country with a weak legal system. It isn't just the central government, but dozens of government agencies and companies that have petition offices. Each year, lines snake for blocks outside the National Bureau of Letters and Calls in southern Beijing with people from all corners of the country.

"I don't know where else petitioners like us can go without going to a national bureau," said Jiang Rongsheng, a petitioner from Anhui province who has been to the national petitions office three times in the past year to protest what he describes as the seizing of land by local officials without an offer of compensation.

Yang Dan, a petitioner from Honggang village in Hubei province appealing the seizure of her house for a government project, said it is a good idea to solve the problem locally. "But the problem is that most local officials are corrupt," Ms. Yang said. "Who will supervise the local officials?"

Specifically, the notice said top province, city and county-level officials must designate at least one day every month for receiving public visits, with lower-ranking officials available one day a week. Provisions should also be made for public appeals to be filed on the Internet.

Local authorities would have the right to terminate cases they feel have already been reasonably resolved after undergoing a "public hearing, public questioning and public reply." Central government authorities will inspect and review terminated cases on a regular basis to prevent local authorities from abusing the system, and if any problems are discovered "responsible people will be held accountable," it said.

In addition, the notice said there will be a 60-day limit for resolving appeals that, if enforced, would be an improvement for petitioners who say their complaints often go unanswered for months.

Still, the new measure is already drawing criticism. This regulation "won't have good results," said Li Fangping, a human-rights lawyer in Beijing who said it seems aimed at preventing petitioners from taking their cases to a higher authority.

—Ellen Zhu and Kersten Zhang contributed to this article.

Associated Press

A petitioner wears a hat reading 'Officials Corrupt, Changed Judiciary.'

Beijing frees jailed legal activist Xu Zhiyong

By Sky Canaves

Associated Press

Chinese lawyer and activist Xu Zhiyong at a meeting in Beijing in July.

BEIJING—Chinese authorities unexpectedly freed from jail a prominent legal activist on Sunday after an increasingly vocal campaign against his detention by China's growing ranks of citizen activists.

Xu Zhiyong, a co-founder of the now shuttered legal-research and advocacy group, the Open Constitution Initiative, was taken from his home by police before dawn on July 29 and formally arrested on accusations of tax evasion two weeks later. The Beijing tax bureau had ordered the OCI to pay 1.4 million yuan (about $200,000) in back taxes on contributions, including hefty fines, a decision Mr. Xu was trying to appeal before he was detained.

Human-rights groups and legal experts said the tax charges were a pretext for jailing Mr. Xu and shutting down the group, which represented families of children sickened during last year's melamine-tainted-milk scandal, and also advocated against illegal detentions.

Mr. Xu said he didn't know the reason for his sudden release, but the public campaign "definitely could have had an influence." Speaking by phone, he said Zhuang Lu, another OCI staffer detained around the same time, also was released Sunday. Still, Mr. Xu said he might yet face prosecution.

Chinese Internet censors blocked Mr. Xu's name from search engines in mainland China. But activists managed to launch a campaign, largely online, to focus attention on the case.

The movement shows an "increasing awareness of the important role of law in society," says Li Fangping, one of Mr. Xu's lawyers.

After the OCI's Web site was shut down, other members of the group, a loose association of lawyers, academics and volunteers, relaunched the site on a server outside mainland China. Through Aug. 13, its online campaign had raised almost 850,000 yuan from mainland citizens to help pay the fines.

Another coalition, including bloggers and college students, started an offshore Web site dedicated to Mr. Xu's defense, www.WeZhiyong.org. Slogans on the site read, "Anyone can be Xu Zhiyong" and "tens of thousands of Zhiyongs are not in jail, but they are on the road to jail."

Joshua Rosenzweig, a senior researcher with the U.S.-based human-rights group Duihua Foundation, said Mr. Xu's release on bail indicated that authorities were treating him differently from political dissidents, who often are charged with more serious crimes of subversion.

"It shows the difference between this kind of case and a purely political case," Mr. Rosenzweig said. "Xu Zhiyong is not a dissident, unless you really stretch the definition of dissident."

He said the rare use of bail shows authorities "might be wavering" over Mr. Xu's case, although he doesn't rule out tax evasion and other charges.

The campaign for Mr. Xu attracted wide support. "Many people who seldom talk about politics have come out" in support of Mr. Xu, says Jean Yim, a Ph.D. student in the sociology department at the University of Hong Kong. She and a friend organized a talk on Mr. Xu in Hong Kong on Saturday, which they made available to Internet users in mainland China via Twitter, and through video and audio files.

Loan explosion in China misses small companies

By Terence Poon

BEIJING—China's small companies are struggling to raise capital even as the government has engineered a massive credit expansion, raising questions about the durability of the country's economic recovery.

The first-half surge in bank lending mostly benefited big state-owned enterprises, the agents of Beijing's economic-stimulus program. Those firms are driving a sharp acceleration in investment and growth, buoying commodity exporters like Australia and helping to pull Asia's economy out of a slump.

But it is the small and medium-size enterprises—employers of eight out of 10 workers in China—that will need to pick up the slack when the government eases back on its stimulus measures. Small companies could also play a crucial role in new sectors such as services, which Beijing wants to grow to boost domestic demand and ease China's reliance on exports for economic growth.

"The private sector is the most dynamic part of the economy and it's most likely to find new growth sectors," said Royal Bank of Scotland economist Ben Simpfendorfer. "It is now that these companies need to restructure and expand in new industries. ... They need funds to do this."

Government efforts, such as prodding banks to lend more to SMEs and letting microfinance firms form, as well as the easing of monetary policy late last year have helped. SMEs received roughly one-third of the 7.37 trillion yuan ($1.08 trillion) in new local-currency loans in the first half of the year.

But SMEs generate nearly 60% of Chinese economic output and analysts say smaller companies among SMEs likely had a harder time borrowing funds. China classifies companies that employ as many as 3,000 workers as SMEs.

"Banks are still stringent in assessing loan applications, not just for us, but also for others," said Liu Fangfang, assistant general manager of **Dalian Minyong Group** Co., a supermarket and real-estate firm in the northeastern port of city of Dalian that employs around 700 people.

Recognizing these problems, the State Council, China's cabinet, said Wednesday it will make it easier for small businesses to raise money, and will use more public funds to help them. It will encourage local governments to subsidize institutions that lend more to small companies, dropping the usual reference to SMEs.

The State Council added it will accelerate work to set up a Growth Enterprise Market—a Nasdaq-style stock market—and increase fund raising through so-called bundled bonds, which are single debt issues from a group of SMEs.

Bundled bonds help SMEs get around rules that restrict them to selling such a small amount of bonds that investors tend to shun the offerings.

But regulatory obstacles and a shortage of big financial institutions catering to SMEs hobble efforts to expand the bundled bonds, showing how Beijing needs to fix rules and build institutions to help SMEs, and why analysts say it will take time for China to ease the financing difficulties.