News in Depth: The dangers of turning inward in the face of the economic crisis

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What's News

BP insisted it could continue to invest in future production and pay dividends to shareholders despite a falling oil price that is squeezing the finances of some of the West's biggest oil companies. **Page 3**

■ **The U.S. launched** a program aimed at generating up to $1 trillion in consumer and small-business loans. **Page 7**

■ **Bernanke appeared** to back the White House's efforts to stimulate the U.S. economy, saying aggressive action is needed. **Page 7**

■ **Obama and Brown** began crafting a framework for re-regulating world financial markets before next month's G-20 summit in London. **Page 8**

■ **U.S. market indexes** hovered near their lowest closes in almost 12 years, as Europe shares dropped again. **Page 16**

■ **The ECB opposes** changing the criteria for euro adoption to let struggling Eastern European nations join the common currency early. **Page 15**

■ **The IMF said** the world's poorest nations may need a total of $25 billion more in funding this year. **Page 8**

■ **Luxury-car makers** BMW, Daimler and Audi said sales remained weak last month, but the market could start recovering late this year. **Page 4**

■ **The EU voted** to place punitive antidumping tariffs on imports of U.S. biodiesel for six months. **Page 3**

■ **A Russian official moved** to squelch speculation the economic crisis could lead the Kremlin to loosen its tight control over politics. **Page 2**

■ **A new trial started** for tycoon Khodorkovsky in Russia. Police arrested 10 supporters shouting "freedom for political prisoners."

■ **Ukraine's Parliament** dismissed the foreign minister, risking a further split between the country's president and prime minister.

■ **The U.S. is boosting** efforts to isolate Iran, sending envoys to Syria and wooing Russia for help in blocking Tehran's nuclear ambitions. **Page 28**

■ **Lufthansa is set to unveil** new Italian routes Wednesday, stepping up competition against Air France-KLM.

■ **A building housing archives** collapsed in the German city of Cologne, and at least three people were missing.

EDITORIAL & OPINION

The Obama drop
Falling markets suggest the new president is part of the problem. **Page 9**

Breaking news at europe.WSJ.com

Associated Press

U.S. President Barack Obama, who has won wide support of the American public in a new poll, and British Prime Minister Gordon Brown after their meeting in Washington on Tuesday. See article on page 8.

Optimistic signs from U.S.

Obama's popularity lifts mood despite economic crisis

By Laura Meckler

WASHINGTON—President Barack Obama enjoys widespread backing from a frightened American public for his ambitious agenda, a new poll shows.

But there are also early warning signs in the Wall Street Journal/NBC News poll that show downside risks if his plans don't produce signs of progress by the end of the year. The president's support, while deep, looks increasingly partisan as Republicans move away from him. Americans have more confidence in the president himself than in some of his initiatives, such as the economic stimulus package. And some groups that came to support Mr. Obama late in the campaign—such as senior citizens—are starting to look a little more wobbly in their backing.

The White House is betting that the president can bring the public along on an agenda that includes overhauling the U.S. health-care system, controlling carbon-dioxide emissions to halt global warming, and raising taxes on the wealthy and lowering them for others.

"The American people trust him and like him. That's how you make change possible, because it's not threatening but accessible," Rahm Emanuel, the White House chief of staff, said in an interview.

To that end, the president emphasizes the aspects of his program that are easiest to support. On energy, he focuses on the upsides of alternative energy and the need for efficiency, glossing over the impact of punishing polluters. On health care, he focuses on the need to reduce the cost of care, with the need to help the uninsured often cast as almost an afterthought.

He will attempt to sell his

Please turn to page 27

Car makers widen scope of aid search

By John D. Stoll and Takashi Nakamichi

The auto industry crisis that started in Detroit is rapidly expanding into a global problem, pressuring governments around the world to join the U.S. in providing aid to struggling auto makers.

On Tuesday, **General Motors** Corp. warned its European operations could run out of money as soon as April or May if Germany and other European countries don't grant its requests for help. GM also said it is now willing to consider selling a majority stake in its Opel unit, the core of its European business, in order to secure governmental aid.

At the same time, in Japan, **Toyota Motor** Corp. appealed to its government for a $2 billion loan to its finance arm.

At the Geneva auto show, GM Chief Operating Officer Frederick "Fritz" Henderson said the company's European business could be out of money by "the first half of the second quarter" if it doesn't get loans or other financial assistance.

He added GM is "open to ideas and opinions," including the sale of a significant majority stake in Germany-based Opel if that would help clear the way for aid.

So far the U.S. has agreed to provide at least $42 billion in loans and other financial help to GM, **Ford Motor** Co., **Chrysler** LLC and their suppliers. Canada has agreed to provide additional help to the Big Three, and France is offering aid to French car makers **Renault** SA and **PSA Peugeot Citroën** SA.

GM has gotten an agreement to have Spain guarantee €200 million in loans, and has sought help from Germany, Britain and Sweden—all nations where it has plants. In Geneva, GM's top European executive, Carl Peter Forster, said the company may also appeal to Poland, where it makes small cars.

Driven lower
U.S. auto sales plunged in February, stoking concerns 4

Toyota requested aid from Japan after the Tokyo government said it will lend some of its foreign-exchange reserves to Japanese firms that operate overseas and are struggling to raise foreign-currency funds. Finance Minister Kaoru Yosano said the government plans to lend $5 billion of its $1 trillion reserves—the second-largest reserves in the world after China's—to the Japan Bank for International Cooperation by the end of March, so the bank can make dollar loans to cash-starved companies.

Toyota, which lost $1.8 billion in the quarter ending Dec.

Please turn to page 27

Gunmen kill seven people in Pakistan strike

By Peter Wonacott

Gunmen in Pakistan attacked vehicles carrying Sri Lanka's cricket squad Tuesday, killing six policemen and a driver in the latest sign of the government's weakening grip on the country's security.

About a dozen men fired assault weapons at the convoy carrying the Sri Lankan team to a match in the cosmopolitan city of Lahore, according to Pakistani and Sri Lankan officials. A bus carrying the players was able to escape into the cricket stadium, while police guards engaged in a gun battle with the attackers.

Seven players, an umpire and a coach were wounded, none with life-threatening injuries, the Associated Press reported.

Haider Ashraf, a police officer, said in addition to the six policemen, a driver of a Pakistan Cricket Board vehicle was killed, according to the AP.

Agence France-Presse

Pakistani police stand guard outside the National Stadium after gunmen attacked the Sri Lankan cricket team in Lahore on Tuesday.

Lahore's police chief, Haji Habibur Rehman, said none of the attackers was killed or captured, AP reported.

Police arrested four suspects, but didn't offer details about who carried out the ambush armed with Kalashnikovs, grenades and rocket launchers. No group claimed responsibility immediately after the attack.

By early afternoon, the Sri Lankan team departed by helicopter from the cricket stadium and announced it was canceling the tour.

"They were our guests," Pakistan's Sports Minister Aftab Shah Gilani told NDTV, an Indian channel. "We are very sorry about this. It's really shocking."

The incident dealt another blow to a government reeling from security setbacks and other crises. Tuesday's assault is likely to heighten international worries about the nuclear-armed nation, as it reinforces an im-

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Inside

Local hero

China embraces buyer who bid on sculptures in protest
Marketplace, page 26

Markets

4 p.m. ET

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DJIA	6726.02	-0.55
Nasdaq	1321.01	-0.14
DJ Stoxx 600	161.34	-1.80
FTSE 100	3512.09	-3.14
DAX	3690.72	-0.52
CAC 40	2554.55	-1.04
Euro	$1.2563	-0.23
Nymex crude	$41.65	+3.74

LEADING THE NEWS

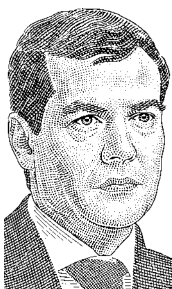
Kremlin official rebuffs calls to loosen tight grip

Some liberal advisers to president argue slump requires shift

By Gregory L. White

MOSCOW—A top Russian official rejected calls to ease tight control over politics, moving to squelch growing speculation that the deepening economic crisis could lead the Kremlin to loosen its grip.

After nearly a decade of growth, Russia's oil-fired economy is facing a deepening recession, with unemployment rising and living standards slumping. Scattered protests have broken out, although support for President Dmitry Medvedev and his patron and predecessor, Prime Minister Vladimir Putin, remains strong. The crisis has set off debate among Russia's political and business elite, much of which came to power in the previous era of relative plenty.


Dmitry Medvedev

Some liberal advisers to President Medvedev have argued in recent months that the crisis challenges what they describe as the "social contract" of the Putin era, under which ordinary Russians consented to a rollback of political and other democratic freedoms in return for long-awaited economic prosperity. These advisers, most notably Igor Yurgens, who runs a research institute where Mr. Medvedev is chairman of the board, contend the Kremlin needs to loosen the screws now that the economy is slumping.

But in unusually strong, public comments, Vladislav Surkov, first deputy chief of staff in the Kremlin, denounced that argument as "dangerous."

"The system is working, it will cope with the crisis and get through it," he told a forum of the ruling United Russia party held Monday and later shown on video on a local Web site. "If we had entered this zone of turbulence in a more-loosened condition, I assure you, the damage the state and society would have suffered would have been much greater," he said.

Since he was elected a year ago, President Medvedev's liberal rhetoric has fueled hopes that he might restore some media freedoms and other democratic rights that the Kremlin steadily rolled back under his predecessor, Mr. Putin. Mr. Medvedev has proposed some relatively modest reforms of the electoral system and called for strengthening judicial independence, but generally he has followed very closely the line of Mr. Putin, who retains huge power as prime minister.

The unusual "tandem of power" arrangement, as the Kremlin calls it, has led some analysts to predict an eventual split between Messrs. Putin and Medvedev. So far at least, the main differences appear to be in style and tone, not substance, and both the Kremlin and government are dominated by Putin-era appointees. Mr. Surkov, for example, is the Kremlin's domestic-politics chief, a job he also held when Mr. Putin was president.

But in a sign of how the worsening economic situation has shaken the political elite, a prominent political consultant who has worked regularly for the Kremlin suggested this week that Mr. Medvedev's liberal advisers could be conspiring to use growing public discontent as an excuse to depose Mr. Putin as prime minister.

"There is a multiparty system with the authorities," Gleb Pavlovsky told the Moskovsky Komsomolets newspaper. "One of those is the pro-crisis party, those who want a new little coup."

Yevgeny Gontmakher, a senior staffer at Mr. Yurgens' Institute for Contemporary Development, dismissed those comments as nonsense. But he said Mr. Surkov's statement suggests growing concern within the Kremlin about the stability of the political system.

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Bouygues net rises 16%, prompting dividend increase

By A.H. Mooradian And Jethro Mullen

French construction and engineering conglomerate **Bouygues** SA posted a 16% rise in fourth-quarter net profit amid higher sales and raised its 2008 dividend 6.7%.

Fourth-quarter net profit rose to €299 million ($376 million) from €257 million a year earlier, as revenue increased 3.6% to €8.61 billion.

But the company set a sales target of €31.7 billion for 2009, which would be down 3.1% from the last year's total of €32.71 billion.

Net profit for the full year grew 8.7% to €1.5 billion in 2008 from €1.38 billion in 2007. Bouygues said it plans a dividend of €1.60, up from €1.50.

Central banks look past rate cuts

By Martin Gelnar And Natasha Brereton

ZURICH—As European central banks gear up to cut their benchmark rates closer to zero, policy makers are increasingly considering using tools apart from interest rates to boost faltering economic growth.

Tuesday's news that Switzerland slipped into a technical recession in the fourth quarter of 2008 firmed expectations that the Swiss national bank will lower its policy rate closer to zero. The U.S. Federal Reserve lowered its benchmark rate to near zero in December.

The Swiss National Bank is now expected to lower its policy rate to a historic low of 0.25% from the current 0.5% when it meets next week.

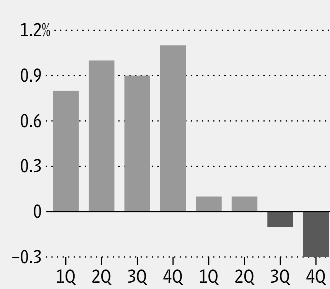
The European Central Bank and the Bank of England, both of which announce rate decisions on Thursday, are also expected to discuss taking unconventional policy steps to unclog jammed credit markets.

Switzerland's gross domestic product shrank 0.3% in the fourth quarter from the third, government agency Seco said. That marks two consecutive quarters of declines.

"Contracting exports combined with slumping investment and easing private consumption is a worry for Switzerland and suggests that economic growth will come in significantly weaker in 2009," said Melanie Bowler, an economist with Moody's economy.com.

Stalled in Switzerland

Swiss GDP contracted for two straight quarters, signaling a recession



Source: Swiss Federal Statistical Office

Swiss central-bank officials have in the past few weeks indicated that their next monetary-policy steps could include elements such as buying government bonds to boost the amount of money in the Swiss economy or intervening on the foreign-exchange market to weaken the Swiss franc or stem a rise in its value relative to other currencies.

Separately, U.K. Chancellor of the Exchequer Alistair Darling indicated the Bank of England could boost the money supply through the purchase of assets such as government debt as soon as this month. "We've given them the levers," Mr. Darling said Monday, according to an interview published by the Daily Telegraph.

The framework under which the measures would be implemented is due to be published in an exchange of letters between Mr. Darling and Bank of England Gov. Mervyn King. Many economists expect the central bank's Monetary Policy Committee to announce the start of such steps following its two-day meeting this week.

Markets expect the government to allow the central bank to increase money supply by about £100 billion to £200 billion ($140 billion to $280 billion) by purchasing public and private-sector securities. The bank also is widely expected to cut its main policy rate to 0.5% from 1% on Thursday.

The European Central Bank, expected to cut interest rates again on Thursday after more signs of economic contraction in February, also could soon begin introducing unorthodox monetary policies to feed cash into companies.

ECB governing-council member Christian Noyer said the central bank for the 16 countries using the euro is studying whether to go ahead with plans to release more money in to the economy by unconventional means, saying the ECB is considering all options.

The ECB is expected to cut interest rates to 1.5% from the current 2% after witnessing a string of negative economic indicators, including contracting manufacturing and rising unemployment.

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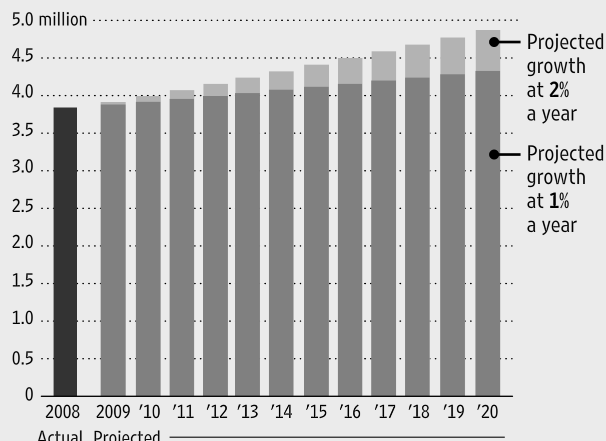
LEADING THE NEWS

An employee works at the In Salah Gas Project in Algeria, run by Sonatrach, BP and StatoilHydro.

Slower growth

BP has revised slightly lower its production-growth target.

Average output in the fourth quarter, in barrels of oil equivalent a day



Sources: BP (actual); Dow Jones Newswires (projections)

BP stays true to dividend

CEO says oil firm would even borrow to maintain payout

By Guy Chazan

LONDON—**BP** PLC insisted it could continue to invest in future production and pay dividends to shareholders despite a falling oil price that is squeezing the finances of some of the West's biggest oil companies.

In an interview, BP Chief Executive Tony Hayward said if necessary the company would borrow to maintain payouts to shareholders. "We think today the right balance is to continue to pay the dividend, continue to invest for the future and allow the balance sheet to take the strain while the industry cost structure adjusts," he said.

But some analysts weren't convinced. "The current dividend level is unadvisable," said Mark Gilman, oil analyst at Benchmark Co. in New York. "If they do pay it, it's going to be at a cost and that cost is going to be investment in future growth."

BP raised its total dividends last year to 55 cents a share, up 30% from 2007. The increase came at a time when oil prices were on the rise and the future looked bright for the big Western oil companies. But crude is now trading at $41.65 a barrel, down about $100 from the highs of this past July. That is putting pressure on the majors: Prices are back to the levels of 2004, but industry costs have doubled since then. Analysts at Barclays Capital say 2009 will see the largest year-to-year fall to date in the earnings of the big European oil companies, to levels not seen since 2002 when crude was trading at $25 a barrel.

Tony Hayward

In a strategy update for investors Tuesday, Mr. Hayward said BP needs an oil price of $60 a barrel this year to cover its dividend and capital-spending plans. Below that, and if industry costs stay at their current level, BP might struggle to make shareholder payouts from free cash flow and would have to cut capital spending or borrow to sustain them.

Mr. Hayward said there was nothing wrong with borrowing to keep investment on track. BP's gearing—its ratio of debt to equity—is relatively low, at 21%: The company raised $4.6 billion of new bonds in the last quarter of 2008, a time when a lot of companies were being frozen out of debt markets. "We've got plenty of flexibility in terms of the balance sheet," he said in the interview. "Our ideal gearing band is between 20% and 30%, and at the moment we're at the bottom end of it."

But some analysts worry that BP's forecasts are predicated on a rapid rebound in the oil price. And if the global economic downturn turns out to be much longer than expected, and crude stays low for years to come, forcing BP to take on more and more debt, it may have to radically reduce spending or cut the dividend. The last time it reduced the payout was in 1992 at a time of turmoil for the company caused by the abrupt departure of then CEO Sir Robert Horton.

Ahead of Tuesday's strategy update, BP also slightly revised down its forecast for future production to reflect a slower pace of some investments. The oil company said this time last year that it was targeting production of 4.3 million barrels a day by 2012. Tuesday it said it expected output to rise by between 1% and 2% a year through 2020. That implies production of about 4.1 million barrels a day by 2012, a little less than the earlier target.

—James Herron contributed to this article.

Gazprom plans to reduce spending

By Jacob Gronholt-Pedersen

MOSCOW—OAO **Gazprom**, the world's largest producer of natural gas, posted solid third-quarter profit but said it will be forced to cut spending this year due to falling demand in key markets.

Natural-gas demand is crumbling in key markets as national economies slow, and gas-export prices are set to decline significantly later this year. As a result, state-controlled Gazprom's earnings are expected to fall throughout 2009, possibly affecting the Russian company's ambitious investment plans.

Gazprom's output fell in the first two months of this year, and data from the first days of March show output down by one-fifth from average production in March 2008. This has triggered concern among analysts that lower demand will cut into its profit.

"The big question is how much demand will fall this year," said Ron Smith, chief strategist at Russia's Alfa Bank.

"It's already clear we'll have to revise the production plan approved late last year," said Andrei Kruglov, deputy chairman of Gazprom, noting lower demand in Europe, the company's key export market. "We simply won't be able to sell such volumes," he added.

Mr. Kruglov also said that Gazprom might revise its investment program several times this year. The company usually reviews its spending plans twice a year.

Gazprom, which supplies a quarter of Europe's natural-gas needs, estimates it lost about $2 billion in January when supplies were cut off to European countries for nearly three weeks amid a pricing dispute with Ukraine. In February, the gas producer saw output drop 16% from a year earlier, according to government statistics this week.

Less than a year ago, Gazprom's Chief Executive Alexei Miller forecast oil prices would hit $250 a barrel and voiced ambitions to boost the company's market capitalization to $1 trillion. Since then, the price of oil has plunged, taking Gazprom's share price with it. The company's stock, which has lost 80% in value since its peak in mid-May, closed 2.8% lower Tuesday on Moscow's RTS exchange.

In the quarter ended Sept. 30, Gazprom's net profit rose 16% to 131.7 billion rubles ($3.66 billion) from 113.1 billion rubles in the year-earlier period, helped by European export prices, which rose to record levels during the period. Still, the earnings missed analyst expectations.

The results were weighed down by a foreign-exchange loss and a revaluation of the option held by Italy's **Eni** SpA to buy a 20% stake Gazprom Neft, the Russian company's oil arm.

Gazprom's quarterly sales rose 60% to 829.7 billion rubles from 516.2 billion rubles, backed by a 25% boost in domestic gas tariffs Jan. 1 and higher export volumes. Operating profit more than doubled to 306.1 billion rubles.

EU officials vote to put tariff on U.S. biodiesel

By John W. Miller

BRUSSELS—The European Union voted to slap punitive antidumping tariffs on imports of U.S. biodiesel for six months, according to EU officials, threatening an industry that saw $1.5 billion in sales to Europe last year.

The goal of the duties is to erase the advantage from a U.S. tax credit industry brokers say allows U.S. exporters to sell biodiesel in the EU for $800 a ton, compared with the average $1,000 charged by EU producers over the past six months.

The duties will amount to $400 to $500 per ton of biodiesel imported from the U.S., EU officials said.

U.S. producers "will get shut out of the EU market while the duties last," says Kevin McGeeney, CEO of Starsupply Renewables SA, a Geneva-based broker. Several of his U.S.-based sellers could go out of business as a result, he said.

U.S. producers have already been hammered by a collapse in crude oil prices that has made biodiesel more expensive to buy than regular fossil fuel, as well by an excessive buildup of plant capacity.

Officials in the U.S. biodiesel industry say they plan to ride out the provisional phase of the high import tariffs. The EU is due to decide later this year whether to extend the duties for a period of five years.

U.S. companies say they hope to get the duties reduced, arguing that the $300 per ton U.S. tax credit didn't injure a sufficient number of European producers during the period surveyed, as required to justify extra duties under World Trade Organization rules. In this case, the reference period is parts of 2007 and 2008, a time of high oil prices during which most biodiesel companies prospered, regardless of the U.S. subsidies, because biodiesel was cheap by comparison to regular fuel.

"We think we have a case for either eliminating the duties, or getting them substantially cut," says Manning Feraci, vice president of the National Biodiesel Board in the U.S.

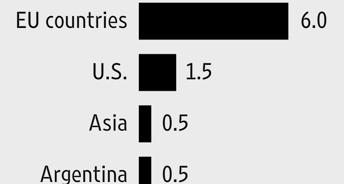
A committee of trade officials from the EU's 27 member states voted Tuesday to approve the temporary extra tariffs, the EU officials said.

Brokers say the new tariffs won't necessarily be a boon to European producers because Argentinean and Asian biodiesel is $50-$100 cheaper than fuel produced in the EU.

The new antidumping tariffs will be announced March 12.

Buying biodiesel

The European Union is the world's biggest consumer of biodiesel. Major suppliers to the EU in 2008, in millions of tons:



Source: Starsupply Renewables

BG Group nears control of Australia's Pure Energy

By Ross Kelly

SYDNEY—**BG Group** PLC has moved closer to securing control of **Pure Energy Resources** Ltd. after **Royal Dutch Shell** PLC said it would sell its 11% stake in the coal-seam gas producer into BG's offer of 1.03 billion Australian dollars (US$648 million).

Brisbane-based Pure is the subject of a bidding war between BG and Shell's joint-venture partner in Australia, **Arrow Energy** Ltd.

Arrow, along with Shell, and BG are among a host of companies wanting to secure CSG reserves to feed five liquefied-natural-gas processing plants planned for construction in Queensland state.

"Shell intends to accept BG's offer for Pure Energy Resources in the absence of a superior offer," a Shell spokesman said.

The move is a sign that Shell has given up on accessing coal-seam gas through Pure to support its LNG plans. But it doesn't mean that Shell has given up on building a large liquefied-natural-gas project in Australia, and investors will be watching to see where the European energy giant turns next.

BG, which has already secured 29% of Pure, last week increased its all-cash bid for the company to A$8.25 for each Pure share, above its previous offer of A$8 a share, despite already having the best offer on the table.

The A$8-a-share offer had trumped a rival bid by Arrow of A$3 cash plus 1.57 of its shares for each Pure share. Arrow, which holds 20% of Pure, said Friday that it is still considering its options and hasn't ruled out increasing its offer for Pure.

But it has been about two weeks since BG launched its A$8-a-share offer, and investors had started to become doubtful that Arrow, a minnow compared with BG and Shell, had deep-enough pockets to come back with a higher bid.

Belgian Shoes
Henri Patent

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CORPORATE NEWS

U.S. auto sales fell about 40% last month

Setbacks affected nearly all car makers, raising concern about further deterioration; discounts appear to help Chrysler

By Alex P. Kellogg
And Matthew Dolan

DETROIT—U.S. auto sales plunged yet again in February, declining an estimated 40% to roughly 690,000 vehicles. The steep drop left auto makers worried the industry may not yet have bottomed out.

Almost all car makers suffered significant setbacks. **General Motors** Corp.'s sales fell 53% to 126,170 cars and light trucks, **Ford Motor** Co.'s declined 48% to 99,400 and **Toyota Motor** Corp.'s fell 40% at 109,583.

Chrysler LLC, which has suffered drops of more than 50% in recent months, fared somewhat better, reporting sales of 84,050 vehicles, down 44%, thanks to heavy spending on sales incentives. According to Edmunds.com, an auto-shopping Web site, Chrysler's discounts and other incentives averaged $5,566 for every vehicle it sold—about $2,000 more than either Ford or GM.

An exact total for the month's sales wasn't available late Tuesday afternoon because some auto makers had yet to report their results.

Car makers estimated the seasonally adjusted annualized selling pace for light vehicles was about nine million, down from 9.8 million in January and far below the pace of 15.4 million recorded in February 2008.

AFP

Ford vehicles on a snow-covered Wisconsin lot earlier this year. Ford and other auto makers reported steep February sales declines.

Last month's drop marked the fifth straight month that U.S. auto sales have fallen by 35% or more, and signaled a weakening in the market after January's decline of 37%.

The further deterioration in February was "concerning," Ford economist Emily Kolinski-Morris said in a conference call. "It may be that this month is not the bottom."

Efraim Levy of Standard & Poor's Equity Research said in a research note that the industry is suffering an "automotive depression." Consumers, he added, are "fearful for their jobs, the value of their homes and stock-market assets" and are "wary of making the sizable discretionary purchases of new vehicles."

Ford, which posted a record annual loss of $14.6 billion last year, said it now plans to produce 425,000 vehicles in North America in the second quarter, down 38% from a year earlier. Ford's top sales analyst, George Pipas, said the company would continue to match its production to current demand.

Sales in its Ford, Lincoln and Mercury brands fell 48.2% to 96,044 units in February from a year earlier. Ford posted a 55% decline in sales for its Volvo brand, which it is reviewing for a possible sale.

In Ford's core brands, sales of sport-utility vehicles fell 71% while passenger-car sales declined 41%

Chrysler was under pressure in February to boost sales to make its case for more bailout loans from the U.S. government. It cut prices on many vehicle to below even the prices it typically offers its own employees.

Incentives, which eat into car makers' profits, aren't jump-starting demand, said Jesse Toprak, executive director of industry analysis at Edmunds.com. "They're trying to show Congress they're still a viable business" by selling cars at a discount, he said, "but you've got to do the math to see if it's worth it."

—Jeff Bennett contributed to this article.

BMW, Daimler eye late-year turn

By Christoph Rauwald

GENEVA—The world's biggest luxury-car makers—**BMW** AG, **Daimler** AG and Audi AG—said sales remained battered by weakened demand last month but that the market should start recovering late this year or early next.

Historically, the luxury-car segment has been less affected by economic downturns than the rest of the auto industry. But the magnitude of the current global recession has left no auto maker untouched.

BMW's total car sales fell 24% in February from a year earlier, and the outlook for the year remains uncertain, Chief Executive Norbert Reithofer told reporters at the Geneva auto show Tuesday. He said, however, that the market should enter a recovery phase next year but that it would be a slow process.

An incentive plan in Germany, the home turf of the world's three largest luxury-car makers, is paying €2,500, or about $3,100, to consumers who scrap old cars and buy new ones, but the program is expected to spark demand mainly for small cars rather than for luxury vehicles. German new-car registrations rose 21% in February from a year earlier, boosted by the government plan, the German car-makers association VDIK said.

Norbert Reithofer

Mr. Reithofer said BMW will focus on liquidity this year rather than profitability, explaining that the company will aim to manage its inventories effectively, reduce fixed costs and optimize working capital.

Mr. Reithofer said BMW has cut 4,000 salaried staff, more than the 3,100 cuts planned, which will lead to savings of €500 million, or about $625 million, this year. The company has no plans for forced layoffs, he said.

Mr. Reithofer said BMW is always interested in cooperation with other auto makers but said BMW is "strong enough to survive on its own." BMW has been in talks with Daimler and **Fiat** SpA to cooperate in purchasing and sharing certain components.

BMW also aims to sell more engines to other auto makers to generate more revenue, said executive-board member Klaus Draeger. BMW currently supplies engines to some niche car makers such as Wiesmann and also makes boat engines in the 170 to about 300 brake horsepower range.

Meanwhile, Daimler CEO Dieter Zetsche said January's weak demand for cars spilled over to February but that auto markets are expected to start recovering toward year-end. Daimler didn't report global sales for February, however.

Mr. Zetsche reiterated that Daimler, the maker of Mercedes-Benz cars, plans to maintain spending on research and development, even amid eroding sales industrywide, so that the company can be more competitive when the global economy improves.

Emerging markets such as China could "lead the path to a market recovery" toward year-end, Mr. Zetsche said at the auto show. For a broader upturn, however, Western Europe, the U.S. and Japan will have to rebound as well, he said.

Daimler has to "get rid of some inventory and keep adjusting production to demand," he said. Last month, Daimler said it swung into the red in the fourth quarter because of a slump at its core Mercedes-Benz unit and a huge loss on its stake in Chrysler LLC.

Volkswagen AG's premium brand Audi said its global car sales fell by 11% in February and that it anticipates a decline of as much as 10% in vehicle sales for the full year.

Despite tough conditions worldwide, Audi plans to increase its market share this year, said Peter Schwarzenbauer, Audi's board member in charge of sales and marketing. Audi's market share rose to 5% in Western Europe in January from 3.9% a year earlier, while its U.S. market share increased to 7.2% from 6.7%.

—David Pearson contributed to this article.

The Mossberg Solution

Friends...with cash

Facebook Marketplace helps you get rid of your real-life stuff > **Page 24**

General Motors to purchase Delphi's steering business

By Peter Lattman
And John D. Stoll

General Motors Corp. said it will buy **Delphi** Corp.'s global steering business as a critical move in the restructuring of both troubled companies.

GM has been in talks with Delphi for several weeks in hopes of buying some of the auto-parts maker's plants that are central to GM's vehicle manufacturing. Delphi, in bankruptcy protection since October 2005, is GM's largest supplier and its former subsidiary.

The steering business, based in Saginaw, Mich., is the first in what will likely be a series of purchases GM will make from Delphi. In some cases, Delphi is running certain businesses—all of which used to belong to GM— mostly for the benefit of the auto maker. These businesses are believed to lose money.

Terms of the steering-business deal weren't disclosed Tuesday. The two companies did say that GM will increase to $450 million from $300 million the amount it will advance Delphi to improve its liquidity.

GM is expected to turn around and try to sell the steering business as soon as possible, a person familiar with the matter said.

The deal is subject to various hurdles, and could need approval from the Treasury Department, which has a major say in GM's operations after giving the auto maker a $13.4 billion loan.

For Delphi, selling off pieces of its North American unit back to GM is likely to lower the company's leverage in dealings with the auto maker. Because Delphi makes several parts at money-losing factories that are essential to GM's vehicle-production activities, it has been able to continue asking for financial assistance to cover labor costs and other expenses while under bankruptcy protection.

Still, shedding the unprofitable businesses to GM could help stanch losses that have long held the Troy, Mich., supplier down. Despite having a relatively healthy international business, bleeding in Delphi's North American operations has been difficult to offset.

Delphi runs certain businesses mostly for the benefit of the auto maker.

For GM, the deal will give the auto maker more control over the production of its vehicles and allow it to back away somewhat from its intense participation in Delphi's reorganization process.

Delphi struck a deal more than two years ago to sell its steering business to Los Angeles private-equity firm **Platinum Equity**. As the automobile market worsened, the two sides were unable to reach terms to complete the transaction, according to people familiar with those negotiations.

GE's focus on services faces test

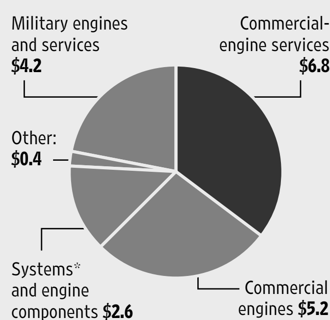
Aviation unit leans on fixing engines, but rivals step up

BY PAUL GLADER

EVANDALE, Ohio—Amid the recession, **General Electric** Co. is banking on making money by fixing things it has already sold. But those hopes are being tested as competitors step up their own services offerings.

From aircraft engines to locomotives, GE expects that 75% of its industrial operation's $85 billion in revenue will come from services this year, up from 65% in 2007. To support that goal, GE has been investing in new equipment and taking other steps to improve its service offerings.

GE's backlog in aviation services rose 9.5% last year. A mechanic services an engine at GE's facility in Wales.



The company needs all the cash it can get, with declines projected for the conglomerate's financial-services operations and its credit ratings in danger of being cut. The company last week reduced its dividend to preserve cash, and the company's shares tumbled 11% Monday. On Tuesday afternoon, shares were trading down 6.5% at $7.11.

Companies in other industries, such as Siemens AG and Caterpillar Corp., also are leaning on service revenue as product sales slow. At **United Technologies** Corp., whose products include Otis elevators and Sikorsky helicopters, roughly 40% of revenue came from parts and services last year. United Technologies unit Pratt & Whitney, a competitor to GE in aviation, has been looking to grab work servicing GE engines.

After-sales services and parts typically yield 25% of revenues and nearly 50% of profits for industrial companies, according to consulting firm Accenture Ltd. Many experts expect that calculus will tip further in favor of after-sales services during the recession.

At GE's aviation unit, total orders fell 12% in the fourth quarter as higher fuel costs and plunging demand drove airlines out of business. But rising service orders propelled a 21% profit increase for the unit. GE's backlog in aviation services rose 9.5% last year to $55.2 billion, representing nearly half of the company's total services backlog.

GE made military-aircraft engines from 1940 to 1970, and branched into commercial-jet engines in the 1970s to power such aircraft as the Boeing 747. GE engines can cost up to $30 million each. But GE, like other engine makers, makes little profit on an engine sale. Even in good times, the higher profit margins are on spare parts and engine repairs.

GE, based in Fairfield, Conn., is facing stepped-up competition, however. Pratt & Whitney in 2006 launched a rare assault by one engine maker on a rival's core business, with a campaign to win service contracts on an engine made by a joint venture of GE and the Snecma unit of France's **Safran Groupe** SA.

Kevin Michaels, a partner of AeroStrategy LLC, a consulting firm in Ann Arbor, Mich., says Pratt & Whitney has faced "a difficult road," in part because United Airlines grounded much of a Boeing fleet that would have used Pratt & Whitney parts.

GE has sold $13 billion in aircraft engines since 2006. Over their 30-year life, those engines will generate about $90 billion in service revenue, GE Chairman and Chief Executive Jeffrey Immelt said at a recent presentation.

A Pratt & Whitney spokesman says the company is offering GE customers a choice and still profits from taking even bits of market share.

Independent parts makers such as **Heico** Corp. and **Chromalloy Gas Turbine** Corp. also hope to whittle away a portion of GE's business.

"The reason they want to do services is primarily to control the parts," says Eric Mendelson, president of the flight-support group at Heico in Miami. He estimates that GE accounts for $3 billion of the roughly $17 billion in annual sales for commercial-aircraft parts. His strategy isn't to take over GE's market share but to prevent a total monopoly, he says.

In 2005, GE consolidated several aviation-service businesses into one brand, called OnPoint. Last year GE transferred Tom Gentile, a customer-service and marketing specialist, from its financial-service businesses in Australia to give OnPoint its own overhaul and speed service time.

GE also brought in more-efficient equipment for its two dozen OnPoint facilities world-wide—from Texas to Brazil to Japan—that overhaul engines or repair damaged components. GE employs squads of mechanics who will fly anywhere in the world within 24 hours to repair a GE engine while it remains mounted on a jet's wing.

Working recently in a GE services facility in this Cincinnati suburb, special-process engineer Mandeep Sahota opens an induction oven and shows off a fist-size, freshly braised, nickel-alloy blade: a small piece inside the engine for a Boeing 737. Mr. Sahota, 28 years old, points out racks of worn blades, awaiting their turn in the oven. The $250,000 machine, installed in September, can repair a blade in two hours, instead of five. "It's a microwave instead of an oven," says Chris Lahna, a GE manager.

GM's Saab unit accelerates talks with its suitors

BY JOHN D. STOLL

GENEVA—**General Motors** Corp.'s flagging Saab division will accelerate talks this week with "a number" of potential buyers, the unit's top executive said Monday.

Saab Managing Director Jan Ake Jonsson, in an interview at the Geneva auto show, said Saab is working with **Deutsche Bank** and has begun discussions with potential investors from the auto industry and outside it. He declined to name any of Saab's suitors but said it is possible a deal could be completed by next year.

Mr. Jonsson also said Saab needs €500 million, or about $625 million, in aid from the Swedish government to survive amid the deep downturn in global auto sales. Saab recently sought to reorganize under court protection in Sweden, a process similar to Chapter 11 bankruptcy protection in the U.S.

The reorganization was prompted by GM's decision to turn Saab into an independent company. Saab will be challenged to survive on its own, however. GM and Saab have asked the Swedish government for financial aid, but the request hasn't yet been granted.

Without aid, Saab could run out of money, Mr. Jonsson acknowledged.

Mr. Jonsson added he is confident Saab can attract government support thanks to its importance to Sweden's economy. Saab and its suppliers employ 15,000 people in Sweden, and it has more than 1,000 dealers world-wide.

Saab is committed to reaching profitability by 2011, Mr. Jonsson said. That commitment is at the core of its discussions with the Swedish government concerning the need for loans to keep it afloat.

Its sales fell to fewer than 100,000 vehicles in 2008, down from a peak of 130,000 in 2006, mainly because it has only had three vehicles in its lineup and GM hasn't updated its main models.

Capitalism will be 'reset' by crisis, GE's chief says

BY PAUL GLADER

General Electric Co. Chairman and Chief Executive Jeffrey Immelt admitted that he and his top executives, "never anticipated a global financial system failure and its continuing economic fallout."

In a sober letter to shareholders, Mr. Immelt wrote that 2008 "was a tough year and we expect 2009 to be even tougher." Since he last wrote to shareholders about a liquidity challenge, the company has seen a "global financial meltdown," he added.

Jeffrey Immelt

He recounted losses in the trillions and said "we have now entered an economic recession across most of the world."

He noted positive developments, such as GE's participation in government loan-guarantee programs. He also said the company's industrial businesses and geographic diversity globally will help it get through the credit crisis. "Despite our efforts, the GE stock got hammered," he wrote. Companies with a presence in financial services, such as GE, are out of favor, he added. Mr. Immelt said that he will work hard to restore investor trust and to build GE for the long term.

He offered a guarded view of the future.

"We are in a recession and, at times like these, it is difficult to predict how bad and for how long. We are running GE to 'weather the cycle.' However, I believe we are going through more than a cycle," he said. "The global economy, and capitalism, will be 'reset' in several important ways."

He said interactions between government and business will be changed, and he added that the financial industry will restructure with less leverage and fewer competitors.

Bayer lowers forecast for '09 as demand for plastics wanes

BY ALLISON CONNOLLY

Chemical and pharmaceutical company **Bayer** AG lowered its outlook for 2009 as demand for plastics, polymers and other high-tech materials continues to slide.

Bayer also said fourth-quarter net profit jumped 58% from a year earlier, when it recorded a tax expense. Net profit rose to €106 million ($133.3 million) from €67 million a year earlier. Sales fell 1.5% to €7.92 billion from €8.04 billion.

Adjusted earnings before interest, taxes, depreciation and amortization fell 4.6% to €1.36 billion from €1.42 billion.

Adjusted Ebitda—which excludes items such as costs related to Bayer's 2006 acquisition of Schering AG and the integration of the company—declined as sales growth in Bayer's health-care and agricultural-chemicals businesses failed to compensate for a 20% drop in sales at the MaterialScience division, which makes plastics and high-tech materials.

The MaterialScience business isn't developing as strongly as expected during the first quarter, Bayer said, as orders from key auto and construction customers drop on shrinking demand for end products such as car seats and drywall. Production cutbacks and restructuring efforts only partially offset lower volumes and higher raw-materials cost.

Bayer's health-care unit, which represents the largest portion of the company's sales, saw fourth-quarter revenue rise 8.9% on the back of increased demand for its Yaz contraceptives, multiple-sclerosis treatment Betaseron/Betaferon and cancer drug Nexavar.

The CropScience division, which makes herbicides, fungicides and other agricultural products, saw sales grow 2.3%.

The Leverkusen, Germany, company expects sales and adjusted-Ebitda growth for both its CropScience and health-care units in 2009, but expects a "severe drop" for MaterialScience.

Bayer aims to limit the 2009 decline in adjusted Ebitda to 5%, with sales of about €32 billion, just under the €32.92 billion posted for 2008.

EMI's parent writes down value of music firm

BY ETHAN SMITH

Terra Firma Capital Partners Ltd. has written down half its £2.3 billion ($3.23 billion) investment in **EMI Group** Ltd., according to the private-equity firm's annual review, an acknowledgment that the British music company's value isn't likely to recover amid continuing global declines in music sales.

Terra Firma took a charge of €1.37 billion ($1.72 billion), which it attributed to the "permanent impairment in value" of investments—primarily EMI, which it bought in 2007.

The write-down came despite what the company characterized as increased cash flow at EMI. For the nine months ended Dec. 31, the recorded-music division's earnings before interest, taxes, depreciation and amortization rose to £104 million from £12 million the year earlier. Ebitda from music publishing rose to £91 million from £81 million.

But those cash-flow gains were likely wiped out by interest payments on a £2.7 billion loan from **Citigroup** Inc.

CORPORATE NEWS

Cellphone sales drop 5%

Moderate growth is forecast for 2010; Nokia loses ground

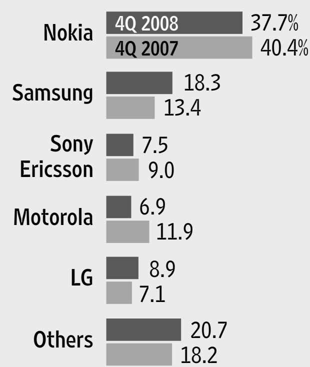
By Gustav Sandstrom

STOCKHOLM—Global handset sales declined in the fourth quarter and demand isn't expected to stabilize before next year, research firm Gartner Inc. said Tuesday.

Gartner said about 315 million mobile phones were sold in the fourth quarter, down 5% from a year earlier, as manufacturers continued to struggle against weak consumer confidence in both emerging and mature markets.

Emerging as well as developed markets saw growth of 2% from the previous quarter—the lowest such growth ever recorded for a fourth quarter, said Gartner's mobile-device research director, Carolina Milanesi. "Efforts to reduce inventory will intensify in the first quarter of 2009 and continue into the second quarter," she added.

"At the moment we are seeing growth in 2010," Ms. Milanesi said. "It will be very moderate, but growth."



Ms. Milanesi said the focus in the handset market is shifting from hardware to software services and applications. "I think it's going to be the vendors which are following that trend best that will benefit from the growth," she said.

The mobile-phone industry did see growth for 2008 as a whole, with sales to end users increasing 6% to surpass 1.22 billion units, though demand tapered off toward the end of the year.

Ms. Milanesi said the world's biggest mobile-phone maker, **Nokia** Corp., will be well-placed when the market bounces back, thanks in part to its diversified portfolio. Nokia's market share fell to 37.7% in the fourth quarter from 40.4% a year earlier. Its delay in rolling out products with touch-screen functionality caused its smart-phone sales to suffer, Gartner said. Ms. Milanesi said Nokia will need to come up with more interesting products in the smart-phone segment. "Since the N95 we haven't really seen any other iconic devices, and that's what they need to gain back," she said.

South Korea's **Samsung Electronics** Co. increased its market share to 18.3% from 13.4% in the year-earlier period, due to its quick response to demand for touch interfaces. **LG Electronics** Inc. increased its market share to 8.9% from 7.1%.

Sony Ericsson, a joint venture of Japan's **Sony** Corp. and Sweden's **Telefon AB L.M. Ericsson**, saw its market share fall to 7.5% from 9%.

U.S.-based **Motorola** Inc.'s market share fell to 6.9% from 11.9%, hurt by a lack of third-generation products, Gartner said.

Genentech defends rejection of bid

By Ron Winslow And Dana Cimilluca

Genentech Inc.'s top executives gave a spirited defense of the biotechnology company's scientific and commercial prowess at an investors' meeting in New York, arguing that both its track record and its prospects are significantly undervalued in **Roche Holding** AG's $86.50-a-share hostile takeover offer for the Genentech stock it doesn't own.

David Ebersman

Genentech officials projected that U.S. sales would jump 79% to more than $17 billion by 2015, fueled by its cancer drug Avastin. They forecast a 16% compound annual growth rate in earnings per share for five years ending in 2015 and predicted approvals for as many as 15 new drugs by 2015.

The company also described projects that are broadening its product line beyond cancer and immunology to include Alzheimer's disease, infectious diseases and cardiology.

"We don't believe the tender offer adequately reflects the value and future prospects of Genentech's business," said Art Levinson, chairman and chief executive officer of the company, which is based in South San Francisco, Calif. A special committee of the company's board has valued the company at $112 a share.

The New York presentation did little to help Genentech shares in Monday's broad market selloff. Genentech dropped 4.6% to $81.59 in New York. Tuesday, the shares were up 28 cents to $81.87 in midafternoon trading.

One factor depressing Genentech shares is an escape clause buried in Roche's Feb. 9 takeover proposal. The clause allows Roche to abandon its $86.50-a-share offer for Genentech, which was already lowered from its original $89-a-share offer, if there is decline of more than 15% in major U.S. stock gauges including the Standard & Poor's 500-stock index. That drop has since occurred.

The tender offer is set to expire March 12.

David Ebersman, Genentech's chief financial officer, described 13 "points of divergence" with Roche that reflect the $25.50-a-share valuation difference. They include disagreement over projections of long-term growth, future tax rate; and the value of rights to Genentech's drugs outside the U.S., which Roche holds until 2015.

To make the last point, Mr. Ebersman posted a slide showing Roche's drug pipeline as of the end of 2008. It listed 78 projects in mid-to-late stages of development, with those involving Genentech compounds shown in blue. Then he deleted the Genentech studies and just 21 projects remained.

Roche declined to comment on Genentech's presentation.

New Mac lineup trims some prices

By Kevin Kingsbury

Apple Inc. unveiled an updated lineup of desktop computers, including a new 24-inch iMac and a high-end Mac Pro that are cheaper than the prior versions.

The Cupertino, Calif., company avoided drastic price cuts Tuesday, though the new models generally offer more features and computing power for the same price as previous models.

The flagship 24-inch iMac, which will sell for $1,499, or $300 less than the prior model, has twice the memory and storage. The new Mac Pro, which starts at $2,499, or $300 less than the previous model, includes a next-generation Nehalem microprocessor from **Intel** Corp.

Kaufman Bros. analyst Shaw Wu said he would have liked to see more-aggressive price cuts from Apple.

The new desktops come amid what is expected to be a weak year for computer sales. Desktop shipments are expected to fall by nearly one-third globally in 2009, research firm Gartner Inc. projected Monday, as consumers increasingly shift to mobile devices.

Apple's desktop-PC business, which represents about 17% of revenue, has been suffering because the company hasn't significantly refreshed its lineup in more than a year, analysts say. The new additions could bolster sales.

The updates were expected, and iMacs have been hard to come by in the past few weeks, according to various Apple resellers. Apple usually lets supplies of products dwindle shortly before an updated version goes on sale.

—Ben Charny contributed to this article.

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GLOBAL BUSINESS BRIEFS

Barry Callebaut AG

Agreement is reached to sell consumer business to Natra

Switzerland-based **Barry Callebaut** AG, the world's biggest bulk-chocolate producer, said it plans to sell its consumer business to **Natra** SA in exchange for a minority stake in the Spanish company. Financial details of the deal weren't disclosed. After the deal, Natra would become a significant player in Europe's private-label chocolate sector, with combined sales of €850 million ($1.07 billion) for 2008, Barry Callebaut said. The move will allow Barry Callebaut to focus on its core business: making chocolate intermediate products for global companies such as Hershey Co. and Nestlé SA. The Swiss company has sought to rid itself of its consumer-chocolate division, which includes its German-based Stollwerck operations, a business that has been restructured during the past few years but still lacked scale.

Air France-KLM SA

Air France-KLM SA said Tuesday it will delay the delivery of two A380 Airbus aircraft. The Franco-Dutch carrier said the deliveries of the sixth and seventh of the 12 A380 aircraft it has ordered from Airbus, a unit of **European Aeronautic Defence and Space** Co., will be postponed. It declined to give further details on the reason and length of the delay. A spokeswoman for Air France-KLM also said that the carrier is still studying the possibility of making an offer for Czech Airlines. "Air France-KLM is watching the dossier very closely and will express something soon," she said. The Czech state-owned carrier is already a partner of Air France-KLM in the Skyteam airline alliance.

Qantas Airways Ltd.

Qantas Airways Ltd. said Tuesday it grounded its three Airbus A380 superjumbo aircraft for about 24 hours but has since resolved a number of electrical and mechanical issues. A spokesman for the Australian flag carrier said two aircraft had experienced a fuel-tank-indication-system problem while the third aircraft suffered a nose-wheel ground steering issue and an unrelated fuel leak. Two of the A380s were due to return to service Tuesday and the third today. The airline deployed Boeing 747s to cover the services affected by the delays but has returned one A380 to the skies, on the London to Melbourne route via Singapore. The second aircraft was due to operate the London to Sydney service Tuesday.

Meggitt PLC

Meggitt PLC posted an 11% rise in full-year net profit as the U.K.-based aerospace and energy company saw good growth in key markets, but it cautioned it was taking action to position itself for uncertainty in 2009, including cutting hundreds of jobs. Net profit rose to £99.1 million ($139.3 million) in 2008 from £89.3 million in 2007, as sales increased 32% to £1.16 billion. The company plans to reduce headcount at its civil-aerospace unit from mid-2008 levels by 15%, or about 600 jobs. The company employs about 8,000 people in total. Meggitt will also freeze management pay. Chief Executive Terry Twigger said Meggitt could try to reduce management costs at the civil-aerospace unit by a further 10% in 2009 if markets deteriorate.

Beiersdorf AG

Germany's **Beiersdorf** AG, the maker of Nivea brand creams and Tesa tape, saw net profit jump 29% in 2008 but warned that declining consumer spending could mean slower growth in 2009. Net profit rose to €562 million ($706 million) from €437 million in 2007 as sales were up 8.3% at €5.97 billion from €5.51 billion. The Hamburg-based company didn't break out fourth-quarter results. In light of the world economic crisis, Beiersdorf said it couldn't provide a specific earnings outlook for 2009, but said it expects growth to wane in the U.S. and Western Europe. In Eastern Europe, Asia and Latin America, the company said it anticipates "a clear drop in the pace of growth over the short term" as the economic downturn weighs on consumer spending.

Société Générale SA

Société Générale Australia will cut staff by 30% in 2009. The reduction will likely include both redundancies and relocations to Société Générale's Hong Kong operations. The business divisions affected are for spot and foreign-exchange options pricing, base- and precious-metals pricing and interest-rate-derivatives desks. A spokeswoman said Société Générale Australia has about 280 people. "It would be crazy to say there will be no redundancies," she said. "But obviously, the first point will be to try to relocate people," she said. French investment bank **Société Générale** SA closed the securitization unit of its Australia-based operations early last year.

Linde AG

Linde AG said net profit fell 25% in 2008 and cautioned that demand has dropped, particularly in the final months of the year, amid the global economic crisis. The Munich-based industrial-gases company reported full-year net profit of €717 million ($901.7 million), compared with €952 million in 2007, when results were boosted by gains from disposals. Sales rose 2.9% to €12.66 billion from €12.31 billion. Linde engineers and builds chemical and gas plants and produces gases, including hydrogen, oxygen, nitrogen and argon, for the medical, industrial and scientific fields. Linde didn't break out fourth-quarter earnings figures in its statement, nor did it give an outlook for the current year, but said it would provide more earnings information on March 16.

ST Microelectronics SpA

Semiconductor maker **ST Microelectronics** SpA said it will temporarily lay off about 4,000 Italian workers. The Geneva-based company said the challenges brought on by the crisis in the fourth quarter of 2008 had "progressively" worsened. ST Microelectronics said it met Monday with the Italian industry ministry. In January, ST Microelectronics said it planned to cut 4,500 jobs in 2009 to reduce costs by $700 million. Those job cuts excluded France and Italy. ST Microelectronics has more than 50,000 employees world-wide and some 8,067 workers in Italy. The European Union expects unemployment in Italy to spike in 2009 and 2010, rising to 8.2% and 8.7%, respectively, from 6.7% in 2008.

—Compiled from staff and wire service reports.

U.S. Fed chairman backs stimulus effort

Bernanke supports aggressive moves to avoid a prolonged economic downturn even if they raise the federal debt

By Maya Jackson Randall And Brian Blackstone

WASHINGTON—U.S. Federal Reserve Chairman Ben Bernanke on Tuesday appeared to back the White House's efforts to stimulate the economy, saying aggressive action is needed now to avoid a prolonged downturn even as it adds new government debt.

The U.S. economy is likely to remain under severe pressure in the near term, Mr. Bernanke signaled, amid signs that the labor market is weakening further and the global recession is broadening.

"By supporting public and private spending, the fiscal package should provide a boost to demand and production over the next two years as well as mitigate the overall loss of employment and income that would otherwise occur," Mr. Bernanke said in prepared testimony to the Senate Budget Committee.

President Barack Obama recently signed a $787 billion stimulus bill that includes infrastructure spending, aid to states and tax cuts. Approval came almost entirely without Republican support in Congress, making Mr. Bernanke's supportive comments noteworthy, because he served as President George W. Bush's top economist in 2005 before becoming Fed chairman.

Mr. Bernanke said that while the federal government has yet to stabilize the ailing banking system, there are no "zombie" banks and he doesn't think nationalization is "either warranted or necessary."

Mr. Bernanke noted that the term "zombie" institution was used in the context of Japan, where bankrupt customers were kept on life support for long periods and banks weren't making loans.

However, the U.S. is in a very different situation today, the Fed chief said. "I don't think that any major U.S. bank is currently a zombie institution," he said. "They're all lending. They're all viable."

He added that the government had no choice but to step in and rescue ailing firms such as insurer **American International Group** Inc., which Mr. Bernanke described as a good company "ambushed" by its financial-products division.

The cost of the failures of both AIG and Lehman Brothers Holdings Inc. would have been in the "multiple trillions" of dollars, he said.

Mr. Bernanke's latest comments come amid signs that the recession, which began in December 2007, is deepening. Gross domestic product plunged at a 6.2% rate last quarter, the Commerce Department said last week, the steepest slide since the early 1980s. And the recent bloodbath on Wall Street brought the Dow Jones Industrial Average on Monday to levels not seen in a dozen years. Late Tuesday in New York, the blue chips had fallen 12.26 points to 6751.03.

"The recent near-term [economic] indicators show little sign of improvement," Mr. Bernanke said, citing higher levels of new jobless claims since mid-January, "suggesting that labor market conditions may have worsened further in recent weeks."

The Labor Department will release the February employment report on Friday. Economists are bracing for a drop of roughly 650,000 in nonfarm payrolls, according to a Dow Jones Newswires survey, which would push the unemployment rate up to 8%.

Meanwhile, businesses "have apparently cut back their plans for capital expenditures significantly," Mr. Bernanke said, and the contraction in foreign economies seems to be broadening.

Against that grim backdrop, the Fed chief said, "we are better off moving aggressively today to solve our economic problems."

The alternative, he warned, "could be a prolonged episode of economic stagnation that would not only contribute to further deterioration in the fiscal situation but would also imply lower output, employment and incomes for an extended period."

The mix of stimulative fiscal policy and the severe recession will take a toll on government finances in the near term, Mr. Bernanke acknowledged. The deficit could hit $1.8 trillion this year and remain at roughly $1 trillion in 2010 and 2011, meaning the debt-to-GDP ratio will go from 40% before the onset of the financial crisis to more than 60%, Mr. Bernanke said, the highest since the 1950s.

"Of course, all else equal, this is a development that all of us would have preferred to avoid," Mr. Bernanke said.

But given the economic climate, "enormous" deficits are "unavoidable," Mr. Bernanke said. He urged policy makers to keep the debt-to-GDP ratio from climbing above 60%.

Mr. Bernanke did offer some glimmers of hope for both the economy and the budget. Over time, Mr. Bernanke said, "a number of factors should promote the return of solid gains in economic activity in the context of low and stable inflation" including fiscal and monetary stimulus, lower energy prices and better inventory levels.

But reiterating a message he delivered to lawmakers last week, Mr. Bernanke said "historical experience strongly suggests that, without a reasonable degree of financial stability, a sustainable recovery will not occur."

"Although progress has been made on the financial front since last fall, more needs to be done," he said.

He remained upbeat that the government will recoup the hundreds of billions of dollars it has plowed into major financial institutions.

"If all goes well, the disposition of assets acquired by the Treasury in the process of stabilization will be a source of added revenue for the Treasury in the out years," he said.

Mr. Bernanke couldn't tell lawmakers what the total cost of government rescues would be or whether officials will need Congress to authorize additional funds. Congress approved a $700 billion bank rescue package last year. However, in his budget plan, Mr. Obama included a "placeholder" that effectively warned Congress that the government could need more than $700 billion more to stabilize the financial sector.

The need for funds will be determined by the "stress tests" regulators are conducting on the nation's largest banks, Mr. Bernanke said, adding that it will also depend on how the economy evolves.

Mr. Bernanke also said the U.S. must tackle entitlement reform or else face huge budget deficits for years to come. That would, in turn, make it tougher to sell U.S. government debt and raise interest rates, Mr. Bernanke warned.

Reuters

U.S. Federal Reserve Chairman Ben Bernanke testifies before the Senate Budget Committee in Washington on Tuesday.

U.S. launches effort to jump-start consumer lending

WASHINGTON—The U.S. government is moving forward with two legs of its effort to restart troubled credit markets, launching a program to spur consumer lending and figuring out how to buy up the bad loans and other distressed assets that lie at the heart of the financial crisis.

By Meena Thiruvengadam, Deborah Solomon and Jon Hilsenrath

The U.S. Treasury and Federal Reserve on Tuesday launched a highly anticipated program aimed at generating up to $1 trillion in consumer and small-business loans. Under the program, known as the Term Asset-Backed Lending Facility, or TALF, investors will get access to cheap loans from the Fed to purchase securities backed by consumer debt such as car loans and credit-card receivables.

The Fed has said it will eventually lend up to $1 trillion through the program, and the Treasury has pledged $100 billion.

The program was announced in November but has taken months to get off the ground. The government said Tuesday that it will begin disbursing funds March 25 and offer new funding monthly through at least December.

"By reopening these markets, the TALF will assist lenders in meeting the borrowing needs of consumers and small businesses, helping to stimulate the broader economy," the Treasury and Fed said in a statement.

Officials and some investors see great promise in the effort to jump-start the market for asset-backed securities. Many lenders in recent years packaged and sold their loans as such securities, relying on the proceeds to fund additional lending. That market has dried up, making it difficult for many consumers to borrow and hurting consumer spending.

"The program could represent a turning point for the economy and the financial markets by jump-starting lending in critical areas of the economy," said Miller Tabak & Co. Chief Bond Strategist Tony Crescenzi in a client note.

The early rounds of lending are critical, others noted. "If for some reason the early rounds of the TALF do not work out well, the system could be in a lot of trouble, because it is becoming painfully evident that the powers that be do not have some new brilliant idea up their sleeves," Stephen Stanley, chief economist at RBS Greenwich Capital, wrote to clients.

Several issues remain to be addressed. For example, issuers of asset-backed securities that benefit from Fed financing must be willing to submit themselves to new Treasury Department limits on executive compensation. The Fed's loans are three-year loans, which could tie their executives down for years. (Investors who borrow from the Fed to buy the consumer-loan-securities aren't covered by the compensation rules.)

And at least one company—GMAC Financial Services, the financial arm of auto maker **General Motors** Corp., which has received $5 billion in government aid—suggested the TALF's impact may be muted because of ratings requirements on securities. The Fed has insisted that any deal it helps finance be given a triple-A rating from the major ratings agencies. For GMAC, "rating agencies are not willing to provide the required rating level while GM's situation remains unresolved," the auto maker said last month.

Meanwhile, the Obama administration is filling in some of the blanks in its so-called bad-bank plan to offload distressed assets and bad loans from financial institutions. It is considering creating multiple investment funds to purchase the assets, according to people familiar with the matter.

The Obama team announced its intention to partner with the private sector to buy $500 billion to $1 trillion of distressed assets as part of its revamping of the $700 billion bank bailout last month.

No decision has been made on the final structure of this private-public financing partnership, but one leading idea is to establish separate funds to be run by private investment managers. The managers would have to put up a certain amount of capital. Additional financing would come from the government, which would share in any profit or loss.

These private investment managers would run the funds, deciding which assets to buy and what prices to pay. To encourage participation, the government would try to minimize risk for private investors, possibly by offering loans.

The public-private partnership grew out of the "bad bank" concept, which would have required the government alone to buy up the troubled assets.

The Obama administration jettisoned that idea after running into the thorny issue of pricing. The government hopes that the involvement of private investors will help set a market price where no market currently exists.

Many details remain unclear, in particular, how the government and the private sector will share the risk. An administration official said a key goal is to provide investors with "price safety" so they feel safe enough to get back into the market.

IMF urges aid for poorer nations

As global crisis hits, emerging economies need $25 billion more

By Bob Davis
And Sarah Childress

Twenty-six of the world's poorest nations may need a total of $25 billion in additional funding this year, the International Monetary Fund said, as the global financial crisis sweeps into corners of the world, especially sub-Saharan Africa, that seemed largely insulated from international banking problems.

After battering rich countries and wealthier developing nations, "a third wave from the global financial crisis is now hitting the world's poorest, most vulnerable countries," said IMF Managing Director Dominique Strauss-Kahn. He said the IMF wants to double its very low interest loans to such countries to $11 billion over the next five years. But that still wouldn't be enough to fill the financing need, which he said must come from wealthier nations.

It's far from clear that nations will contribute anything remotely on the scale of what the IMF says is necessary. The World Bank, for instance, is having trouble getting nations to dedicate just 0.7% of their stimulus packages—less than $10 billion in all—to a fund for poor nations hurt by the global downturn.

According to an IMF study, about half of the vulnerable nations are in sub-Saharan Africa, including Angola, Côte d'Ivoire, Ghana and Nigeria, and half are outside the continent. They include Albania, Armenia, Haiti, Honduras, Vietnam and Tajikistan. While the nations vary in size and economic strength, all have seen sharp downturns in growth prospects for 2009. Official reserves also are generally thin, covering only three or four months of imports. The combination makes it hard for the countries to pay their import bills and government expenses.

The IMF said on Tuesday that Armenia, for instance, is seeking a 28-month $540 million IMF loan. As a condition of the loan, the IMF is insisting that the country let its currency, the dram, float, according to the Armenian central bank.

Reuters

Many of the countries the IMF considers most at risk are in sub-Saharan Africa. Above, a woman sells fruit salad in Lagos, Nigeria.

Many of the countries the IMF deems vulnerable had seemed somewhat protected from the crisis because their banks had little exposure to the complex financial instruments peddled in the U.S. and Europe. As a result, the financial crisis largely passed these nations by. In the IMF's April 2008 forecast, sub-Saharan Africa was expected to grow 6.7% in 2009, much higher than the 3.8% predicted for the global economy.

But financial problems produced a recession in the U.S. and Europe and that has been exported to the poor countries through sharp decreases in trade, investment and remittances. At the same time, foreign aid has stagnated. The IMF's most recent forecast, made in January, cut its estimate for sub-Saharan growth in 2009 to 3.5%, and forecast global growth of just 0.5%. Even those estimates, Mr. Strauss-Kahn said Tuesday, were probably "too optimistic."

The IMF added that if economic conditions worsen substantially, 48 nations would need an additional $138 billion in financing.

In sub-Saharan Africa, many of the region's 48 countries prospered over the past several years, as prices for oil and metals boomed. Foreign investors from the Middle East, Asia and the west flocked to do deals in South Africa and Nigeria, building up commercial hubs in Johannesburg and Lagos. African countries demanded greater concessions from multinational companies eager for their resources. Some instituted democratic reforms and saw the birth of a new middle class.

That growth began to slow last year. Many countries were hit by food and fuel inflation, forcing governments to draw on their reserves to offer subsidies, and import basic staples at higher prices.

That left some already poor countries in a weaker position when the downturn hit and demand shriveled for the region's precious stones, metals and other commodities, cutting away revenue just when African countries need it.

A number of the countries the IMF named as vulnerable are still expected to grow in 2009. In January, the IMF forecast that Vietnam would expand by 4.8%, Albania by 3.7%, and Nigeria by 3.3%. But in all three cases that growth is far less than what was anticipated last spring.

While poor nations are likely to appreciate the IMF's pitch for more money, they may fight its counsel to tighten their belts and cut budget deficits. That's the opposite of the advice the IMF is giving wealthier countries, who are being urged to boost spending even if that means widening budget deficits.

Mr. Strauss-Kahn defended the different messages, saying that many poor nations are already hamstrung by heavy debt and shouldn't increase it substantially. "We don't have two kinds of policies depending on who we are talking with," he said.

Inflation is slowing in developed economies

By Paul Hannon

Consumer prices in developed economies rose at the slowest annual rate in at least 38 years during January, figures released by the Organization for Economic Cooperation and Development showed Tuesday.

The Paris-based research organization said the annual rate of inflation in its 30 members slowed to 1.3% from 1.5% in December. As recently as July 2008, it had stood at an 11-year high of 4.8%. Seen month-to-month, prices were broadly stable during January, after falling 0.5% in December from November.

The 1.3% was the lowest annual rate of inflation since the OECD started collecting data in January 1971. The previous record low was December's rate, and prior to that the 1.7% rate of inflation recorded in March 2004.

The main reason behind the slowdown in inflation was the continuing decline in energy prices, which dropped 9.6% in the 12 months to January. In the 12 months to December, prices had fallen by 8.9%.

Food prices also made a contribution to the decline in the annual inflation rate, albeit a much smaller one. Food prices rose by 5.4% in the 12 months to January, compared with a 6% increase in the 12 months to December.

In addition, there were signs that inflation is easing quickly across a broad range of goods and services. The OECD said that, excluding energy and food, the annual rate of inflation fell to 1.9% in January from 2% in December.

Among OECD members, Iceland continued to have by far the highest annual inflation rate with 18.6%, while the U.S. and Japan had the lowest annual inflation rates. In the world's two largest economies prices were at the same level as in January 2008.

EU ready to avert euro-zone defaults

A WSJ News Roundup

BRUSSELS—The European Union would act to help a government in the 16-member euro zone if it ran into financing trouble, an EU official said Tuesday.

Joaquin Almunia, the EU's monetary affairs commissioner, said the bloc had a "solution" for euro-zone countries at risk of defaulting on their debt, but he wouldn't say what it was. "By definition, this type of thing should not be explained in public," he said.

He said the EU solution would come before a country had to seek last-resort aid from the International Monetary Fund.

Deteriorating conditions in some euro-zone members, including Portugal, Greece and Ireland have pushed yields on those countries' bonds well above historical levels as investors rate them as a greater risk of default. Mr. Almunia's spokeswoman described a default as "unlikely."

Mr. Almunia's remarks draw the line between the generally wealthier euro-zone members and the struggling non-euro countries of Eastern Europe.

At a Sunday summit, EU leaders led by German Chancellor Angela Merkel dismissed a call by Hungary for a regional bailout of Eastern Europe and instead suggested that any needed aid should come through the IMF or other multilateral bodies.

Exactly what the EU's central institutions could do for members of the euro zone isn't clear.

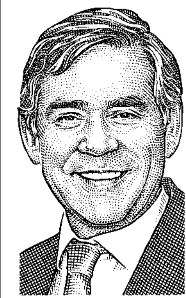
Obama, Brown talk of changes in world markets

By Jonathan Weisman
And Mark Whitehouse

WASHINGTON—President Barack Obama and British Prime Minister Gordon Brown huddled at the White House on Tuesday to begin crafting a framework for re-regulating world financial markets before next month's G-20 summit in London.

"There's got to be deep regulatory change," Mr. Brown said, sitting next to the president during a brief session with reporters in the Oval Office.

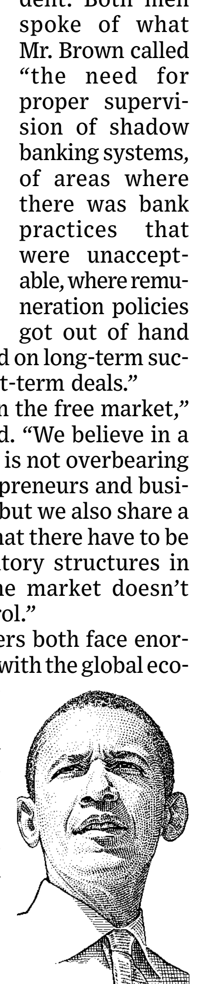
The meeting was Mr. Obama's first with a European leader as president. Both men spoke of what Mr. Brown called "the need for proper supervision of shadow banking systems, of areas where there was bank practices that were unacceptable, where remuneration policies got out of hand and weren't based on long-term success, but on short-term deals."



Gordon Brown

"We believe in the free market," Mr. Obama added. "We believe in a government that is not overbearing and allows entrepreneurs and businesses to thrive, but we also share a common belief that there have to be sufficient regulatory structures in place so that the market doesn't spin out of control."

The two leaders both face enormous challenges with the global economic downturn. But while the American president retains the nation's confidence just five weeks into his term, Mr. Brown is feeling the pressure of a restive electorate now into the second decade of a Labour Party government. The British leader served his predecessor, Tony Blair, as treasury chief for 10 years.



Barack Obama

Mr. Obama worked to give his visitor a boost. "Great Britain is one of our closest, strongest allies and there is a link, a bond there that will not break," he said.

Forging a strong relationship with Mr. Obama is crucial for Mr. Brown, who needs U.S. support as he seeks a leading role in shaping a global response to the financial crisis.

In an effort to set the agenda for the G-20 meeting in April, which will bring together the world's 20 leading economic powers, Mr. Brown has called for a "global New Deal" in which governments would coordinate economic-stimulus efforts and agree to avoid protectionist measures. He also wants to expand the resources and powers of the International Monetary Fund.

Mr. Brown must call an election by May 2010 amid what economists expect to be a prolonged recession. His approval ratings, which jumped in October after the U.K. introduced an ambitious bank-bailout plan that became a template for similar plans across Europe, have since fallen as the recession has taken hold and unemployment has surged.

REVIEW & OUTLOOK

The Obama Economy

As 2009 opened, three weeks before Barack Obama took office, the Dow Jones Industrial Average closed at 9034 on January 2, its highest level since the autumn panic. Monday the Dow fell another 4.24% to 6763, for an overall decline of 25% in two months and to its lowest level since 1997. The dismaying message here is that President Obama's policies have become part of the economy's problem.

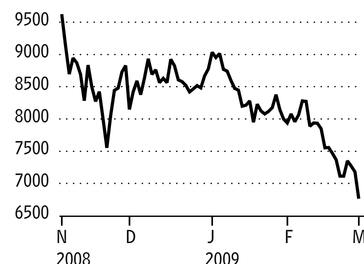
Americans have welcomed the Obama era in the same spirit of hope the President campaigned on. But after five weeks in office, it's become clear that Mr. Obama's policies are slowing, if not stopping, what would otherwise be the normal process of economic recovery. From punishing business to squandering scarce national public resources, Team Obama is creating more uncertainty and less confidence—and thus a longer period of recession or subpar growth.

* * *

The Democrats who now run Washington don't want to hear this, because they benefit from blaming all bad economic news on President George W. Bush. And Mr. Obama has inherited an unusual recession deepened by credit problems, both of which will take time to climb out of. But it's also true that the U.S. economy has fallen far enough, and long enough, that much of the excess that led to recession is being worked off. Already 15 months old, the current recession will soon match the average length—and average job loss—of the last four postwar downturns. What goes down will come up—unless destructive policies interfere with the sources of potential recovery.

And those sources have been forming for some time. The price of oil and other commodities have fallen by two-thirds since their 2008 summer peak, which has the effect of a major tax cut. The world is awash in liquidity, thanks to monetary ease by the U.S. Federal Reserve and other central banks. Monetary policy operates with a lag, but last year's easing will eventually stir economic activity.

U.S. housing prices have fallen 27% from their Case-Shiller peak, or some two-thirds of the way back to their historical trend. While still high, credit spreads are far from their peaks during the panic, and corporate borrowers are again able to tap the credit markets. As equities were signaling with their late 2008 rally and January top, growth should under normal circumstances begin to appear in the second half of this year.



So what has happened in the last two months? The economy has received no great new outside shock. Exchange rates and other prices have been stable, and there are no security crises of note. The reality of a sharp recession has been known and built into stock prices since last year's fourth quarter.

What is new is the unveiling of Mr. Obama's agenda and his approach to governance. Every new President has a finite stock of capital—financial and political—to deploy, and amid recession Mr. Obama has more than most. But one negative revelation has been the way he has chosen to spend his scarce resources on income transfers rather than growth promotion. Most of his "stimulus" spending was devoted to social programs, rather than public works, and nearly all of the tax cuts were devoted to income maintenance rather than to improving incentives to work or invest.

His Treasury has been making a similar mistake with its financial bailout plans. The banking system needs to work through its losses, and one necessary use of public capital is to assist in burning down those bad assets as fast as possible. Yet most of Team Obama's ministrations so far have gone toward triage and life support, rather than repair and recovery.

AIG on Monday received its fourth "rescue," including $70 billion in Troubled Asset Relief Program cash, without any clear business direction. (See below.) Citigroup's restructuring last week added not a dollar of new capital, and also no clear direction. Perhaps the imminent Treasury "stress tests" will clear the decks, but until they do the banks are all living in fear of becoming the next AIG. All of this squanders public money that could better go toward burning down bank debt.

The market has notably plunged since Mr. Obama introduced his budget last week, and that should be no surprise. The document was a declaration of hostility toward capitalists across the economy. Health-care stocks have dived on fears of new government mandates and price controls. Private lenders to students have been told they're no longer wanted. Anyone who uses carbon energy has been warned to expect a huge tax increase from cap and trade. And every risk-taker and investor now knows that another tax increase will slam the economy in 2011, unless Mr. Obama lets Speaker Nancy Pelosi impose one even earlier.

Meanwhile, Congress demands more bank lending even as it assails lenders and threatens to let judges rewrite mortgage contracts. The powers in Congress—unrebuked by Mr. Obama—are ridiculing and punishing the very capitalists who are essential to a sustainable recovery. The result has been a capital strike, and the return of the fear from last year that we could face a far deeper downturn. This is no way to nurture a wounded economy back to health.

* * *

Listening to Mr. Obama and his chief of staff, Rahm Emanuel, on the weekend, we couldn't help but wonder if they appreciate any of this. They seem preoccupied with going to the barricades against Republicans who wield little power, or picking a fight with Rush Limbaugh, as if this is the kind of economic leadership Americans want.

Perhaps they're reading the polls and figure they have two or three years before voters stop blaming Republicans and Mr. Bush for the economy. Even if that's right in the long run, in the meantime their assault on business and investors is delaying a recovery and ensuring that the expansion will be weaker than it should be when it finally does arrive.

AIG's Black Box

Say this for the U.S. Treasury and New York Federal Reserve: At least they've gained a sense of humility. Unveiling the fourth draft of their AIG bailout Monday, the feds were unwilling to rule out No. 5. Fixing AIG "will take time and possibly further government support," the regulators declared. Perhaps someday the feds will even explain to taxpayers which AIG creditors had to be rescued and why.

Monday's changes reduce the interest that AIG will be required to pay taxpayers, while increasing taxpayer risk by exchanging some debt for equity. AIG will receive access to another $30 billion from the Troubled Asset Relief Program, for a total of up to $70 billion, and on better terms. The New York Fed will also reduce the rate it charges AIG on a revolving credit line, and forgive some of AIG's debt in exchange for interests of up to $26 billion in two AIG life insurance subsidiaries. The New York Fed will also loan up to $8.5 billion to vehicles holding pools of AIG life insurance policies.

When all is said and re-re-redone, the U.S. government will still own almost 78% of AIG, plus large stakes in subsidiaries that may be sold to the public. Closing at 45 cents a share Monday, AIG now stands as a monument to the folly of regulatory panic.

Since September 16, when the government began its serial interventions into AIG, not one of these deals has been approved by AIG shareholders, and not one has been fully explained to taxpayers. If you thought the derivatives in AIG's financial products unit were a black box, try figuring out exactly who benefits when taxpayer money arrives at the insurance giant. What we know is that since the end of last August, AIG has sent more than $20 billion in collateral to trading counterparties, but neither the Fed nor AIG will name the recipients.

> The fourth rescue is not a charm.

We have to take it on faith that they are vital to a healthy financial system. One theory held that the $20 billion AIG owed to Goldman Sachs inspired the original rescue, but Goldman CEO Lloyd Blankfein recently told Congress that the firm had offsetting trades and therefore was not materially exposed. So which creditors needed a healthy AIG?

Both the government and AIG noted Monday that the company is "systemically important," but good luck getting a precise definition of what this means. Here's how the statement from the Fed and Treasury made the case: "AIG provides insurance protection to more than 100,000 entities, including small businesses, municipalities, 401(k) plans, and Fortune 500 companies who together employ over 100 million Americans. AIG has over 30 million policyholders in the U.S. and is a major source of retirement insurance for, among others, teachers and non-profit organizations. The company also is a significant counterparty to a number of major financial institutions."

The Treasury and the New York Fed appear eager to show that continuing to pour money into AIG is about saving Main Street, not just Wall Street. But neither the Treasury nor the Fed is an insurance regulator. State laws segregate the assets needed to protect policyholders within the highly regulated insurance subsidiaries at AIG, and if they were to fail, state guarantee funds exist to ensure claims are paid. Have Fed and Treasury staff, with their copious amounts of free time, studied state and international insurance regulatory schemes and deemed them inadequate?

If the argument is that an AIG failure would deprive customers of needed insurance products, this seems to be even more of a stretch. Industry observers tell us the firm had to discount heavily to keep corporate customers during its recent renewal period for property and casualty coverage. One insurance executive said that many of these discounted policies will be money losers in years ahead, though AIG insists that it has careful underwriting and is not selling unprofitable policies.

Readers will recall that some large AIG investors, including former CEO Hank Greenberg, believed the firm would have been better off in Chapter 11 bankruptcy compared to the onerous terms of the September rescue. Mr. Greenberg and others urged a plan that invited private capital to save AIG. We are instead witnessing what happens to a once-great firm when it is run by the federal government. Instead of an open-ended commitment to pour money as needed into AIG, the Fed and Treasury should be offering taxpayers an exit strategy.

Pepper . . . and Salt

THE WALL STREET JOURNAL

"I was feeling nostalgic, so I thought we'd talk instead of text."

Global View / *By Bret Stephens*

In Praise of Mexico's Drug War

On a recent trip to Mexico, I asked a family friend—a professor at the National University—whether she thought the government was collapsing under the weight of the drug war, which has claimed close to 9,000 lives in the past two years, turned border cities into no-go zones and elicited comparisons between Mexico and Pakistan. "Collapsing?" she said. "It's finally picking itself up."

Her point: Mexico's "drug problem" is of very long standing. The rest of the world is only noticing it now because President Felipe Calderón has decided to break with his predecessors' policy of malign neglect of, if not actual complicity in, the drug trade.

The Wall Street Journal has been writing about drug trafficking in Mexico for decades. In 1967, an intrepid young reporter named Peter Kann—later CEO of Dow Jones—hoofed his way through the high sierra of Sinaloa, on the trail of poppy growers and heroin smugglers. The story he filed then could just as easily have run 40 years later:

"In cases where the big traffickers operate with [Mexican] political protection," he wrote, "U.S. agents content themselves with breeding hostility between rival traffickers. 'We'll put the heat on one dealer and then let the word out that his competition is feeding us information about him. It can stir up a little violence,' says one smiling agent."

Now fast forward to 1985. In February of that year a DEA agent named Enrique "Kiki" Camarena was abducted outside the U.S. consulate in Guadalajara, horrifically tortured and murdered. His kidnapper was marijuana kingpin Rafael Caro Quintero, who was able to flee Mexico to Costa Rica with the help of officers in Mexico's version of the FBI.

Associated Press

Drug lords: No longer operating with impunity.

Anyone who lived in Mexico in the 1980s, as I did, could just as easily name other drug lords and the politicians who protected and profited from them. It's an old story. At bottom, the problem isn't the drug cartels per se. Much less is it—and here I can sense the collective blood pressure of the Cato Institute rising—America's drug laws.

The problem is Mexico's record of corrupt, weak and incompetent governance, which has created the environment in which the cartels have hitherto operated with impunity. The same might be said about other countries in Latin America: These states did not become basket cases on account of the drug trade. It is the fact that they were basket cases to begin with that allowed the drug trade to flourish.

In a recent op-ed in this newspaper's American edition, former presidents of Mexico, Brazil and Colombia called the war on drugs a failure and warned that the "alarming power of the drug cartels is leading to a criminalization of politics and a politicization of crime." They also called for the decriminalization of cannabis and greater emphasis on education and treatment programs.

A beguiling argument, wrong on every point. Huge sums already go to drug education and treatment. Decriminalizing pot would do nothing to stem the violence from the illegal traffic of hard drugs. (Decriminalizing hard drugs would also send addiction rates skyrocketing, as the British experience of the 1970s shows, with criminal consequences of its own.) As for the argument about the "criminalization of politics," that story is as old as Latin America itself.

All this aside, the plain political fact is that drug legalization in the U.S. is not going to happen as long as a powerful moral and social consensus opposes it. To make the case for it now while Mexico bleeds is an exercise in fecklessness. What Mexico urgently needs are stronger institutions of state, beginning with its army but also including the judiciary and the police.

In 2007, the Bush administration agreed to the Merida Initiative (derisively called "Plan Mexico" by its critics, who seem not to have noticed that "Plan Colombia" actually helped Colombia) with the governments of Mexico and Central America. The administration offered to spend about $1.5 billion over three years on counternarcotics efforts. So far only about $300 million has actually been released.

To put the numbers in context, an estimated $15 billion flows annually into the coffers of Mexican drug cartels. The Calderón government has vastly increased military and police budgets, but remains vastly outspent by the cartels. Clearly more needs to be done, and if the Obama administration had its foreign priorities straight, the $300 million it now plans to spend to relieve Hamas of its obligations in Gaza would go to our Mexican partners instead.

Still, Mexico's achievements have not been negligible. The government has managed to spark power struggles within and among cartels, and the vast majority of Mexico's murder victims are themselves involved in the drug trade. More important, Mr. Calderón has sent the signal that his government will not repeat the patterns of complacency and collusion that typified Mexico for decades. Whatever else might be said about his government, it's a serious one.

This does not mean Mr. Calderón will win this war. But for those of us who know Mexico well, it is an astonishing turn, deserving neither of pity nor sagacious snickering, but of respect.

Write to bstephens@wsj.com

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Letters to the Editor

Should Bumbling Government Own Banks?

"The Journal Interview with Nouriel Roubini: 'Nationalize' the Banks" (Feb. 23) once again demonstrates that the credibility of economists is inversely related to their level of celebrity and their proximity to political power. To paraphrase Lord Acton: Celebrity corrupts, and political celebrity corrupts absolutely. Mr. Roubini tells us that markets fail and have failed to clear because of excesses, greed and irrational exuberance.

Amazingly, Mr. Roubini makes no mention whatsoever of the government interventionism that is largely the cause of our current crisis. Was the U.S. Federal Reserve's policy of holding interest rates below the real rate of interest and thereby causing a credit bubble and debt-fueled consumption a market failure? Or was the market failure that market participants did not read F.A. Hayek's "Monetary Theory and the Trade Cycle" and divine the peril that was not being signaled through the price mechanism? Or does Mr. Roubini consider it a market failure that lenders were coerced by the government to make mortgage loans that never would have been made based on market-driven underwriting standards? Is the failure of unqualified homebuyers to decline the cheap, no-down-payment loans that lenders were coerced to offer them another market failure? Was it market failure that lenders knew they would never have to suffer the consequences of reckless underwriting when they could dump their rotten portfolio on the taxpayers via the government-backed Fannie Mae and Freddie Mac?

Robert Drane
Lakewood Ranch, Fla.

It is a matter of public record how we reached the point where the idea of nationalizing the banks arose. I doubt even the most cunning and unscrupulous member of Congress foresaw the ultimate prize, when under the guise of minority home ownership, they put us on the path to crisis.

Now picture the likelihood that a Sen. Chris Dodd or a Rep. Barney Frank could pressure loans to be made or withheld, and this without public knowledge of where money is being directed. Political contributions would flow from the chosen back to politicians.

It is not enough to control the federal Treasury. By nationalizing the banks, a huge slush fund, safe from prying eyes will be created. Who needs a dictator when we have the U.S. Congress?

Joel Brandes
Chestertown, Md.

Mr. Roubini totally misses the mark about what Alan Greenspan got wrong. The former Federal Reserve chairman spent a career playing the Wizard of Oz, pulling the levers to set the price of money. As the ultimate master of the universe, free markets were not allowed to set interest rates and properly allocate capital. Far from taking Ayn Rand's view of the world to an extreme, his implementation was just the opposite—he knew better where to set the price of money. Sadly, now that the wizard has been revealed, we have so many willing to accept his explanation on how free markets let us down. No, Mr. Greenspan, *you* did.

Dale Meyer
Madison, Wis.

Innovation Must Come From Within, Not Just Public Handouts

Innovation as a tool to survive the global recession is appearing increasingly often in the Journal ("Intel to Spend $7 Billion on U.S. Plants," Leading the News, Feb. 11; and "How to Drive Innovation in Europe," op-ed, Feb. 12). But there is a missing point.

A growing number of companies are investing substantial amounts of money in research and development, with the aim of driving efficiency, productivity and new technologies. It was only this month that you reported that Intel Corp. was asking other high-tech companies to invest in innovation.

Supporting innovative companies that need government help is all very well, but how are we going to restimulate the economy if all companies do not start pulling their weight?

Innovation can and should come from within. Organizations are missing a trick: They spend a lot of money on R&D but fail to consult those who really know their business. Consulting the entire employee base, from the shelf stackers to the CEO, and learning where economies and improvements can be made is a simple yet effective way to save money and innovate. To challenge failing business models, explore new strategies and develop better methods of execution, businesses need to consult the people who know the company the best—its employees.

Mark Turrell
CEO
Imaginatik
London

'Executive' Pay Provisions Strike Workers on Lower Rungs, Too

I read with great interest the article by Lucian Bebchuk ("Congress Gets Punitive on Pay," op-ed, Feb. 18). However, with the crux of his argument focusing on executive incentives, he misses a key point. This bonus restriction is going to hit the banks hardest in terms of its intake of driven, high-achieving newcomers. Recruiting talented people matters more than ever in the current economic environment. And with bonuses reined in so arbitrarily, U.S. financial institutions will now be competing with a significant disadvantage. Soon-to-be graduates like myself will be lost to competitors willing to offer significant incentives, further hampering the already hard-hit U.S. sector. If this issue is not quickly resolved, executive incentives will cease to matter altogether: They will have no one left in their organization to do their bidding!

Ian Rodgers
Corpus Christi College
Cambridge, England

California to France Via Initiatives

I sent Matthew Kaminski's "How California Became France" (op-ed, Feb. 24) to my older brother, currently living in California. He responds:

Arnold Schwarzenegger's reforms came close to passing, but failed due to his supporters being out-spent five to one with union money. It set the record amount for money spent on an initiative process until we had the marriage initiative this last election. The Democrats and the unions have killed the golden goose, and now they are arguing over how to split the carcass.

Nancy Thill
Chicago

Gray Davis was not simply hapless, he was unprincipled and rapacious, a pay-for-play governor who gutted our state's economy. He appointed political hacks to restructure electricity. Result: Enron gobbled up all our state surplus and then some, utilities were driven into bankruptcy, and our electric rates doubled or tripled. The large public pension funds that were heavily invested in safe in-state utilities were crippled by huge stock losses.

The Enron scandal brought us the quick-fix Sarbanes-Oxley law, which brought us mark-to-market requirements, which brought the U.S. to where it is today.

The same people who ruined California are still in power, making the same quality decisions and allocating scarce public resources. Like France? Hardly.

Mark Jurecki
Carlsbad, Calif.

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