Leading the News: Turkey, Armenia move closer to border-opening deal

THE WALL STREET JOURNAL.

VOL. XXVII NO. 173 | EUROPE | WEDNESDAY, OCTOBER 7, 2009

DOWJONES A News Corporation Company | europe.WSJ.com

THE WALL STREET JOURNAL.

What's News

An unexpected increase in Australian interest rates revived hopes of economic recovery, sending stocks in Europe and the U.S. sharply higher, and pushed gold to a record. Asian gains were more muted. Pages 23, 26

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Breaking news at europe.WSJ.com

Demonstrators protest IMF, World Bank meetings

Associated Press

STREET ACTION: Turkish police fired warning shots into the air and used water cannons, tear gas and pepper spray on Tuesday to disperse hundreds of stone-throwing activists in Istanbul.

Sterling looks ready to join the sick list

By Neil Shah

After wobbling for the past few weeks, the British pound nose-dived in the wake of weaker-than-expected economic news, raising the prospect that the U.K. currency could be in for a renewed bout of weakness against major currencies.

Currency moves

U.K. industrial production declined in August, undercutting optimism about a swifter-than-expected economic recovery. That news helped drive share prices higher, partly on the expectation that policy makers would have to keep monetary conditions excessively easy for some time in order to ensure economic recovery. That domestic stance, of course, undercuts the attractiveness of the pound to foreign-exchange investors.

The tough U.K. economic news coincided with a short-term rate increase by the Australian central bank, the first Group of 20 nation to raise rates since the financial crisis intensified more than a year ago. That move boosted the Australian dollar to its strongest level against the pound since 1985.

Similar to how investors sorted good banks from bad banks earlier this year, foreign-exchange buyers are starting to sort strong currencies from weaker currencies. The pound appears to be joining the dollar in the weak camp. Both countries have near-zero interest-rate targets, an aggressive policy aimed at boosting the economy, and yawning deficits. The euro and Japanese yen have edged higher, and so-called commodity currencies, such as the Canadian and Australian dollars, seem the most strongly positioned. Oil-rich Norway is also in the favored camp, and its central bank is expected to follow Australia

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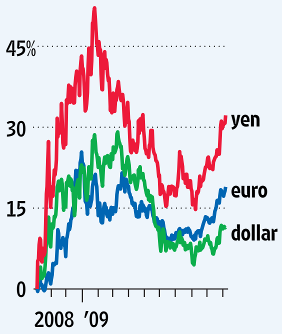
Pounded

Over the past year, the yen, euro and U.S. dollar have been gaining strength against the pound



Source: WSJ Market Data Group

Conservatives vow public-sector pay freeze

By Laurence Norman

MANCHESTER, U.K.—Britain's opposition party detailed a number of measures it would take to improve public finances, vowing a one-year pay freeze for most public sector workers beginning in 2011.

Playing with a lead

Getty Images

Shadow chancellor George Osborne addresses delegates on debt Thursday at the Conservative convention in Manchester, England.

In his keynote speech to the Conservative party annual convention—the last before a general election due in mid-2010—the party's treasury chief, George Osborne, said a Conservative government would have an "unwavering commitment to fiscal responsibility."

The move comes the day after Prime Minister Gordon Brown's Labour government said it was freezing salaries for higher paid public-sector workers from April 2010 as the two parties battle to show they can improve the public finances without slashing front-line services.

Among the measures Mr. Osborne announced were a one-year pay freeze for all public-service workers earning more than £18,000 ($28,650). The Conservatives say the measure would save taxpayers roughly £3.2 billion. Mr. Osborne confirmed the party plans an early increase in the retirement age to 66 as soon as 2016 and said the party would eliminate means-tested benefits for families earning more than £50,000 and would no longer hand out a £250 "child trust fund" for babies born to wealthier families.

He announced a cap for public-sector pensions at £50,000 a year.

Mr. Osborne pitched the call for savings with a promise that no single group would have to bear the brunt of restoring the U.K.'s public finances, which have been rav-

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Solution as problem

German coal-burning plants spark ire with CO_2 burial plan

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Markets

4 p.m. ET

	CLOSE	PCT CHG
DJIA	9731.25	+1.37
Nasdaq	2103.57	+1.71
DJ Stoxx 600	241.17	+2.15
FTSE 100	5137.98	+2.26
DAX	5657.64	+2.70
CAC 40	3770.21	+2.59
Euro	$1.4748	+0.82
Nymex crude	$70.88	+0.67

LEADING THE NEWS

Finance minister says Iceland deal is closer

Sigfússon describes talks to repay U.K. and Netherlands

Iceland, the U.K. and the Netherlands are closer to agreeing to loan terms for Iceland to repay the massive losses by foreign depositors in the collapsed Icesave Internet bank, said Iceland Finance Minister Steingrímur Sigfússon.

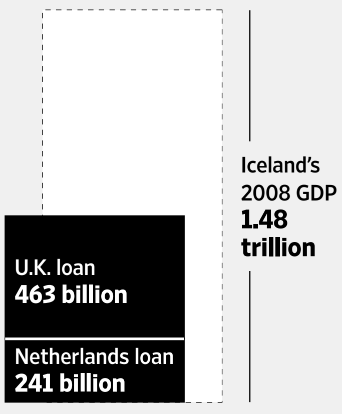
*By **Marc Champion** in Istanbul and **Charles Forelle** in Brussels*

"I feel there is a real will now to move ahead," said Mr. Sigfússon, after what he described as good meetings on the issue with his British and Dutch counterparts at the International Monetary Fund's annual meeting in Istanbul. He said the situation in the U.K. in particular had changed as the issue of lost Icelandic savings moved out of newspaper headlines there.

"We are all getting a little bit embarrassed by this—the IMF program is constantly being delayed," said Mr. Sigfússon in an interview. The fund has pledged substantial aid to Iceland, but the Icesave dispute has slowed it down.

Big debts

Repayments to the U.K. and the Netherlands could make a sizeable dent in Iceland's economy, in kronur



Source: Statistics Iceland

Mr. Sigfússon declined to discuss details of his talks with the Dutch and British finance ministers. But he said one major sticking point remains that the U.K. and Netherlands want a guarantee they will have been paid back in full in 15 years.

A spokeswoman for the Dutch finance minister, Wouter Bos, confirmed Mr. Bos had met with his Icelandic counterpart and that "things are moving ahead." A spokesman for the U.K. Treasury said negotiations were ongoing and declined to comment further.

Iceland's economy collapsed spectacularly last year, after the country's outsized banks, which had moved aggressively abroad in the preceding years, suddenly couldn't finance their borrowings. The government seized them.

One bank, Landsbanki Islands, had offered an Internet account called Icesave that offered high interest rates and took in more than $5 billion in deposits in the U.K. and the Netherlands.

Under European Union rules to which Iceland subscribes, Iceland must provide deposit insurance for about the first €20,000 ($29,000) of every account, regardless of whether an Icelander or a foreigner owns it.

Iceland's tiny deposit-insurance fund couldn't come close to covering the Icesave claims after Landsbanki collapsed, so the British and Dutch governments stepped in to pay their own citizens. The two countries are seeking the money back from Iceland.

Iceland owes about 700 billion kronur ($5.6 billion), or 50% of the country's annual gross domestic product. Iceland's parliament spent all summer debating a government plan to reimburse the two countries. In the end, they approved it over substantial popular discord, but added language indicating that Iceland would slow down its repayments if its economy took another hit in the future.

"People find it vey difficult to accept that they, their children and even their grandchildren may have to bear the burden that banks incurred abroad," Mr. Sigfússon said.

Though the Icesave debate has strained the coalition between Mr. Sigfússon's Left-Green Movement and the ruling Social Democrats, he said he didn't expect the government to collapse, contrary to media reports that it was on the verge of collapsing.

Under the broad terms of the Icesave deal, Iceland doesn't have to make payments for the first seven years, and then has eight years to pay the balance with interest.

Iceland will have a claim on some of Landsbanki's assets. Icelandic officials have said that as much as 75% of the balance owed to the U.K. and the Netherlands could be recovered from those assets.

Mr. Sigfússon said that estimate was realistic. He figured that, in the end, Iceland would end up paying 250 billion to 300 billion kronur, or around 20% of GDP. But parliament's amendment leaves it unclear what happens after 2024 if the country slows down repayments and a balance remains.

Mr. Sigfússon also said Iceland is sticking to plans to begin lifting capital controls on the flow of currency in and out of the country by late fall, though "obviously the delay in the IMF loan means that we can't really plan those steps yet." He said the first step would be to lift controls on new investments and inflows, and for others to follow later. "Lifting the controls would be more important for its symbolic value, showing that we are on track," he said.

The IMF agreed in late 2008 to lend $2.1 billion to Iceland over two years. The first $827 million installment was released, but the remainder has been held up.

Mr. Sigfússon said there was little urgency to lift the controls. He said parts of the real economy were doing well as a result of the weak krona, including tourism and the fishing industry. The value of the krona has halved in the past year. Economic growth is projected to fall 8.5% this year, while unemployment reached 9.1% in the second quarter.

Strong euro weighs on ECB effort to keep recovery on track

BY GEOFFREY T. SMITH

FRANKFURT—The soaring euro is threatening the European Central Bank's efforts to keep the recovery on track.

The currency, not interest rates, now dominates concerns about the durability of the 16-country euro zone's recovery. At its meeting Thursday, the ECB's policy board isn't expected to change interest rates or its less-conventional monetary-policy measures, which include bond purchases.

Instead, financial markets are focusing on the euro exchange rate—which the ECB is unlikely to do anything about. Euro-zone policy makers worry that the ECB's best effort to fine-tune the shift from an expansive to a tighter, more anti-inflationary policy of higher interest rates and less liquidity will be thwarted by the euro's strength. The euro has risen nearly 8% against a basket of major trading partners' currencies since February, with much of that gain in the past month. The currency is moving toward a new high for the year offsetting the ECB's efforts to make life easier for European businesses.

"The [global] recovery is going to be pretty anemic anyway, and the euro is one reason why it will be particularly anemic in the euro zone," said Dominic Bryant, an economist with BNP Paribas in London. A strong currency helps hold down inflation by reducing prices paid for imported goods—particularly commodities priced in dollars, such as oil. But it also makes a country's exports more expensive and less competitive on the global market.

Protecting the recovery is now the first concern, economists say. Holding down inflation is a longer-term problem.

"The ECB can, as far as we can see over the next year, maintain a very accommodative monetary policy," Jörg Decressin, head of the International Monetary Fund's department for global economic studies, said in an interview. But with unemployment in the euro area already at a 10-year high and rising, and with many of the zone's economies barely out of recession, the latest leg of the euro's rally has come at a bad time for European policy makers.

The euro's latest surge came after a weekend meeting of finance ministers and central bankers from the Group of Seven leading industrialized nations in Istanbul failed to convey any impression that China and other Asian countries will soon ease their currencies' dollar pegs.

That has had the uncomfortable effect, for the ECB, of boosting the euro at the expense of the dollar and all the currencies tied to it.

—Andreas Kissler contributed to this article.

INDEX TO BUSINESSES

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

THE WALL STREET JOURNAL EUROPE (ISSN 0921-99)
Boulevard Brand Whitlock 87, 1200 Brussels, Belgium
Telephone: 32 2 741 1211 Fax: 32 2 741 1600
SUBSCRIPTIONS, inquiries and address changes to:
Telephone: +44 (0) 207 309 7799
Calling time from 8am to 5.30pm GMT
E-mail: WSJUK@dowjones.com Website: www.services.wsje.com
Advertising Sales worldwide through Dow Jones International. Frankfurt: 49 69 971428 0; London: 44 207 842 9600; Paris: 33 1 40 17 17 01
Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Basınevi.
Registered as a newspaper at the Post Office.

Editeur responsable: Patience Wheatcroft M-17936-2003

CORRECTIONS & AMPLIFICATIONS

Keller Fay Group, a marketing research firm, surveys 100 consumers each day to ask them about what products they mentioned to friends in conversation. A Tuesday Technology article about online reviews by consumers incorrectly said the firm surveys 100 people each week.

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

Italian court to rule on premier's immunity

Decision will affect suspended cases against Berlusconi

By Stacy Meichtry

ROME—Italy's Constitutional Court is expected to decide this week whether to uphold a law that shields Italian prime ministers from criminal prosecution, in a long-awaited ruling that cuts to the heart of Italian Premier Silvio Berlusconi's controversial dual role as the country's leader and a powerful media mogul.

If the bill is struck down, Mr. Berlusconi could find himself in a thicket of legal trouble, ranging from criminal trials relating to his media empire to a corruption investigation stemming from his career in politics.

Agence France-Presse/Getty Images

From left, Niccolo Ghedini, Piero Longo and Gaetano Pecorella, lawyers for Italian Prime Minister Silvio Berlusconi, are seen at a session of Italy's Constitutional Court in Rome on Tuesday to review a law shielding some elected officials from prosecution.

Mr. Berlusconi has long denied all the charges leveled against him. The immunity law was one of the first bills his government pushed through Parliament after he started his third term as prime minister in April 2008, giving him a respite from legal battles. Both chambers of Parliament passed the law in July 2008, but it was subsequently challenged by Italian prosecutors who questioned its constitutionality.

Mr. Berlusconi is unlikely to step down if his legal woes are revived, his lawyers and political allies say. Polls show that nearly half of Italian voters support him, and Italy's center-left opposition is currently without clear leadership. However, Mr. Berlusconi is smarting from five months of intense scrutiny of his private life, and the specter of criminal prosecution could put further strain on his ability to govern, some analysts say.

Silvio Berlusconi

"He'll be forced to divide his time between governing and the courtroom," said Alessandro Campi, director of the right-wing think tank Fare Futuro and a political scientist at the University of Perugia.

During his 15 years in politics, Mr. Berlusconi has been beset by criminal investigations, indictments and trials on charges ranging from false accounting to corruption. The premier has long denied all the charges against him, arguing that he is the victim of left-leaning judges. In some of the cases, Mr. Berlusconi was acquitted at trial. In some others, the statute of limitations on the alleged crimes expired; because of that, he either wasn't charged, or the charges were dropped when the statute of limitations expired.

However, there are three cases pending against the premier. Mr. Berlusconi faces one criminal trial on charges of fraud and false accounting stemming from his role as owner of private broadcaster **Mediaset** SpA, and a second criminal trial on charges of bribing one of the witnesses in the Mediaset-related trial. Separately, Milan magistrates are investigating whether Mr. Berlusconi allegedly corrupted left-leaning senators in early 2008. Mr. Berlusconi denies all the fraud, false accounting and corruption charges against him, said Piersilvio Cipolotti, one of his lawyers, in an interview. All three of these proceedings have have been suspended under the immunity law.

For decades Italian politicians enjoyed immunity from criminal investigations, but the shield was eliminated in the early 1990s amid public outrage over the "Clean Hands" bribery scandals that eventually brought down Italy's reigning political establishment.

In 2003, Mr. Berlusconi first attempted to erect a legal shield for top officials including the sitting prime minister, the president and the heads of the lower and upper houses of Parliament, during their term in office. The law was swiftly struck down by the Constitutional Court, which argued that the law unfairly placed officials above the law. Weeks after returning to office in the spring of 2008, Mr. Berlusconi introduced a new immunity law that, unlike its predecessor, allowed top officeholders to opt out of its protections. Months later, prosecutors in Milan filed an appeal to the Constitutional Court.

On Tuesday, lawyers representing Mr. Berlusconi and the Italian government delivered arguments before the Constitutional Court. Glauco Nori, a lawyer for the government, argued that drawn-out legal proceedings could distract Mr. Berlusconi from his duties as prime minister. Niccolo Ghedini, Mr. Berlusconi's personal lawyer, argued that Mr. Berlusconi's duties as prime minister risked infringing on his right to defend himself in court.

"The premier is not getting special treatment. He's getting a slight postponement to allow him to exercise the mandate given to him by the people," said Mr. Cipolotti.

The suspended case involving fraud and false accounting charges relates to arrangements by Mr. Berlusconi to buy film rights in the 1990s on behalf of Mediaset. Mr. Berlusconi has long denied and continues to deny both charges in that case, Mr. Cipolotti said.

In connection with that case, prosecutors in Milan have also charged Mr. Berlusconi with corruption for allegedly ordering the payment of more than $600,000 to his co-defendant, British lawyer David Mills, allegedly in exchange for false testimony. In February, Mr. Mills was convicted of perjury and accepting the bribe and sentenced to four and half years in prison. Mr. Mills is appealing the conviction. A hearing in Mr. Mill's appeals case is scheduled for later this week. Mr. Berlusconi denies ordering the payment, Mr. Cipolotti said.

Following an investigation in late 2007, prosecutors charged Mr. Berlusconi with "inciting corruption," for allegedly seeking to influence the votes of left-leaning senators. That investigation has also been suspended under the immunity law. Mr. Berlusconi denies the charge, Mr. Cipolotti said, describing the allegation as "science fiction."

"The case is pure politics," Mr. Cipolotti said, adding that all of the proceedings against Mr. Berlusconi "are bound to start up again" if he loses his immunity.

Mr. Cipolotti said the total charges in every pending investigation and trial against Mr. Berlusconi could result in a maximum total prison sentence of up to 21 years, though any penalties that might eventually be leveled against the premier are unlikely to reach the maximum level.

—Margherita Stancati contributed to this article.

Polanski loses bid for freedom

Associated Press

BERN, Switzerland—Roman Polanski lost his first bid to win his freedom Tuesday as the Swiss Justice Ministry rejected an appeal by the 76-year-old to be immediately released from prison, an official said.

Already locked in a Zurich cell for the past dozen days, Mr. Polanski learned he will remain incarcerated for an extended period.

"We continue to be of the opinion that there is a high risk of flight," said ministry spokesman Folco Galli, explaining the decision. Mr. Galli said the risk was too great for the government to accept bail or other security measures in exchange for the release of the filmmaker, who is wanted by U.S. authorities for raping a 13-year-old girl in 1977. Switzerland says there has been an international warrant out on him since 2005.

Mr. Polanski was apprehended Sept. 26 as he arrived in Zurich to receive an award from a film festival. In Paris, Mr. Polanski's lawyers said they will focus on convincing the court to free Mr. Polanski.

LEADING THE NEWS

Turkey and Armenia near friendship pact

Erdogan says deal will come Saturday; a statue's travails

Turkey dropped a key condition to signing a protocol on Saturday that would reopen its border with Armenia and establish diplomatic relations between the two nations, divided for generations by a dispute over genocide.

*By **Marc Champion** in Istanbul and **Nicholas Birch** in Kars, Turkey*

Nicholas Birch for The Wall Street Journal (2)

An uncompleted monument to Turkish-Armenian friendship looms over Kars, above, in eastern Turkey. A monuments commission has ordered that the statue, built when Naif Alibeyoglu, right, was mayor, be torn down because it was built without planning permission. The case is now in the central government's hands.

Prime Minister Recep Tayyip Erdogan of Turkey said in an interview with The Wall Street Journal that the signing wasn't dependent on progress at talks to be held in Moldova this week between the leaders of Armenia and Azerbaijan over their territorial conflict in Nagorno Karabakh.

It was because of Armenia's effective occupation of Nagorno Karabakh, an ethnic Armenian enclave in Azerbaijan, that Turkey closed the border in 1993. An earlier attempt to sign the protocol in April stalled when Mr. Erdogan said it could go forward only if the Karabakh conflict was resolved first.

"The agreement will be signed on Oct. 10. It doesn't have anything to do with what happens in Moldova," said Mr. Erdogan, speaking in Istanbul on Sunday.

The travails of a large concrete monument to unity between the two peoples, built last year in the Turkish border town of Kars, show why a true rapprochement is proving so hard to pull off and could yet derail. The statue of two 30-meter tall human figures, standing face to face on a hill above the city, is incomplete: A giant hand that would join the figures was never attached. It lies abandoned on the gravel below. The monument is now under threat of destruction.

"Small-minded people blocked the monument and they will block the peace process too," says Naif Alibeyoglu, who had the statue built when he was mayor of Kars. His 10 years in office ended in March. "You wait and see, [the deal] will end up like my statue: a statue without hands."

The parliaments of Armenia and Turkey need to ratify the protocol for it to take force, something Mr. Erdogan said he couldn't guarantee, as parliamentarians in Ankara would have a free vote in a secret ballot.

Mr. Erdogan also said the two processes—a resolution of the Karabakh conflict and rapprochement between Turkey and Armenia—remain linked, and that a positive outcome in Moldova would help overcome it all. Turkish officials have continued to indicate the border could take longer to open than the three months set out in the three-page protocol.

The Turkish leader said the only obstacle to signing the deal on Saturday would come if Armenia seeks to alter the text. "This is perhaps the most important point—that Armenia should not allow its policies to be taken hostage by the Armenian diaspora," Mr. Erdogan said. Much of Armenia's large diaspora opposes the protocol.

A spokesman for Armenia President Serzh Sargsyan declined to comment on whether Armenia would seek changes to the protocol. He said the government would make a statement on "steps" concerning the protocol soon.

Mr. Sargsyan has spent the week on a multination tour to explain his position to diaspora groups, some of which have protested against it. They believe it will be used by Turkey to reduce international pressure on it to recognize as genocide the 1915 slaughter of up to 1.5 million ethnic Armenians in what was then the Ottoman Empire. Mr. Sargsyan visited Paris, New York, Los Angeles and, on Tuesday, Beirut, where 2000 Armenians turned out waving banners such as "we will not forget," according to news agency reports. His last stop will be in Russia.

The rapprochement between Turkey and Armenia has strong backing from the U.S. and the European Union. They hope the change could trigger a virtuous cycle, opening up and stabilizing a region that is increasingly important for oil and gas transit and last year saw war between Russia and Georgia.

In addition to eventually opening the border and establishing diplomatic relations, the protocol would also recognize the current frontier. It would set up a joint commission to review issues of history, likely to include the 1915 massacres. Turkey says they were collateral deaths during what amounted to civil war during World War I.

Mr. Alibeyoglu, the former Kars mayor, worked hard to improve relations between his city—a former Armenian capital that changed hands and populations several times over centuries—and its natural hinterland, the Caucasus. He invited Armenian, Azeri and Georgian artists to festivals, signed twinning agreements with cities across the region and, in 2004, gathered 50,000 signatures for a petition demanding the opening of the Turkish-Armenian border.

Kars would stand to benefit from the ability to trade across a border 40 kilometers away by train and truck. Currently, traders must drive hundreds of kilometers via Georgia.

But history has created deep suspicions. When Russia took over Kars in the 19th century, many Armenians returned, only to be driven out again during World War I. Today, some 20% of the city's population are ethnic Azerbaijanis, who consider opening the border while Armenia remains in control of a fifth of Azerbaijan's territory a betrayal.

Sculptor Mehmet Aksoy says he had to abandon his plan to run water down the statues to pool as tears, because nationalists complained these would be tears of Armenian rejoicing at reclaiming territory. Indeed, one complaint of nationalist opponents of the protocol in Armenia is that the treaty's recognition of current borders would prevent any future claim to the swathe of Eastern Turkey that Armenia won in a 1920 treaty, only to lose it again in the 1921 Treaty of Kars between Russia and Turkey.

"Why is one figure standing with its head bowed, as if ashamed?" asks Oktay Aktas, an ethnic Azeri and local head of the Nationalist Action Party, or MHP, who wants the statue torn down. "Turkey has nothing to be ashamed of."

In fact, the two figures in the monument stand ramrod straight.

Nationalists on the other side of the border have taken to the streets to protest against the pact with Turkey. "Turkey will cite the protocol and proceed with its efforts to rewrite history," and deny the genocide, said Vartan Oksanian, a former Armenian foreign minister from the nationalist Dashnak party in a recent speech. He called for the clause on the joint history commission and on recognition of the border to be removed from the text.

Mr. Alibeyoglu says he planned the monument as a counterweight to a memorial in Yerevan to the 1915 massacres and a statue in the nearby Turkish town of Igdir, close to Mount Ararat. The Igdir monument commemorates a much smaller number of Turks who were killed by ethnic Armenian militias around the same time.

Turkey and Armenia are "like two neighbours who do not know each other," Mr. Alibeyoglu says. "Is he a terrorist? A mafioso? We needed to break the ice."

But Mr. Alibeyoglu was running ahead of his own party, Mr. Erdogan's ruling Justice and Development party, or AKP. The government began secret talks with Armenia two years ago, and relations really only took off in September 2008, when Turkey's president went to watch the Turkish football team playing Armenia in Yerevan. He was the first Turkish leader ever to visit Armenia. Mr. Sargsyan is due to close the circle by attending the return match in Turkey next week.

Mr. Alibeyoglu failed to get backing for his projects and was shunted aside by the AKP in the run-up to municipal elections this year. When Mr. Aktas applied to Turkey's Commission for Monuments to get construction stopped, on the basis that a viewing platform for the monument was built without planning permission, the commission ordered work the statue to be demolished. Its fate awaits a final decision from the central government in Ankara.

IMF idea flawed, Malaysia argues, but plan won't affect reserves

By Bob Davis

ISTANBUL—Malaysia's central banker, Zeti Akhtar Aziz, said that the country's foreign-currency reserves wouldn't be affected under a proposal for the International Monetary Fund to become a kind of global central bank.

IMF Managing Director Dominique Strauss-Kahn has used the fund's annual meeting to suggest making the IMF an international lender of last resort. If the IMF had sufficient funds to lend widely, he argues, nations would have less incentive to build up foreign-currency reserves as a kind of insurance. If countries reduced their reserves, they would have more money to spend to build their economies.

Ms. Zeti said that the flaw in the IMF's reasoning is that reserves, at least in Malaysia's case, come from foreign capital inflows, which vary from year to year. The IMF seems to think, she said, that reserves of countries like Malaysia stem from a policy of building a trade surplus by undervaluing the local currency and building a trade surplus, which governments can more easily regulate.

"They have the wrong perception" that the accumulation of reserves is from trade surpluses, said Ms. Zeti in an interview. "It looks like our reserves are very high, but a significant part is short-term [capital] inflows that could reverse." Malaysia's reserves are about $90 billion, she said, down from $120 billion in 2008.

"A certain level of reserves is important," said Ms. Zeti, governor of Bank Negara Malaysia. "Beyond that, it's beyond the control of a small country like Malaysia." Ms. Zeti said Malaysia was weathering the economic crisis reasonably well, thanks in part to fiscal stimulus.

She said the country shouldn't start withdrawing support until it saw a turnaround in private investment. "We have to see a private sector-led recovery that's benefiting from more than fiscal stimulus," she said.

Malaysia, which has grown rapidly for 30 years, isn't a member of the Group of 20 nations or the Financial Stability Board, which rankles many in the country. "We want our voice to be heard," she said, adding that perhaps the G-20 and FSB could "engage with regional groups."

Ms. Zeti said the financial crisis hadn't thrown Malaysia off its plan to award seven new banking licenses to foreigners—the first such award in 40 years—by year-end. Two licenses are for Islamic banks, the other five for traditional ones.

Separately, the IMF has granted Iraq $5 billion to support the government's budget, Iraqi Finance Minister Baker al-Zubaidy said.

Cameron faces challenge to maintain lead

Conservative leader needs to convince U.K. he can reduce record debt without hampering economic recovery

By Alistair MacDonald

Britain's opposition Conservative Party and its leader, David Cameron, are meeting this week with a problem they haven't had in years: how to protect a huge lead that has many convinced the Tories will return to power for the first time since 1997.

Mr. Cameron is increasingly seen as the U.K.'s prime minister in waiting. His party has a big advantage over the ruling Labour Party in opinion polls and his incumbent opponent, Gordon Brown, is faltering ahead of elections due to be held by June.

David Cameron

At the Conservative Party annual conference in Manchester, Mr. Cameron is aiming not to blow the lead. He is detailing plans for containing the U.K.'s big budget deficit; selling the public on what he calls a modern and more diverse party; and trying to prevent his party's candidates from growing complacent.

On the policy front, Mr. Cameron has spent months highlighting the U.K.'s record debt load; now he must convince Britain he can reduce it without hampering the economic recovery. And he must present a united party front just as some old divisions—over questions like how integrated the U.K. should be with Europe—are re-emerging.

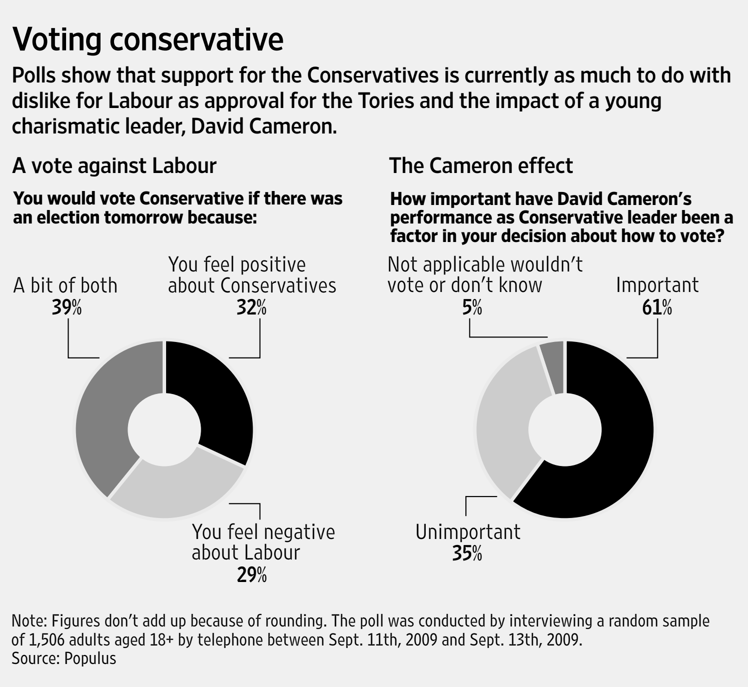
"David Cameron has done enough to make the party acceptable in an era of a deeply unpopular government, but he hasn't done more than that," said John Curtice, professor of politics at the University of Strathclyde. "They need to come out of this conference able to show the nation what a future Conservative government will mean," he said.

On Tuesday, the shadow finance minister George Osborne attempted to address what the Tories would do to cut Britain's record debt load. But his promises of a one-year pay freeze for most public-sector workers and an early increase in the retirement age for state pensions, may do little to dispel a view that the Tories are "constrained by a political narrative that paints them as careless cutters of public services," says Ian Mulheirn, a director at London-based policy research group the Social Market Foundation.

As for the risk of complacency, Mr. Cameron told delegates on Monday: "This is not some week of celebration." To that end, candidates have been told by party officials that they need to watch what they say to the press and behave themselves at the bar, several of those candidates say.

Haunted by three successive general election defeats and the large lead that a celebratory Labour lost to Conservatives in 1992, this Tory generation is taking nothing for granted.

"Emotionally, I really do not want to look at myself in the mirror the next morning, if [Labour MP] Phil Hope has beaten me, and say I lost because I took the foot off the gas," said Louise Bagshawe, a Conservative candidate and a novelist whose "chick-lit" books appear in U.K. best-seller charts. Ms. Bagshawe and many other candidates have been in full election mode since the summer.



Mr. Cameron has made strides in broadening the party's base, an effort that has been criticized as political correctness by some Tories. But in an increasingly diverse country, the party has yet to shake off the image as being one of white, privately educated men.

Indeed, the Conservative slate—including new candidates and sitting members of Parliament—will be 21% female, with 4.7% of candidates drawn from ethnic minorities. This compares with 28% of Labour's slate being female and 6% from ethnic minorities.

The disparity leaves the party open to Labour criticism that Mr. Cameron's "modern" Conservatives are at heart the same party. A poll this week for the Times of London bears this out, with only 28% of those polled believing the party has changed under Mr. Cameron.

The last time the Conservatives won an election, in 1992, a recent census had shown that 6% of England, the party's stronghold, was nonwhite. The Office of National Statistic estimates that, by 2007, that had doubled to 12%. The party has typically struggled to win minority votes, with Labour polling 70% of the nonwhite vote in 1997 and the rest split between the Tories and other parties. Likewise on gender, in the last election in 2005, both parties attracted 34% of male voters, but 38% of women voted for Labour and only 32% for the Tories.

"We have had a massive mountain to climb and there is still a long way to go," said Wilfred Emmanuel-Jones, a Conservative candidate in southwest England who arrived in the U.K. from Jamaica as a child and sells farm produce under the name of the Black Farmer.

Mr. Cameron faces another problem: the sheer size of Labour's incumbent advantage. Because the Conservatives were defeated heavily in the last election, winning 198 seats in Parliament against 356 for Labour, a large slice of these candidates must win to avoid a so-called hung Parliament in which no party has a majority and parties need to form alliances with other parties to push through their agendas. To win a majority, the Tories need to hold on to every one of their current seats and add an additional 117 constituencies. This would be the biggest number of Tory gains at a general election since 1931.

Three win Nobel in physics for breakthroughs in light

By Gautam Naik

Three scientists who harnessed the power of light in ways that turned the Internet into a global phenomenon and launched the digital-camera revolution were jointly awarded the Nobel Prize in physics.

Charles Kao, who was born in Shanghai and has both U.K. and U.S. citizenship, received half the total prize money of $1.4 million. Dr. Kao was lauded for a breakthrough that led to fiber-optic cables, the thin glass threads that carry a vast chunk of the world's phone and data traffic.

The other half of the prize was awarded to Willard Boyle and George Smith of Bell Laboratories in Murray Hill, N.J., for work that led to the charge-coupled device. The CCD sensor turns light into electrical signals and eliminates the need for capturing images on film, a far more cumbersome and expensive approach. Drs. Smith and Boyle are Americans; Dr. Boyle also holds Canadian citizenship.

In 1966, Dr. Kao, while working at Standard Telephones and Cables' laboratory in Harlow, England, tackled the problem of light loss in optical fibers. Back then, messages could travel for 20 meters or so before light began to be lost in the fiber available at the time.

Dr. Kao realized that the light loss was due to imperfections in the glass, not in the technology itself. He figured out a way to increase the distance to 100 kilometers, which then opened the way to moving signals over far greater distances. The first ultrapure fiber was made just four years later, in 1970.

Today, fiber-optic cables make up the circulatory system of the Internet, transporting words, sound and images from one side of the planet to the other in a split second.

Charles Kao, left, Willard Boyle, center, and George Smith were awarded the Nobel Prize in physics Tuesday.

Drs. Boyle and Smith's work transformed photography. By adopting aspects of the photoelectric effect—the breakthrough for which Albert Einstein won his physics Nobel in 1921—the two scientists designed an image sensor that could gather and read out the signals in a large number of pixels, or image points, in a short time.

France's budget deficit almost doubles, as stimulus measures widen gap

By Geraldine Amiel

PARIS—France's budget deficit almost doubled from a year earlier, on increased spending from the country's stimulus measures and lower tax revenue as the economy emerges from recession, data for the January-to-August period showed Tuesday.

During the January-to-August period, the French budget deficit amounted to €127.6 billion ($188.1 billion), compared with a budget deficit of €67.6 billion for the year-earlier period, the French Budget Ministry said.

Of the latest total, €26.4 billion is linked to the stimulus package, while €60 billion is due to lower tax receipts as a result of the economy's deterioration, the ministry said.

"Spending is not the issue," a Budget Ministry spokesman said. He added that current spending, excluding stimulus measures, remains stable on a yearly basis. "Lower tax receipts are rather the issue," he said.

The French government has planned to pump around €26 billion directly into the country's economy, of which €18.2 billion had already been injected between last fall and August 2009, a ministry spokesman said. Even though the improvement of economic conditions could help French companies and boost corporate tax receipts, unemployment is likely to keep rising, further denting tax revenue.

Last week, the government presented France's budget bill for 2010. It forecast a public deficit for this year of €141 billion, or 8.2% of the country's gross domestic product, from a previous forecast of a €104.4 billion deficit and an initial forecast of a €67 billion deficit from 2009's budget bill.

In 2008, the French budget deficit over the year amounted to €56.3 billion, representing 3.4% of the country's GDP, according to the Budget Ministry's database.

From a peak in 2010, France's budget deficit is then predicted to narrow in the following years as the recovery gradually takes hold, reaching 6% of GDP in 2012 and 5% of GDP in 2013, still a long way from the 3% threshold demanded by the European Growth and Stability Pact.

CORPORATE NEWS

Tesco posts modest profit gain

Faster growth in Asia, greater volume in the U.K. provide solid, first-half sales increase

By Cecilie Rohwedder And Kathy Sandler

British retailer **Tesco** PLC reported a modest first-half profit increase, helped by fast growth in Asia and an upswing in its U.K. business.

Earlier this year, sales growth at Britain's biggest retailer lagged behind aggressive price-cutting rivals. For the six months ended Aug. 29, however, Tesco's sales rose 8.3% to £30.4 billion ($48.33 billion). Chief Executive Terry Leahy said the company's U.K. sales growth had caught and was now ahead of rivals.

Mr. Leahy also said global economies have begun what he called a "slow but steady" recovery. Shoppers are spending again on premium products, such as organic foods and prepared meals, and returned to buying nonfood items such as electronics and clothing, he said.

"We're past the low point, things are getting better," Mr. Leahy said. "People have stopped down-trading."

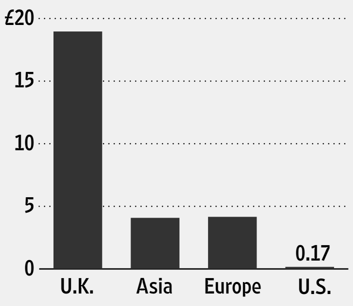
Tesco, based in Cheshunt near London, said net profit in the six months through Aug. 29 rose 1.3% to £1.03 billion, reflecting goodwill write-offs. Profit before tax and one-time items rose 8.6% to £1.57 billion during the period, from £1.45 billion in the first half of last year.

Tesco's rebound comes a year after the grocery retailer launched a line of lower-priced products designed to keep recession-plagued shoppers from defecting to discounters.

The cheaper goods lured consumers back to Tesco, the retailer said, but pushed down the value of their purchases at the checkout. As a result, Tesco acknowledged, its sales growth appears smaller than that of competing stores in pound terms.

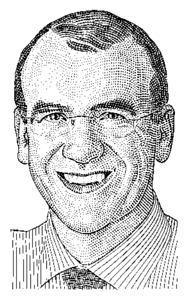
Looking overseas

Tesco's revenue by region for the first half of 2009, in billions



Source: the company

Customers shop in a Tesco supermarket in London.



Terry Leahy

Tesco's main rivals—Asda, a unit of **Wal-Mart Stores** Inc., **J Sainsbury** PLC and **William Morrison Supermarkets** PLC—also increased the number of cheaper products and cut-rate store brands on their shelves. But Mr. Leahy said Tesco outdid them, and therefore suffered slower sales growth in comparison. He said Tesco accepted the development because volume sales, the number of goods shoppers bought, are increasing. Tesco will keep selling the discount brands when economy improves but will not add to them, Mr. Leahy said.

In the U.K, second-quarter sales in stores open at least a year rose 3.1%, a figure excluding gasoline and value-added sales tax. "This growth, and also the pattern of trading we have seen so far during the second half, confirm that our growth rate has converged with the wider industry," Tesco said in a statement.

Like other grocery chains, Tesco is contending with a slowdown in the rise of food prices. The fall in food inflation benefits shoppers, but poses a challenge for retailers because lower checkout receipts reduce sales and profits.

In its fledgling U.S. business, Tesco lost £85 million in the first half of its fiscal year. The retailer made several changes at its U.S. operation, a chain of small grocery stores called Fresh & Easy. It is relaunching Fresh & Easy with a new advertising campaign touting its product quality and competitive prices. Tesco is still adding about one U.S. store a week, but the pace is slower than originally planned and weighs on its bottom line.

"Trading losses reflect the fact that Fresh & Easy has been built with the necessary infrastructure in place to support hundreds of stores and is currently therefore operating with a high cost base relative to the scale of the business," Tesco said.

For future earnings growth, Tesco is planning to expand its banking business, where profit margins are far higher than in grocery retailing. The company said it will consider buying banking assets if European rules force state-aided banks to divest parts of their business, but has no plans to acquire U.K.-based Northern Rock, said group finance director Laurie McIlwee.

On Tuesday, Tesco renamed its personal finance business Tesco Bank, moving closer to becoming a full-service retail bank.

Shell to increase North American natural-gas drive

By Russell Gold

Royal Dutch Shell PLC plans to increase natural-gas production in North America, said Marvin E. Odum, head of the company's U.S. unit.

Though gas prices are low now, Shell believes long-term prices will recover, justifying the company's interest, Mr. Odum said.

He said the growth in gas production would come from the company's deep-water discoveries in the Gulf of Mexico as well as from giant shale formations in western Canada, the Rockies and the Gulf Coast.

Shell's natural-gas production in the U.S. fell to 1.05 billion cubic feet a day last year, down 9.5% from two years earlier, according to company filings. Its Canadian production has been flat. Still, North American natural gas currently accounts for about 7.8% of Shell's global oil and gas production.

North American gas production "could be much more than what we're producing now," Mr. Odum said in an interview Monday. He declined to say how much he expected it to grow, however.

Shell moved quickly to embrace the unconventional gas discoveries made by smaller, independent producers earlier this decade. In 2007, it joined with Calgary-based **EnCana** Corp. to develop acreage in Louisiana's Haynesville shale. Shell last year paid $5.87 billion to acquire Duvernay Oil Corp., a company that had amassed 450,000 acres in western Alberta and British Columbia that appear promising for gas production.

Shell has what Mr. Odum called "a very significant land position" in parts of North America where large amounts of natural gas is trapped in dense rocks such as shale.

Exxon buys stake in Ghana oil field

By Russell Gold

Exxon Mobil Corp. has agreed to buy a $4 billion stake in an oil field off the coast of Ghana, according to people involved in the deal, as the global energy giant seeks a foothold in a major new oil-producing region.

The deal is Exxon's first major purchase in a decade and appears to highlight that the company believes oil prices will rise over the long term. Some energy analysts have asserted that weak demand for the fuel can't support even the current price of $70 a barrel.

A spokesman for Exxon declined to comment. People briefed on the deal said that while the parties have reached a binding agreement, the deal hasn't yet been approved by the Ghanaian government and is therefore subject to change.

The seller is Dallas-based **Kosmos Energy**, which was part of a group that made the 2007 offshore discovery that is estimated to hold 1.8 billion barrels of oil. **Anadarko Petroleum** Corp. and **Tullow Oil** PLC also own separate stakes in the field, known as Jubilee.

On Monday Kosmos informed bidders for its 23.5% stake in the field that it had "entered into an exclusive binding agreement" with Exxon, according to a person who had seen the letter.

The news of the deal was cheered by investors. In London trading Tullow rose 8.4% to £12.09 ($19.28). In afternoon New York trading, Anadarko was up 6.1% to $65.41 and Exxon was up 1.5% at $68.58.

Also in New York, shares of **Blackstone Group** LP, a part-owner of Kosmos along with private-equity firm **Warburg Pincus**, were up 6.1%.

The oil industry has become increasingly optimistic about the prospects for oil production off the West African coast. This summer, a separate consortium announced a discovery off Sierra Leone, leading analysts to speculate that the 1,100-kilometer stretch between the two finds could be dotted with buried sands containing precious light crude oil.

Exxon's entry amounts to a seal of approval. "If Exxon Mobil likes this stuff, then everyone knows it's good," says Neil McMahon, an energy analyst with Sanford C. Bernstein.

The acquisition is the largest deal for the famously conservative company in over a decade. In the late 1990s, Exxon Corp. and Mobil Corp. combined in an $81.2 billion merger, creating the world's largest shareholder-owned oil company.

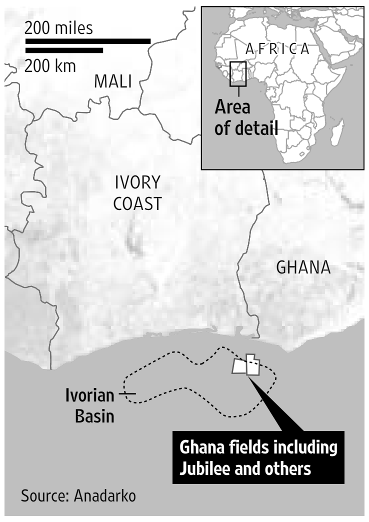
Around the same time, Exxon bid aggressively for exploration licenses in several deepwater blocks off Angola, which was then an unproven oil region emerging from years of civil war. The deal proved prescient: Angola is now a major oil producer and in 2007 became a member of OPEC.

Opening up its wallet to purchase oil assets signals a new strategic direction for Exxon. Over the last decade, the Texas behemoth has been reluctant to make any large purchases, even as its holdings of cash and repurchased stock ballooned. At midyear, it held $15.6 billion in cash, and the value of treasury shares it has bought back since 2001 were worth $173.6 billion.

The Ghana purchase suggests that Exxon is moving to replenish its oil reserves by building its portfolio asset by asset, rather than by making a megadeal. Indeed, analysts say that Exxon, with its $325 billion market capitalization, may be too big already in the eyes of regulators to swallow another large oil company.

In addition to buying into the new West Africa oil province, Exxon is engaged in some high-profile, deepwater exploration activities off the coasts of the Philippines, Turkey, Madagascar and Greenland. It also recently backed a large oil-sands development in Canada and a gas export facility in Australia. While none of these regions is large enough to transform the company, put together they could help Exxon maintain its production and reserves.

The Kosmos deal also underscores a new willingness by Exxon to acquire assets in the face of rising financial strength and global ambition on the part of oil companies backed by the Chinese and Indian governments. **China National Offshore Oil** Corp. and India's **Oil & Natural Gas** Corp. were viewed as potential buyers for the Kosmos stake.



Source: Anadarko

For major privately owned oil companies, "Access to reserves is a huge issue," says Peter Hitchens, an oil analyst with financial services company Panmure Gordon. "In Brazil, they're having to compete with the Chinese and the Indians. So if you can get into a new play at an early stage like this, it's very desirable."

It isn't clear which company would be the operator of Jubilee, which is expected to begin producing oil in 2010. Tullow has a 34.7% stake, larger than the share Exxon is acquiring from Kosmos. Anadarko also holds a large interest. The Ghanaian national oil company and two other companies hold small stakes.

—Guy Chazan and James Herron contributed to this article.

Plaintiffs' lawyer tells jury Vivendi misled the public

By Chad Bray

France's **Vivendi** SA and its management repeatedly misled the public about the company's financial health before a liquidity crisis in 2002, a lawyer for Vivendi shareholders said Tuesday.

In his opening statement in a class-action lawsuit against the company, Arthur N. Abbey said Vivendi management portrayed the company as financially healthy, but that internally, management was concerned about potential liquidity problems. He also said the company's publicly reported financial results were bolstered through "accounting magic" and that executives failed to tell the public the company wasn't producing enough cash to cover its growing debt.

Paul C. Saunders, a lawyer for Vivendi, said the company had enough cash and credit to pay its bills and never defaulted on a single obligation. He said the company properly reported its financials as required under accounting rules.

The suit alleges Vivendi, former Chief Executive Jean-Marie Messier and Guillaume Hannezo, a former chief financial officer, made material misrepresentations and omissions concerning the firm's liquidity position. They have denied wrongdoing.

Special Advertising Section

GLOBAL FINANCE

Unprecedented action helps defuse crisis, postrecession world becomes clear

GETTY IMAGES/3D4Medical.com

With commitments of €5 trillion, government rescue efforts helped avoid 'worst-case' scenario. By Catherine Bolgar

As bad as this recession is, it could have been worse. Unprecedented government action, coordinated among many countries, along with major moves by international organizations helped stem the panic and put a floor under the financial crisis that a year ago threatened to melt down the global economy.

"What's been unusual in this downturn has been the widespread speed in taking action to help stabilize financial markets, done in an unusually coordinated fashion," says Nigel Pain, senior economist at the Organization for Economic Cooperation and Development (OECD) in Paris. Actions taken by one country helped others.

These actions included shoring up bank capital, providing debt guarantees to banks and buying all or parts of banks' distressed assets. According to an assessment of financial-sector rescue programs published in July by the Bank for International Settlements,

Continued on following page

REUTERS/Alex Grimm; Larry Downing; Jason Lee

Central banks around the world, including Europe, the U.S. and China, have coordinated in slashing interest rates. Successive cuts have brought rates near to zero in the U.S. and the U.K.

Unprecedented action helps defuse crisis, postrecession world becomes clear

Continued from previous page

the Basel-based bank for central banks, 11 countries committed a combined €5 trillion, while actual outlays have reached €2 trillion. "Overall, it is fair to say the rescue measures have contributed to an avoidance of 'worst-case scenarios,'" the report says.

Other actions included interest-rate cuts by central banks, starting last October, when the Frankfurt-based European Central Bank, and the central banks of the U.S., U.K., Switzerland, Canada, Sweden and China slashed rates in a coordinated move. Successive cuts have brought rates near to zero in the U.S. and the U.K. In that way, policy makers have learned lessons from the 1990s, when Japan waited while its economy stumbled, and took action only in small steps that weren't enough to shake the malaise for a decade.

The downturn even infected economies that had never touched toxic securities derivatives.

Except for the U.S., most countries have adopted an export-led growth model, which screeched to a halt when demand for their products dried up almost overnight. The World Bank stepped in to aid poorer countries, while the International Monetary Fund bailed out several countries, such as Iceland and Serbia.

'On a roll'

The IMF "hit on a real roll for itself," says Alexei Monsarrat, director of the global business and economics program at the Atlantic Council of the U.S., a Washington think tank. The IMF "did what it was supposed to do: get countries money in a way that made sure the economy didn't collapse," he says. "It was much the ability of a country to open a line of substantial credit even if it didn't draw on it that kept their markets from collapse."

The IMF has a fine line to walk. Its response to the 1997 Asian crisis was criticized for the extent to which it pressed countries there to open their economies and make other structural reforms. This time, the conditions attached to its loans are aimed at getting countries away from the imbalances — such as large public debt — that made them vulnerable.

Often, the reason a country is "in trouble is there are strong interest groups who have consumed resources in one way or another," says Raghuram Rajan, finance professor at the University of Chicago Booth School of Business and IMF chief economist from 2003 to 2006. "Now you have to upset those groups.

"You have to be careful when the IMF is too friendly. If nobody complains, that means it isn't being tough enough."

> *"The question isn't when the recession will end, but what will the new normal look like."*

Exit strategies

As economies around the world stagger slowly back to their feet, it's time to start thinking about exit strategies to unwind the exceptional government participation in, or control of, private-sector companies, the special guarantees, the extremely low interest rates, the ramped-up government spending. "How do you unwind the massive liquidity that's been injected into the system before you have long-term problems with inflation," says Max von Bismarck, director and head of investors at the New York-based World Economic Forum USA. The more immediate question is how to pull out of direct investments in the private sector without new turmoil. "We think that in the end governments might be forced to hold some of these assets longer than they originally thought," he says.

Policy makers need to announce their intentions well in advance to minimize disruptions, says Mr. Pain of the OECD, though it's still too soon to actually withdraw the special recession measures.

'The new normal'

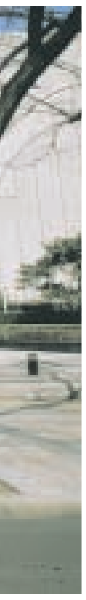
Everybody is wondering how long the recession will last, "under the quiet assumption that everything will go back to normal," Mr. von Bismarck adds. "The key question isn't when the recession will end, but what will the new normal look like."

Two things are becoming clear: The consumer-driven growth of the U.S. and the export-driven growth of much of the rest of the world are likely to evolve into what economists hope will be a healthier, more sustainable mix of consumption and exports all around. And emerging markets are coming into their own politically.

"Clearly there is going to be a shift where the share of consumption to GDP in the U.S. will shrink," says Christian Menegatti, head of global economic research at RGE Monitor, an economic consultancy in New York. "At the same time, emerging markets will want to shift from export-led growth to more domestic consumption."

The change had already begun before the crisis hit, with emerging markets accounting for half of world economic growth, says Dr. Rajan of the University of Chicago.

The other big shift has been that the crisis discussions among policy makers have moved from the Group of Eight big industrial nations to the Group of 20, which was created in 1999 to include key developing countries, such as China and Brazil. The change — formally cemented at the G-20 meeting last month — is proof this recession "is clearly something the whole global economy is thinking about," Mr. Menegatti says.



Reducing risk through coordinated government regulations

By Catherine Bolgar

Bubbles grow, bubbles pop, crises often follow. Will we ever learn?

Though some economists are working to better identify bubbles before they get dangerously big, nobody enjoys wise words from partypoopers. So policy makers try to find ways to keep the party from getting out of hand in the first place.

"At the very least, you should close some stable doors," to prevent a repeat of the same problems, says Raghuram Rajan, finance professor at the University of Chicago Booth School of Business.

Many of those stable doors are in the financial sector, which did a bad job of managing risk. Details of proposed regulations for the sector vary among countries, but broad outlines are becoming clear:

- Higher capital requirements for financial institutions.
- More stringent leverage requirements for banks.
- A crackdown on derivatives that are far removed from the underlying instrument, including requiring banks to keep part of the risk of underlying assets, to encourage them to maintain prudent standards.
- Reforms on financial-sector pay to rein in the bonuses blamed for excessive risk-taking.

Two sets of banks

In the end, we're likely to see "financial markets that operate a bit more simply," says Alexei Monsarrat, director of the global business and economics program at the Atlantic Council of the U.S., a Washington think tank. He suggests that we may end up with two sets of banks: one which concentrates on old-school banking — collecting deposits and making loans — or which at least reins in some of the more exotic trading; and another which engages in the more exotic, riskier but potentially more lucrative aspects of the business. "It's a tradeoff between safety and return," he says.

Another idea is to require banks to draw up their own "funeral plans," to avoid the kind of lengthy investigation regulators faced in dismantling Lehman Brothers and to make it clear that nobody is too big to fail. Such information would include subsidiaries, assets and liabilities in greater detail than now provided. Banks aren't likely to be pleased. "Complexity is a source of profits and tax avoidance," says Dr. Rajan.

Fragile time

The banking sector has been less than enthusiastic about the changes, in part because regulations are likely to add to the cost of business at an economically fragile time.

"At a certain level, there is agreement in the financial industry that capital needs to be increased, leverage needs to be reduced and compensation needs to be much better aligned with the risks traders are taking," says Charles Dallara, managing director of the Institute of International Finance, a Washington-based industry group. "The danger is that if we get all these layers coming at once we may run the risk of nearly suffocating the ability of banks to use their balance sheets to make loans at a critical time in the economic recovery."

He adds that proposals to set higher capital standards for certain "systemically relevant" firms would essentially brand them as "too big to fail." Instead, he says, the integrated and interconnected financial world needs a cross-border resolution system that directly addresses this issue.

In addition, he laments the lack of global accounting standards — a key issue in the debate about how much to raise capital requirements.

Some observers fear that political will to enact tough regulations will wilt as the global economy picks up again.

Productive investment

"In the U.S. and Europe and most middle-income countries, the financial sector is politically dominant and extremely powerful," says Mark Weisbrot, co-director of the Center for Economic and Policy Research, a Washington think tank. "Economics 101 is for banks to act as a financial intermediary that channels savings into productive investment. That's obviously not what was going on in most of the financial activity that preceded this crisis."

A unified face for new regulations is important, says Max von Bismarck, director and head of investors at the World Economic Forum USA in New York. "If you don't get to a certain level of coordination you just see risks shifting to other environments" with banks playing the regulatory differences between countries.

The real picture of postcrisis regulation won't be clear for several years. And new regulations won't "mean crises won't happen anymore," says Christian Menegatti, head of global economic research at RGE Monitor, an economic consultancy in New York. "But you don't have to be a visionary to see that we won't see the kinds of leverage or the kinds of derivatives that led up to this crisis."

"At a certain level, there is agreement in the financial industry that capital needs to be increased, leverage needs to be reduced and compensation needs to be much better aligned with the risks traders are taking."

Special Advertising Section

Turkey retains investor confidence despite downturn

By Justin Keay

As the International Monetary Fund and World Bank convene for their autumn meeting in Istanbul, Oct. 6-7, the mood will be downbeat, despite recent figures that suggest the U.S., Japan and much of the euro zone are showing early signs of recovery.

"Anyone who believes this is a straightforward V-shaped recession is kidding themselves — the road into 2010 and beyond remains bumpy for most economies and many things can go wrong," says Bob McKee, international economist at Independent Strategy, a London-based investment research house.

Host country Turkey, however, has many strengths that could help smooth its ride. As well as its flexible exchange rate, macroeconomic strategy has been supported by the fact that Turkish banks have been well-capitalized and closely regulated since the financial crisis of 2000-2001 reduced their number to 50 from 80. Toxic-asset exposure is close to zero, and the required capital adequacy ratio is 16% against a typical 11% in Central and Eastern Europe and 8% in Western Europe. "Off balance-sheet risk is limited with no derivatives and no subprime loans," says Burak Tansan, executive vice president at Akbank, Turkey's largest bank.

Regulatory foresight

Little wonder that in September, London-based Euromoney magazine voted Durmuz Yilmaz, Turkey's central bank governor, central bank governor of the year for his regulatory foresight but also his astute handling of the current crisis.

Turkey's policy makers are not without challenges, however. The country's gross domestic product is likely to contract more than 6% this year, much worse than the 1.5% predicted by the IMF in March. Certain sectors — such as automotives where sales have fallen 50% in the past 18 months — have been hit particularly hard. Foreign direct investment is predicted to fall below $10 billion (€6.84 billion) this year from $18.2 billion last year.

The government's focus has been on minimizing the impact of the downturn. In March, it unveiled a $3.2 billion stimulus package, which reduced tax rates on the purchase of cars and removed them altogether on household appliances, both for a period of three months, and lowered value-added-tax rates to 8% from 18% on the purchase of apartments of over 150 square meters. It has followed them since with additional measures including new incentives for investment (including cuts in corporate taxes of between 2% and 10% depending on a firm's business), low interest loans for small and medium-size enterprises, and support for businesses investing in Southeastern Anatolia and other poor regions, including tax and social security breaks and state-owned land offered rent free.

These and other measures due to come into effect later this year — including a new package aimed at boosting private-sector employment by 500,000 — have been valued at around 60 billion new Turkish liras.

REUTERS/Fatih Saribas

Turkey's stock market has been booming and three government bond sales in August were four times oversubscribed.

"Turkey has been trying to act like a developed market with fiscal and monetary stimuli replacing the usual need for IMF support," says Charles Robertson, London-based head of emerging markets at Dutch bank ING Group. "So far the policy has worked well — the lira has remained stable and it has been able to roll over external debt."

Other indicators are also positive. Turkey's stock market has been booming and three government bond sales in August (totaling $1.87 billion) were four times oversubscribed. The unveiling on Sept. 15 of the government's upbeat economic plan for 2010-2012, amid confirmation that 2009 inflation would be just 5.5%, was generally well-received. Three days later, ratings agency Standard & Poor's upgraded Turkey's rating outlook from negative to stable.

Unemployment falls

The government has also been eager to stress that privatization is still on the agenda, with plans to sell power distribution and gas distribution plants as well as power-generation plants. And there has been better news on the jobs front, with unemployment figures for April to June showing a drop to 13.9% from the record 16.1% registered in the previous quarter.

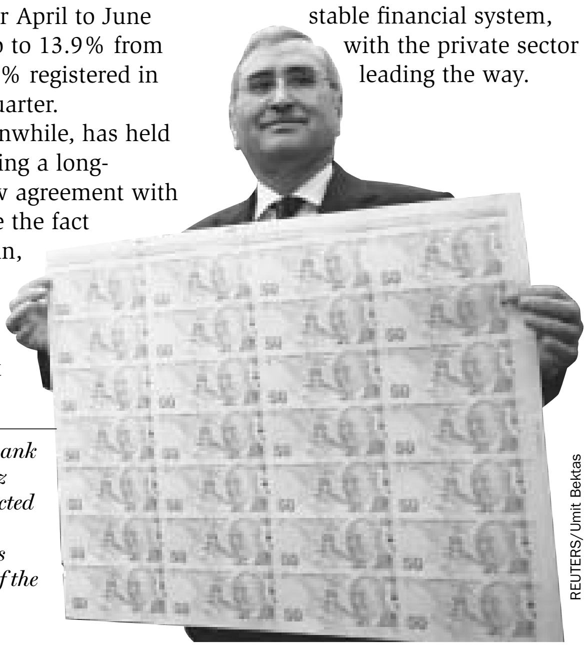
Ankara, meanwhile, has held back from signing a long-anticipated new agreement with the IMF despite the fact that Ali Babacan, Turkey's economy minister, acknowledged last month that this "would strengthen investor confidence." The tough fiscal policy that would be required is seen as counterproductive by Turkish policy makers, who are opposed to large-scale tax increases and expenditure cuts.

Looking to 2010 and beyond, observers say an agreement with the IMF would be useful.

"IMF support would lend credibility to the government program and help stabilize a fragile economic environment," says Abdullah Akyuz, senior spokesman for Tusiad, the Istanbul-based employers' federation. He believes that without an IMF deal real GDP growth next year will be 2.5% rather than the government forecast of 4.9%.

"Ankara is missing a good opportunity — it would get good terms," says Wolfango Piccoli, Turkey analyst at Eurasia, a New York-based global political risk research and consulting firm.

However, Turkey's government is confident that the country is over the worst. As he unveiled his medium-term economic plan, Economy Minister Babacan said economic growth would return next year and in 2011 would accelerate on the back of its stable financial system, with the private sector leading the way.



REUTERS/Umit Bektas

Turkey's central bank governor, Durmuz Yilmaz, has attracted international recognition for his astute handling of the current crisis.