



Google's ads, Street View raise privacy questions for Web king

THE BIG READ 14-15; BUSINESS & FINANCE 21

Senate veteran Stevens killed in Alaska plane crash

U.S. NEWS 7

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Fed takes gloomier growth view

BY LUCA DI LEO AND IAN TALLEY

U.S. Federal Reserve officials made a small, but significant, shift in strategy to spur the U.S. economy's recovery and avoid deflation.

Following a policy-meeting Tuesday, Fed officials said they would reinvest the proceeds from expiring mortgage-backed securities into

longer-term U.S. Treasuries. In the closely watched statement after the meeting, U.S. central bank officials acknowledged that the pace of the recovery had slowed in recent months.

While the Federal Open Market Committee expects the gradual improvement in the economy to continue, officials said the "pace of the economic recovery is likely to be more

modest in the near term than had been anticipated."

Since Fed officials last met in June, signs have been growing that the one-year-old recovery from the worst recession in decades is losing momentum.

The economy shed jobs for the second month in a row in July amid a small rise in private-sector employment. The unemployment rate remains

painfully high, providing little hope that Americans will boost shopping again anytime soon. With unemployment still so high, some officials had started to worry the economy ran the risk of falling into a Japan-like deflationary environment if no action was taken.

The latest move by the U.S. central bank represents just a tweak in its strategy for man-

aging its huge portfolio. But it's a significant one, because it could be a step toward new large purchases of both government bonds and mortgage-backed securities.

Currently, the proceeds of expiring mortgage bonds are not being reinvested, with the result that the Fed's balance sheet would have slowly shrunken over time. This amounted to a slight tighten-

ing bias in the policy stance.

Michael Feroli, economist at J.P. Morgan Chase, said the Fed's latest move indicates the central bank is "very concerned about the sustainability of the recovery."

The Fed's decision to purchase longer-maturity Treasuries, as opposed to shorter maturity debt, indicates the central bank is comfortable *Please turn to page 7*



Michael M. Phillips/The Wall Street Journal

German soldiers in Kunduz airfield in northern Afghanistan on Tuesday. Germany has portrayed its role in the war as more humanitarian than martial, but with security deteriorating in the north, Berlin has ordered a new, 'aggressive' mission. Two German battalions will team up with Afghan soldiers to combat Taliban fighters.

Germans plan Afghan offensive

BY MICHAEL M. PHILLIPS

KUNDUZ, Afghanistan—The German military, long criticized by its allies as too passive in the face of a growing insurgency, plans to go on the offensive in Taliban strongholds in northern Afghanistan—despite the risk of a political backlash back home.

Acting on instructions from Berlin, senior officers have ordered two 600-man German battalions to team up with Afghan soldiers in the coming months and clear Taliban fighters from districts they now dominate.

The new German commander of the battalion in Kunduz province expects to begin a series of attacks in October. "This is a new mission," said Lt. Col. Christian von Blumröder, who took command this month. "My orders are to get this done." *Please turn to page 10*

The Quirk



Frenchman fights to bring Eyaks' dead tongue back from extinction. Page 29

Editorial & Opinion

A strange calm prevails in Moscow amid the smoke from forest fires. Page 12

Lawmakers seek bomber's medical records

BY ALISTAIR MACDONALD AND CASSELL BRYAN-LOW

Politicians in the U.S. and Scotland ratcheted up pressure on Scottish authorities to release all medical documentation underpinning last year's release of the Lockerbie bomber, a move that comes amid growing questions about the medical rationale for freeing the terminally ill prisoner.

The separate calls for more information—one from four U.S. senators, the other from an opposition lawmaker in Scotland—represent a direct challenge to Scottish Justice Minister Kenny Ma-

cAskill's defense of his decision to release Mr. Megrahi. Mr. MacAskill, in granting compassionate release to Mr. Megrahi, relied on a report from the head administrator for Scotland's prison health service saying that it was reasonable to estimate that Mr. Megrahi would die from prostate cancer within three months—though the report didn't present medical evidence directly supporting that prognosis.

At the time, Scotland's legal system was weeks away from facing a potentially embarrassing appeal over Mr. Megrahi's still-hotly debated

conviction for the 1988 bombing of Pan Am Flight 103 over Lockerbie, Scotland, that killed 270 people. Mr. Megrahi dropped his appeal two days before Mr. MacAskill's decision to release him.

The evidence that led to Mr. Megrahi's conviction has long been questioned by some legal experts.

"On absolutely crucial factual points, without which they could not have convicted [Mr. Megrahi], their decision was simply contrary to the evidence," said Robert Black, a senior lawyer and former professor of Scots law at the University of Edinburgh.

Mr. Black helped design the special trial for Mr. Megrahi held in the Netherlands under Scottish law.

Scottish officials have repeatedly asserted that the decision to release Mr. Megrahi was made after consultation with numerous cancer specialists and Mr. Megrahi's own doctors.

But a close examination of the case by The Wall Street Journal, published last week, showed no evidence that any of the four specialists who treated Mr. Megrahi signed off on the three-month prognosis. Scotland has been unwilling to say whether any

doctor at all—aside from Andrew Fraser, who wrote the report—agreed with the dire assessment. Mr. Megrahi remains alive in Tripoli nearly a year after his release.

"It is clear that there was no consensus among specialists treating al-Megrahi's prostate cancer that he had only three months to live," writes Sen. Robert Menendez, a Democrat from New Jersey, in a letter he planned to send Scottish First Minister Alex Salmond on Tuesday.

The letter asks for release of the "full names, medical training and specialization of *Please turn to page 6*

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PAGE TWO

Now could be time for direct EU tax

[Agenda]

BY IAIN MARTIN



Has the time come for the European Union to levy its own direct taxes? Janusz Lewandowski, the commissioner responsible for the EU's €140 billion (\$183 billion) budget, thinks so and will make proposals next month.

Mr. Lewandowski has spirit and clearly likes a challenge. From 1980 the Polish economist advised the Solidarity movement, and after the fall of communism became the minister for privatization. He got the Warsaw stock exchange going.

Now he is turning his attention to the next stage of the EU's potential development. In an interview this week he said: "I'm hearing from a number of capitals, including important ones like Berlin, that they would like to lower their contributions [to the European Union]. Many countries want to be unburdened. In this way the door has been opened to think about revenues that are not claimed by finance ministers."

He suggested that an EU-wide financial transaction or aviation taxes might fit the bill. Incidentally, I wonder if a tourist tax to enter the EU might be considered now that immigration authorities are reportedly considering charging even those with visa-waiver forms \$9 to enter the U.S.

The response to Mr. Lewandowski dipping his toe in the water might best be described as mixed. The German government was less than impressed. A spokesman said it would block any move to give the European Union involvement in direct taxation. The U.K. was even less keen, with Treasury minister Lord Sassoon emphasizing that this is a complete non-starter. For Prime Minister David Cameron, who leads a broadly eurosceptic conservative party in coalition with the broadly europhile liberal



EU Budget Commissioner Janusz Lewandowski delivers a speech.

democrats, the adoption of any EU direct taxes would be electorally toxic.

So, that's the end of that then? Not quite. The initial French opposition was slightly more muted: "We judge this idea of a European tax perfectly ill-timed," said the on-duty finance minister. But describing a proposal as ill-timed is not quite the same as saying it is a terrible idea that must never happen. It sounds a

Logic suggests the euro-zone deal will, in time, force single currency countries even closer together.

little like "not yet".

Prime Minister Jose Luis Zapatero of Spain was circumspect. Emerging from a regular meeting with King Juan Carlos he said: "All debate which aims to strengthen the EU's economic and financial capacity is followed with interest by Spain." There's a fairly neutral response.

As so often with the EU, this row started by Mr. Lewandowski is in some ways a feint. The

negotiations that will agree the EU's next seven-year budget, starting from 2014, are getting underway. There are deals to be done, horses to be traded.

The large contributor states, such as Germany, a cash-strapped U.K. and France want to reduce their contributions to the budget. The European Commission and the Brussels establishment, keen as ever to expand their activities, are unlikely to judge this anything other than a thoroughly bad notion. So, Mr. Lewandowski seems to be indicating that if the member states want to pay less into the central pot then they must realize that the money will have to come from other sources. Hence his raising of the specter of EU direct taxes, possibly in the hope that the member states can be persuaded not to cut their contributions so sharply.

But don't write off the concept of EU direct taxation. That it is a dud idea, and that a continent that needs jobs and growth can do without a layer of new taxes, is besides the point. When so many politicians are involved, and there's an emergency on, all sorts of ideas that sound half-crazed or just highly unlikely can still end

up being implemented.

A year ago, what odds would one have got on the members of the euro zone agreeing a potential \$1 trillion bail-out package, making funds available to governments locked out of the credit markets? Very long odds indeed. The euro zone had been founded without provision for any such rescue. The German government, or hardworking German taxpayers, surely would not countenance a second helping prop-up of the more lackadaisical southern Europeans. But it happened.

Rather rapidly, in a sovereign debt crisis, the impossible became possible and the unthinkable reality.

It is only a few months since the high drama of the Greek sovereign debt crisis. European politicians and commentators have barely begun to digest what happened and to work out the implications.

But logic suggests that the euro-zone deal will, in time, force the countries using the single currency even closer together. If there can be a bailout, then the stronger states who carry the biggest potential burden in a crisis must in time ensure that there is proper, rigorous oversight of national budgets established so that their exposure is minimized. This process will need to be formalized, requiring reform of the structures of the EU. Some direct taxation within the euro zone would not be unimaginable in such a context.

Then states outside the single currency, such as the U.K., would need different, looser arrangements. The fabled prospect of a two-speed Europe hoves into view, once again.

The EU, of course, does not proceed according to logic. It moves in decades, and with difficulty. But the driving impetus is integration, especially for those in the single currency. Mr. Lewandowski's proposal is not as outlandish as it sounds. It is an outlier, an early glimpse of a big argument to come about the shape and reach of the EU.

What's News

■ **GDF Suez and International Power** agreed to merge assets, creating the world's largest independent power producer and strengthening the companies' position in emerging markets. 17, 32

■ **The U.K.'s global goods trade deficit** narrowed more than expected in June as the value of both exports and imports rose to their highest level in almost two years. 5

■ **Britain's central bank** faces a tough balancing act in keeping uneven economic growth moving ahead without rattling markets or exacerbating fears of inflation. 5

■ **The U.S. and BP** are close to a deal to use future revenue from the oil giant's Gulf operations to guarantee its compensation fund. 18

■ **Three U.S. men** who sued the Vatican for alleged sex abuse by priests decided to end the case, in a victory for the governing body of the Catholic Church. 7

Inside



The way Parkinson's disease alters the brain. 27



Federer's 29-year-old body is at breaking point. 28

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2. Opinion: Hillary for VP?
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Vote and discuss: Should wireless systems have different 'net neutrality' standards than wired communications?

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Previous results

Q: Do you expect the Fed to signal deeper concern about the economy?

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71%

No

29%

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NEWS

A glittering resort sold on the cheap

BY CARRICK MOLLENKAMP
AND LINGLING WEI

SEA ISLAND, Ga.—Sea Island Co., the genteel resort for wealthy vacationers, is selling its assets to two funds and filing for bankruptcy protection in a double-barreled move that will cause lenders to relinquish \$340 million in debt.

Under a pact expected Wednesday, funds managed by **Oaktree Capital Management LP** in Los Angeles and **Avenue Capital Management** in New York are paying \$197 million cash for Sea Island, a stunningly cheap price for the 84-year old resort famed for its four golf courses, exclusive clubs and hosting such events as the 2004 Group of Eight summit.

Despite its fame, it hit the wall financially when it couldn't repay the debt taken on by fourth-generation chief Bill Jones III to finance a large renovation.

The deal is a sign of the changes taking place in the commercial real-estate landscape as banks begin to dispose of distressed assets and new land barons emerge. Until recently, banks have been reluctant to sell troubled loans and foreclosed property but the logjam is beginning to break.

The deals are still painful. Sea Island's sale and bankruptcy filing end family stewardship of the resort dating to 1926. Creditors, including, bank lenders **Synovus Financial Corp.** of Columbus, Ga.; **Bank of America Corp.** in Charlotte, N.C.; and **Bank of Scotland**, a unit of **Lloyds Banking Group** in London, who approved the sale late last week, will end up losing \$340 million in loans to Sea Island. A bankruptcy judge is expected to determine how they will split the \$197 million proceeds of the sale.

The bankruptcy process does allow for an auction process but a new, winning bid is unlikely.

Spokespersons for Synovus, Lloyds and Bank of America declined to comment.

Oaktree and Avenue represent the latest breed of distressed real-estate buyers, which also includes veteran players like **Starwood Capital Group's** chief Barry Sternlicht and a number of hedge funds. They have amassed billions of dollars to buy distressed assets.

Experts and officials say they saw an increase in sales in the second quarter partly because values have risen off their lows and banks' balance sheets have stabilized. **BB&T Corp.**, a Winston-Salem, N.C., bank, accelerated its asset disposi-



Sea Island Co.'s Cloister Hotel on Sea Island, Georgia, is being sold for a spectacularly low price to financiers in Los Angeles and New York.

tion plan and sold \$650 million problem assets, including commercial and residential loans.

"We told you back a year and a half ago, we didn't think it was appropriate for a company as strong as BB&T to go out and dump assets in a market that was panicked," BB&T chief Kelly King told investors last month. Mr. King said now there was a sign "of more buyers coming into the market."

Oaktree, the Los Angeles investor, is closing other deals. **Citigroup** is close to completing the sale of a \$340 million portfolio of loans backed by warehouses and manufacturing facilities to Oaktree, said

people familiar with the situation.

To be sure, banks are likely going to be struggling for years with distressed commercial real-estate assets.

The deal to buy Sea Island, which began in February when the firm hired **Goldman Sachs Group Inc.**, ends weeks of bidding. Oaktree and Avenue topped bids from Starwood Capital Group and **KSL Recreation**. A unit of billionaire Philip Anschutz's **Anschutz Corp.** also considered buying the resort both independently and in a venture with Starwood. Spokesmen for the bidders declined to comment.

One upside for Mr. Jones is that

Oaktree President Bruce Karsh and Avenue chief Marc Lasry have vacationed for years at Sea Island, according to people familiar with the situation.

"The principals in those firms vacation here, have places here, and really know Sea Island," Mr. Jones said. "It's the end of an era for our family, but we'll deal with it and we'll go on about life."

Some 2,500 Sea Island members will be transitioned to a new membership structure resembling the current one. Oaktree and Avenue plan to retain employees and management, including Mr. Jones.

The resort was founded on a barrier island in 1926 by Howard Coffin, an industrialist. With his younger cousin, A.W. "Bill" Jones Sr., Mr. Coffin turned the Sea Island land into a popular resort.

In 2006 and 2007, Mr. Jones's grandson, Bill Jones III, oversaw a \$395 million renovation, including a new version of its Cloister hotel, spa and renovated beach club, that drew rave reviews.

Mr. Jones served on the board of Synovus, one of Sea Island's biggest lenders. A spokesman says Mr. Jones left the room when votes were taken on Sea Island lending and that he left the board in 2008.

But Mr. Jones was counting on revenue from the sale of two-acre

lots that were supposed to sell on average in excess of \$1.5 million at a new development called Frederica. Those sales failed to yield enough money to pay the bank debt. Loyal vacationers, such as those from Atlanta, felt alienated by the perception Sea Island now was focused on higher-end guests.

"One of the mistakes we made is we overshot our market," Mr. Jones says. "Given all the facts that we had at the time, it was not a mistake to borrow. It was our belief that slowing the construction process would have resulted in a multi-year disruption."

The economic downturn "hit everything we had," Mr. Jones says. "They are not buying homes, they're not buying resort residential products that we were developing. They weren't buying at Frederica. There was an attack on high-end luxury travel."

In 2009, Cloister revenue was \$34.8 million, a 31% drop from the \$50.5 million in 2007.

Sea Island's travails mean huge swaths of Sea Island and coastal Georgia are changing hands. In November, Mr. Jones turned over the Frederica development to **Wells Fargo & Co.**, which had acquired Wachovia, the development's lender.

—Kris Hudson
contributed to this article.

Runaway flight attendant in court

BY CHRIS HERRING

NEW YORK—A judge set bail Tuesday for Steven Slater, the jet-blue flight attendant who allegedly swore at a plane full of passengers over the public-address system, swiped two beers, activated the plane's emergency chute and slid away at John F. Kennedy Airport.

Judge Mary O'Donoghue set bail at \$2,500 for Mr. Slater, a 38-year-old flight attendant.

His attorney, Howard Turman, said his client was expected to post bail Tuesday.

Since news of his escape broke Monday afternoon, Mr. Slater has

become a folk hero, spawning Facebook pages and receiving tributes in the press.

Mr. Slater's appearance in Queens Supreme Court felt theatrical. He walked into the courtroom in a green shirt and plaid shorts, wearing what appeared to be a smirk on his face—a reaction his attorney said was prompted by the widespread media coverage of his outburst and subsequent arrest.

"I think he can't believe the amount of attention this is getting," said Mr. Turman.

Mr. Slater did not speak during the five-minute arraignment, and Judge O'Donoghue ordered him to

stay away from two airline employees who offered witness statements—something both prosecution and defense said was a standard procedure.

Mr. Slater faces two charges of reckless endangerment and criminal mischief for cursing at passengers over an intercom system and opening an emergency door. The escape followed an argument with a passenger aboard the Pittsburgh-to-New York flight who accidentally hit him with her luggage and reportedly refused to apologize, swearing at Mr. Slater instead.

Mr. Slater then ran to the employee parking lot and drove to his

home in Queens, where he was later arrested. If convicted, he could face up to seven years in prison.

Mr. Turman declined to say that his client went over the edge, saying that the job of flight attendants has become more difficult since the terrorist attacks of Sept. 11, 2001.

Arguing for Mr. Slater's release, the attorney suggested that the passenger played a role in the outburst. "Airline civility is missing these days," Mr. Turman said outside the courtroom.

JetBlue Airways removed him from duty pending the investigation; the airline declined to comment on the specifics of the flight.



Steven Slater

The judge set a Sept. 7 date for a conference in the case, and a Sept. 21 date for Mr. Slater's next hearing.

—The Associated Press
contributed to this article.

NEWS

Wheat fears lift Australian firms

By RAY BRINDAL

CANBERRA—Worries over global wheat supplies could prove to be a bonanza for Australia, a big exporter of high-quality wheat to Asia.

The optimism could change quickly, though, as dry weather and government warnings about the potential for a locust plague have raised skepticism about output. If Australia's wheat production falls significantly below forecasts, it could drive wheat prices even higher for some importers, including poorer Asian countries such as Indonesia, Vietnam and the Philippines.

For now, the improving outlook for demand and prices is helping to boost the outlook for big Australian companies such as **AWB Ltd.**, an agribusiness company. Its shares have risen 19% since the beginning of July.

AWB General Manager for Commodities Mitch Morison said the hot, dry weather that has stunted Russian wheat production and prompted a ban on exports from there is affecting a much wider area, with yields also down in Kazakhstan, Ukraine, Germany, the U.K., Poland, Hungary and northern France.

"This means a lot of uncertainty, which pushes prices up as buyers move to secure their supply lines," he said. "The world is now watching supply from other regions more closely."

Supply worries have ebbed somewhat amid indications that stocks remain healthy. Wheat for September delivery on the Chicago Board of Trade, a global benchmark for prices, jumped as high as \$8.41 a bushel last week before easing in recent days. It ended Tuesday trading in the U.S. at \$6.9425 a bushel, as some worried that concern was overdone. Still, the price is more than 50% higher than in early June, boosting incomes for farmers and aiding the profits of industry players.

Australia exports about 15 million metric tons of what in a good year, which accounts for more than 10% of this year's expected global exported wheat trade of about 122 million tons, as projected by the Food and Agriculture Organization. A metric ton is equal to 2,204.62 pounds. It also is a big supplier to Asia, especially Indonesia, which is the world's fourth-largest wheat importer behind Egypt, Brazil and the European Union.

Fransiscus Welirang, chairman of the Indonesia Flour Mills Association and director of PT **Indofood Sukses Makmur**, a big Indonesian maker of instant noodles, said he wasn't worried about getting supplies because Indonesia has sufficient reserves. Still, he added, the problems in Russia may mean "the end of cheap wheat."

Exporters in Turkey have canceled sales of around 40,000 tons of wheat flour to Indonesia owing to shortfalls from the Black Sea region. Mr. Welirang said there could be a domino reaction from the recent wheat surge as feed industries buy more corn and soybeans, pushing their prices higher, too.

He said Indonesia is monitoring growing conditions in Australia but won't know until November how the harvest fares.

Feeding the market

Biggest wheat exporters, in millions of metric tons

U.S.	27.0
EU	23.0
Canada	15.5
Australia	15.0
Russia	15.0
Kazakhstan	8.0
Ukraine	8.0
Argentina	7.0
Turkey	3.1
Mexico	1.2

Note: Forecast for the 12-month period ending June 2011; exporter figures contain trade-year data that puts all countries on a uniform 12-month basis for comparison purposes. Source: U.S. Department of Agriculture

Analysts say they believe Indonesia has sizable wheat stockpiles that should help the country weather troubles for a while. Other Southeast Asian countries could be forced to scramble if expected deliveries from the Black Sea aren't available and Australia fails to produce a bumper crop.

Another major Australian agribusiness company, **GrainCorp Ltd.**, has seen its shares rise 16% since the beginning of July. Other farm-related stocks have risen as well, including rural services firm **Elders Ltd.** and crop protection company **Nufarm Ltd.**

The higher prices could help smooth over recent major changes in Australia's wheat industry, which was liberalized in mid-2008, with AWB losing a monopoly over the country's wheat sales amid an Iraqi kickback scandal. Until then, AWB pooled the country's wheat and negotiated prices on behalf of the industry in an effort to get the best pricing—an arrangement that drew protests from other countries who called it anticompetitive. Competition in Australia has been ratcheting up since then, as other firms have entered the market.

Citing weather, some analysts have become less positive about some Australian wheat regions, including Western Australia, which normally accounts for almost 40% of national output and more than 50% of exports. Rabobank Australia on Monday lowered its wheat-production estimate for the state to around 6.5 million tons from 8.25 million tons produced in the last crop year.

Separately, the Australian Bureau of Meteorology last week said the southwestern region, which also grows wheat, experienced its third driest start to the year, January through July, since records began in 1900. There also have been warnings about the threat of plague locusts in large areas of Australia's eastern states. The potentially damaging locust plague could start hatching as early as next week in Eastern Australia, South Australia and Queensland and continue across adjacent states into the summer, the Australian Plague Locust Commission said Monday. Federal and state agencies have taken initiatives such as spraying pesticides to enable landholders to deal with any outbreak.

—Patrick Barta, Sameer Mohindru and Yayu Yuniar contributed to this article.



Reuters

A man in a protective mask walks in Moscow on Aug. 4. Officials face criticism for their handling of the heat and fires.

Rising toll in Moscow puts heat on officials

By RICHARD BOUDREAU

MOSCOW—Antonina Babenko, who survived World War II on a Belarussian battle front, spent her final days in a sweltering Moscow apartment, struggling against a choking smog that rolled in through open windows.

The 86-year-old Soviet army intelligence veteran collapsed on Friday, when contaminants in the city's air were five times the acceptable norm, and died the next day in a hospital, her niece said Tuesday. The cause was listed as a heart attack.

Hundreds of ailing and elderly Muscovites have died since a heat wave gripped much of Russia in mid-July and spawned wildfires that have blanketed the capital with a noxious, milky-white haze. How and why they died is a matter of controversy.

By official count, 52 people have died nationwide, outside big cities, as a direct result of forest fires. As bodies piled up in morgues, authorities declined to say how many deaths could be linked indirectly to the twin crises of heat and fires, feeding rumors of a coverup.

This week the city's chief health official announced that the daily death toll in Moscow in recent days had reached 700, nearly double what he called the norm, and attributed the increase to the extreme conditions.

"This is no secret," said the official, Andrei Seltsovsky. "Everybody thinks we're making secrets out of it."

After Mr. Seltsovsky gave his estimated death toll Monday at a televised meeting of the city council, his federal counterpart, Health Minister Tatyana Golikova, called it "bewildering" and dismissed it as unofficial.

Mr. Seltsovsky said the normal daily death toll for this time of year is 360 to 380, in a city of about 11 million people. He said the city's morgues are filling up, with 1,300 of

the 1,500 slots taken.

Struggling to keep up, morgues and cemeteries have added workers and work shifts. Istra cemetery, just west of the city, registered 21 burials Monday, the most in a day since World War II.

Irina Karmonovna, whose 72-year-old mother died Sunday, was told that a backlog would delay her burial at Khovanskoye cemetery, the city's largest, at least until Thursday.

Independent experts say a rise in mortality isn't exceptional for a city ill prepared for such temperatures, even without the smog.

Temperatures have been scorching for weeks, and most Moscow dwellings lack air conditioning.

Moscow's health chief attributed a surge in deaths to the extreme conditions, but the health minister quickly dismissed his comments as unofficial.

But the death toll is sensitive because officials at all levels face public criticism for their handling of the heat emergency and the fires, which continued to burn Tuesday in more than 550 places across Russia, including about 40 near Moscow.

Boris Revich, head of Moscow's Laboratory for Environmental Health, an independent research institute, said Mr. Seltsovsky's estimate was plausible.

"The important thing is what our leaders failed to do," he said. "The civilized world long ago made a list of urgent measures to reduce the influence of heat waves on people's health, such as increasing the number of ambulances on duty and equipping them with all the necessary things, such as bottles of mineral water....None of that was done."

Marina Pirozhnikova, the war

veteran's niece, echoed that criticism outside the Sechenova morgue in southern Moscow.

She said her aunt, who lived with a daughter, had no safe place to go when the temperature rose and the smoke came.

"Of course it's a natural disaster, but if the government had been skillful it could have done more to prevent all these deaths," Ms. Pirozhnikova said.

As she and other relatives awaited the body, workers nailed together a simple pine coffin, lined it inside with silky black cloth and topped it with red and white carnations.

Ten grieving families came and went in the space of one hour.

Officials say they have taken steps to ease the emergency. The country's most senior doctor, Genady Onishchenko, has urged employers to grant leaves from work.

Some measures have come late: Only this week did the city publicize the availability of 123 air-conditioned community centers for people seeking daytime relief.

Officials have urged people to wear masks to prevent harmful particles in the smog from entering their lungs. But few are able to get hold of the kind of construction masks that offer real protection; most make do with less-effective surgical masks.

Many Muscovites have fled. About 104,400 boarded planes Sunday, the city's airports reported, a record for 2010.

Those left behind hang wet towels inside their Soviet-era tower-block apartments and take cold showers. They complain of breathing difficulties, stinging eyes and severe depression.

"They keep asking, 'When is it all going to end?'" said Larisa Romana, a psychologist serving one of the community centers. "Most people who come to the center are old.... All I can do is give them a gentle pat on the shoulder and say, 'Soon, I hope.'"

EUROPE NEWS

For U.K., an economic balancing act

BY NEIL SHAH

Britain's central bank faces a difficult balancing act as it refreshes its economic forecasts on Wednesday: Keeping the U.K.'s uneven growth moving ahead without rattling markets or exacerbating inflation fears.

Worries about a slowdown in the U.S. recovery have prompted investors to wonder whether the Bank of England will need to revive emergency relief efforts to keep the economy from stalling. The U.K. depends heavily on trade with the U.S., its second-biggest trading partner after the 16-member euro zone.


But such a move toward quantitative easing would also coincide with a problem that the U.S. and euro zone don't share: stubborn inflation. Since December, the U.K.'s inflation rate has stayed above the BOE's target of 2%. It stood at 3.2% in June and one dissident on the nine-member interest-rate policy committee, Andrew Sentance, says the bank needs to focus on inflation by raising rates.

The dilemmas surrounding Britain's economy will become more stark on Wednesday when the Bank of England issues its latest quarterly forecasts for economic growth and inflation. Economists expect the bank to significantly lower its growth estimates for 2011 and 2012, while simultaneously jacking up its expectations for inflation next year.

"The outlook is very uncertain," says Colin Harte, director of fixed-interest and currencies at Baring Asset Management in London, which has roughly \$50 billion under management. "If you make a big, bold policy move, you may end up destabilizing things... You could get yourself in a real policy mess."

Few observers expect the U.K. to continue growing the way it did in the second quarter, when it expanded about 4.5% at an annualized rate, faster than it has in more than four years. During that quarter, exports jumped in June, an indication that the private sector had started helping the recovery.

More recent figures, however, have disappointed. Britain's key services sector, which accounts for about 75% of its gross domestic



Tough choices
Bank of England chief Mervyn King and his colleagues face a dilemma: Should they focus on reviving growth or fret about inflation?

Factors pointing to slower growth...

- £113 billion** The British government has announced spending cuts and tax increases of as much as £113 billion over the next five years in an effort to fix its finances. But the move could drain cash from the economy at a time when growth remains fragile.
- 53.1*** The purchasing-managers index for Britain's key services sector grew at its slowest pace in July since June 2009. A reading over 50 indicates expansion.
- 8 percentage points** A survey of the U.K. housing market by the Royal Institution of Chartered Surveyors showed the proportion of surveyors reporting a fall in house prices in July exceeded the proportion reporting a rise, resulting in a balance of -8 percentage points. That is the first negative balance since July 2009.

Factors indicating better growth and higher inflation...

- 3.2%** Consumer-price inflation eased to 3.2% in June, though it remains well above the Bank of England's medium-term target of 2%.
- 4.5%** Britain's economy expanded 4.5% in the second quarter, measured on an annualized rate, beating the U.S.'s 2.4% growth.
- 4.3%** Exports jumped sharply in June, hitting their highest level since July 2008. That suggests British companies may finally be starting to benefit from a weaker pound and aiding the U.K. recovery.
- 20%** Britain's value-added-tax rate will rise from 17.5% in January, temporarily accelerating inflation.

*Markit; Chartered Institute of Purchasing & Supply
Photo: Reuters

product, had a weaker-than-expected July. On Tuesday, a widely watched survey showed that U.K. house prices fell last month for the first time in a year. Moreover, Britain's new government has embarked on well over £100 billion (\$158 billion) in spending cuts and tax increases that will eventually bite into growth.

BOE officials have a problem: If they take further action by pumping freshly created cash into the economy—a policy tool called “quantitative easing”—they could rattle investors' confidence in the recovery, or worse, stoke fears of inflation. Officials have already pumped £200

billion into the economy through purchases of government securities, an effort that ended in February.

Reviving the quantitative-easing program could spark investor concern by underlining the weakness of the U.K. economy while also possibly signaling that the bank is focused on growth at the expense of price stability. Since the start of the week, the pound has pulled back to around \$1.5735 from near \$1.60. Stocks have also retreated.

Economists and investors are expecting tough news from the Bank of England—but nothing shocking. The BOE's current 2011 growth forecast of 3.4%—considered optimistic

by many observers—is likely to be revised to below 3%, due to Britain's looming fiscal austerity measures and other factors, economists say.

At the same time, bank officials will likely push their 2011 inflation forecast higher to take account of a sales-tax increase that starts in January. BOE Gov. Mervyn King, meanwhile, is expected to continue emphasizing the need to focus on growth while insisting that all options remain open given the uncertainty surrounding the economy.

Indeed, many economists expect Mr. King and his colleagues to sit on their hands for now given the uncertain growth and inflation out-

look. At least that's what they did in the summer of 2008, when Britain faced slowing growth and rising price pressures, says Nick Bate, an economist at Bank of America Merrill Lynch in London. “There are big risks in both directions. Until one of them starts to dominate the other, it's prudent to stay where you are.”

Mr. Harte of Baring expects rising inflation to force the bank to raise rates sooner. Analysts at BNP Paribas SA take a different view, saying Britain faces a tough slog and Mr. King is likely to leave the door open to more quantitative easing—the opposite of rate increases—which would hurt the pound.

British exports, imports show strong rise

BY NICHOLAS WINNING

LONDON—The U.K.'s global goods trade deficit narrowed more than expected in June as the value of both exports and imports rose to their highest level in almost two years, in a sign the economy is strengthening, official data showed Tuesday.

The goods trade deficit shrank to £7.4 billion (\$11.77 billion) in June from a downwardly revised £8 billion in May, the Office for National Statistics said.

Economists were expecting a deficit of £7.8 billion, according to a Dow Jones Newswires survey last week.

Exports rose 4.3% from May to £22.4 billion, the highest level since July 2008. Exports to non-European Union countries hit their highest level since records began in 1998, while exports to the U.S. hit their highest level since that series began in 1988.

However, imports also gained, rising 1% to £29.8 billion—the second-highest level on record after July 2008's £31 billion.

As imports have been rising faster than exports on average, net trade probably subtracted from gross-domestic-product growth during the second quarter, said Alan Clarke, an economist at BNP Paribas.

“Nonetheless, the fact that companies have been sucking in intermediate goods and raw materials shows signs of life in manufacturing,” he said. Intermediate goods are items such as sugar or steel, which are used in the production of other goods.

The figures showed that the volume of exports increased in June to its highest level since September 2008. The volume of imports was slightly lower than in the previous month, but not counting May, it was the highest since October 2008.

Notable changes from May to

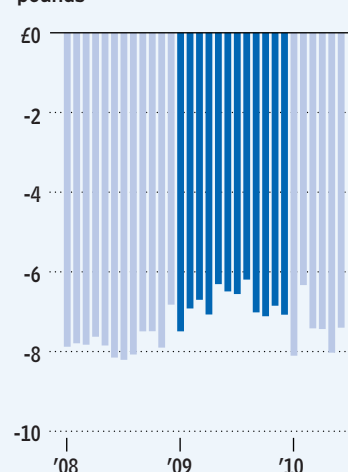
June included a £525 million increase in oil exports. There was also a £216 million increase in exports of chemicals, a £130 million drop in imports of capital goods, and a £78 million rise in intermediate-goods imports. Capital goods are the equipment or plants used to make final products.

The British government, led by Prime Minister David Cameron, has put increasing foreign trade, particularly with fast-growing nations such as India and Turkey, at the heart of a drive to fuel economic growth. Hopes that the depreciation of the pound during the recession would boost exports have been dimmed somewhat by sluggish growth in Europe.

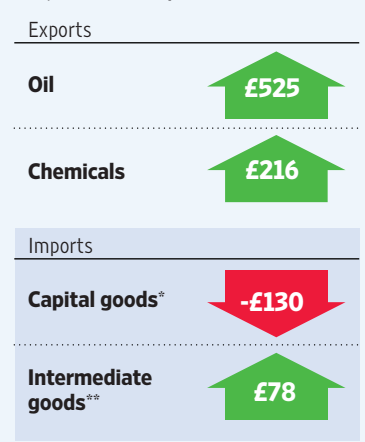
“The concern is, though, that exports will be hit over the coming months by slowing global growth and recurrent problems in the euro zone,” Howard Archer, chief U.K. and European economist at Global Insight, said in a note.

Trade gap shrinks

U.K. goods trade balance, billions of pounds



Notable changes in the U.K.'s trade in goods in June, compared with May, millions of pounds



*Equipment or plants used to make final products
**Goods manufactured and used in production of other goods, such as sugar or steel
Source: Office for National Statistics

U.S. NEWS

U.K. officials push effort to halt phony marriages

By CASSELL BRYAN-LOW

LONDON—British authorities are cracking down on sham marriages designed to allow immigrants to stay in the country, part of a broader effort to tighten up U.K. borders.

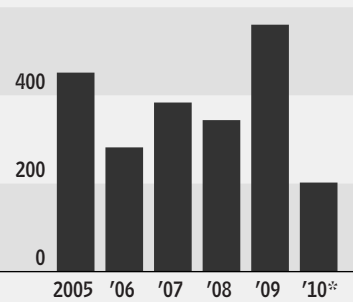
Immigration officers, working with local police, have mounted a series of operations recently, including one last week in which they arrested two Church of England vicars, searched their homes and raided their East London churches. Authorities say they suspect the clergymen of helping to breach immigration laws, though they haven't been charged.

A number of the sham unions consist of Eastern Europeans—who have rights to live and work in the U.K. along with their spouses—marrying immigrants from places such as West Africa who don't have the requisite visas to live and work in England.

On Saturday afternoon, officers arrested a 19-year-old Nigerian woman and a 22-year-old Czech man before their wedding at a church in Streatham, London. The two were charged this week before a London magistrate court; the would-be groom is accused of suspicion of assisting unlawful immigration, and the woman faces charges of perjury and identity-related fraud. Both remain in custody.

The operations are part of a broader effort to get tough on immigration in a country long considered to have an open-door policy on the matter. Among other initiatives: stepping up enforcement efforts, introducing limits on the numbers of non-Europeans that come to work here and closing bogus colleges that enroll illegal immigrants in the

Sham marriages
Suspected cases of fake marriages reported by registrars in England and Wales



*First half
Source: U.K. Home Office

country on student visas.

The case comes on the heels of the conviction of Rev. Alexander Brown for conducting hundreds of sham marriages in what law-enforcement officials call the largest case of its kind in the U.K. Last month, a jury at Lewes Crown Court, in Southeast England, found Mr. Brown, a 61-year-old retired vicar, guilty of conspiring to facilitate breaches of immigration law.

A lawyer for Mr. Brown declined to comment.

Mr. Brown denied conspiring to breach immigration laws but pleaded guilty to a charge of carrying out marriage ceremonies without following the correct public-announcement procedures. There was no evidence to suggest Mr. Brown received large sums of money for conducting the weddings though he did collect the standard fee for performing the ceremonies, according to authorities.

Border authorities say that be-

tween 2005 and 2009, Mr. Brown conducted some 360 alleged sham marriages at his parish church in East Sussex. Many of the unions involved Eastern Europeans, who received up to £3,000 (\$4,800) each to wed individuals looking to stay in the country, many of whom were from West Africa, border authorities said.

To coordinate its offensive against immigration fraud, the U.K. over the past two years has established regional immigration crime teams, including police officers, that have been seconded to immigration authorities. The teams now total more than 300 individuals and give border authorities access to broader powers and local intelligence.

The new Conservative government—which took power in May, after elections in which immigration was a key issue—has called for a crackdown.

"I have tasked the U.K. Border Agency with carrying out an intense period of enforcement activity over the summer to tackle the most problematic routes" for immigration

To coordinate its offensive against immigration fraud, the U.K. over the past two years has established regional immigration crime teams.

abuse, including sham marriages, said immigration minister Damian Green last month, adding: "Britain is no longer a soft touch."

Border-authority representatives say activity on the phony-marriage



Rev. Alex Brown, seen last year, was found guilty by a jury in England in July.

front has increased recently, leading to a flurry of arrests and convictions.

For the five-week period beginning in early July, there were about 33 operations involving sham marriages and roughly 22 arrests, a spokesman for the U.K. Border Agency said. That is more than the estimated 23 marriage-abuse investigations between 2004 and 2009.

The past few years have seen an increase in the number of suspected fake marriages reported by registrars in England and Wales to 561 in 2009, up 63% from the year earlier, according to the Home Office.

The two East London vicars, who remain out on bail, couldn't be reached to comment. Both have been suspended, a Chelmsford Diocese spokesman said. "This doesn't imply any judgements against them but enables the investigations, with which we're co-operating, to proceed," he added.

In connection with case of the two vicars taken into custody last week, authorities arrested three other people—including a Nigerian man and a Dutch woman about to

wed—and charged them with immigration-related offenses.

During Rev. Brown's trial, among those who testified was a Lithuanian woman who said that moments before she was about to be married, her African husband-to-be handed her £2,000 in cash while sitting in a car outside the church, according to media reports. After the ceremony, the woman returned home with a friend rather than with her husband.

Two other individuals were convicted on similar charges in relation to the same case: a Nigerian-born immigration lawyer who dealt with many of the individuals looking to get married and a Ukrainian national who used contacts in factories and food-processing plants where he worked to recruit potential spouses.

All three are due to be sentenced next month.

The Diocese of Chichester, in which Mr. Brown's former parish sits, said the vicar had been suspended, that it co-operated with authorities and that it expects its clergy to comply with the law and honor the trust placed in them.

Lawmakers demand bomber's medical records

Continued from first page
all of the doctors who examined Mr. Megrahi, as well as "the details about each doctor's role in the final medical assessment."

The letter is co-signed by Democratic Sen. Frank Lautenberg of New Jersey and New York Democrats Sen. Charles Schumer and Sen. Kirsten Gillibrand.

Scotland first fended off a legal appeal by Mr. Megrahi in 2002. But in 2007, a review by the Scottish Criminal Cases Review Commission identified six grounds in which it concluded that there "may have

been a miscarriage of justice" in the case.

That triggered a second appeal for Mr. Megrahi, which was due to be heard in the fall of 2009.

The appeal was set to focus on issues that had been challenged, such as the validity of statements by a key witness.

With his compassionate-release application hanging in the balance, Mr. Megrahi met on Aug. 6, 2009, with Mr. MacAskill.

On Aug. 18, Mr. Megrahi dropped his appeal. Two days after that, on Aug. 20, Mr. MacAskill agreed to release Mr. Megrahi on compassionate grounds.

Some politicians and critics have said Mr. MacAskill was influenced by the pending appeal.

"Kenny would want to do what he would genuinely think is the right thing, and would try and protect the Scottish justice system," said Margo MacDonald, an independent member of the Scottish Parliament. Scotland defends the conviction, and denies Mr. MacAskill traded Mr. Megrahi his freedom in exchange for the dropped appeal.

"Megrahi was convicted by a Scottish Court, and Scottish Ministers do not doubt the safety of the conviction," said a spokesman for Mr. MacAskill.

Prosecution points

The case against Mr. Megrahi centered on several strands of evidence:

- Police traced clothing from the suitcase that held the bomb to a shop in Malta, whose owner identified Mr. Megrahi.
- The owner said the clothes were bought on Dec. 7, 1988, when Mr. Megrahi was staying nearby.
- Mr. Megrahi was at a Malta airport when baggage was put on a flight to Frankfurt, where it would be transferred to a London flight and onto Pan Am Flight 103.
- Parts of the bomb's timer were traced to a Swiss company that admitted to dealings with Mr. Megrahi and the Libyan military.

A spokeswoman for the Scottish prosecution service said the service "has supported the conviction vigorously and stood ready, willing and able to do so throughout the appeal process which Mr. Megrahi abandoned."

Mr. Megrahi wasn't legally required to drop his appeal to win

compassionate release. He would have been obligated to do so under a separate petition he had filed to be returned to Libya under a prisoner-transfer agreement, but Scotland rejected that in favor of compassionate release.

Mr. Megrahi was convicted based on a mix of physical and circumstantial evidence. Police traced fragments of clothes from the suitcase in which the bomb was detonated to a shop in Malta, whose owner, Antony Gauci, identified Mr. Megrahi as looking "a lot" like the purchaser. Based on the evidence, the court concluded that the clothes were bought on Dec. 7, 1988, a date when Mr. Megrahi was staying in a nearby hotel.

The court also heard evidence that Mr. Megrahi was at a Malta airport at a time when baggage was loaded onto a flight to Frankfurt, where it would be transferred to a flight to London and onto Pan Am Flight 103.

Other key parts of the prosecutor's case involved fragments of the bomb's timer, traced to a Swiss firm that admitted to dealings with Mr. Megrahi and the Libyan military.

But when the Scottish commission reviewed the conviction, it said there was new evidence that raised questions about the identification

by Mr. Gauci. Though the commission declined to disclose this material, Mr. Megrahi has since released documents claiming fresh evidence, including inconsistencies in what Mr. Gauci had told prosecutors.

Mr. Gauci's testimony about the date varied, according to these documents, and at one point he said the clothes were bought on Nov. 29, 1988—not Dec. 7.

The shopkeeper had also said Mr. Megrahi bought the clothes before the switching on of local Christmas lights, while evidence submitted by Mr. Megrahi's defense claims to show the lights were turned on earlier.

There also was previously undisclosed evidence that Mr. Gauci had expressed interest in a financial reward prior to testifying, which Mr. Megrahi's lawyers said raises questions about the reliability of the witness.

The documents quote extracts from a British police officer's diary that suggest the Department of Justice offered Mr. Gauci \$2 million if he gave evidence. The Department of Justice denies offering such a payment.

Mr. Gauci couldn't be reached for comment.

—Paul Sonne
contributed to this article.

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U.S. NEWS

Plane crash kills ex-U.S. senator

A Wall Street Journal Roundup

Former Alaska Senator Ted Stevens died after a plane carrying him, ex-NASA Administrator Sean O'Keefe and seven others crashed in a remote area of Alaska Monday night, a family spokesman said Tuesday.

Mitch Rose, who served as the former senator's chief of staff, said Mr. Stevens's family has been notified of the death. Mr. Stevens was 86.

Former National Aeronautics and Space Administration spokesman Glenn Mahone said Mr. O'Keefe survived the crash. Mr. O'Keefe is chief executive of **European Aeronautic Defence & Space Co.'s** North American division.

Five people on the single-engine plane were confirmed dead and one had a serious injury, according to a person familiar with the FAA's preliminary information.

Mr. Mahone said Mr. O'Keefe's teenage son, Kevin, was also among the four survivors.

The former spokesman for the space agency said he has talked to the O'Keefe family. Family members told him that Mr. O'Keefe and his son had some broken bones and other injuries.

Five of the people on the single-engine Otter turboprop were confirmed dead and one had a serious injury, according to a person familiar with the Federal Aviation Administration's preliminary information.

At least three crash victims were being airlifted to Anchorage, said Kalei Brooks Rupp, an Alaskan mili-

tary spokeswoman.

The crash occurred outside the city of Dillingham, which is about 330 miles southwest of Anchorage.

The Alaska Air National Guard said the crash was reported at approximately 7 p.m. Monday local time after a passing aircraft spotted the plane's wreckage.

The Anchorage Daily News, which reported the crash earlier, said Mr. Stevens's flight was headed to the Agulowak Lodge near Lake Aleknagik, a popular fishing destination.

Mr. Stevens was the longest-serving Republican senator in U.S. history.

He also was one of the best-known and most influential figures in his state. Many local institutions, including the Anchorage airport, are named for him.

In the U.S. Senate, Mr. Stevens used his perch as an appropriator to direct federal dollars to his home state. His penchant for earmarks eventually led to political trouble as the process became increasingly unpopular with the public.

His final years in politics were clouded by a federal investigation that led to an initial conviction on corruption charges and an election defeat in 2008 to Democrat Mark Begich. In April 2009, the Justice Department dropped all charges, citing prosecutorial misconduct. Mr. Stevens had since largely been absent from public life.

The National Transportation Safety Board sent a team from Washington to Alaska early Tuesday. Federal Aviation Administration spokeswoman Laura Brown said the plane was registered to GCI, an Alaska telecommunications company. The aircraft was flying under visual flight rules, which allow a pilot to visually navigate an aircraft, and wasn't in communication with air-traffic control.



Former Sen. Ted Stevens's plane went down in Alaska Monday night.

Sexual-abuse suit against the Vatican is abandoned

BY ASHBY JONES

Three men who sued the Vatican for alleged sex abuse by priests have decided to end the case.

The men's lawyer asked U.S. District Judge John G. Heyburn II on Monday to dismiss the lawsuit, filed in 2004 in a Louisville, Ky., federal court. He essentially conceded his clients had no chance of winning the suit, which tried to hold the Vatican responsible for alleged sex abuse.

"We're not interested in banging our heads against the wall anymore," said William F. McMurry, the plaintiffs' lawyer. "The truth is that the U.S. courts have placed an impossible burden on plaintiffs trying to hold the Holy See responsible."

The Kentucky case gained notoriety as it targeted not U.S.-based clergy, but the Vatican itself. According to the allegation, Catholic clergy in the U.S. engaged in a systematic cover-up of abuse under explicit instruction from the Holy See. The plaintiffs said the cover-up led to numerous incidents of sex abuse.

Mr. McMurry blamed earlier legal decisions supporting the Vatican's argument that as a sovereign nation it was largely immune from lawsuits. "Plaintiffs in this case are permitted only to pursue claims against the Holy See for the acts of its 'officials or employees' in the United States," he wrote. "Plaintiffs are without the legal right to pursue the Holy See for its direct acts."

Jeffrey Lena, a lawyer for the Vatican, said: "Six years ago, the plaintiffs' lawyers concocted a series of allegations. But they never had the evidence to back those allegations up."

Rangel welcomes ethics trial, vows not to quit Congress

BY DEVLIN BARRETT AND BRODY MULLINS

WASHINGTON—Rep. Charles Rangel took to the House floor Tuesday to make a combative and theatrical defense in which he vowed not to quit Congress and welcomed a full trial by the House ethics committee this fall.

In a direct shot at his party's leaders, he told fellow Democrats he wouldn't resign just to make their election campaigns easier.

"If I can't get my dignity back here, then fire your best shot in getting rid of me through expulsion," said Mr. Rangel of New York. He apologized to his Democratic colleagues for "any embarrassment that I've caused," but added, to applause, "I am not going away. I am here."

Mr. Rangel took issue with some colleagues who have called for his resignation. He said he helped raise money for many Democrats now in Congress, but said he understands that some Democrats would turn against him if they are in tough reelection races.

Nonetheless, "You're not going to tell me to resign to make you feel comfortable," he said.



Rep. Charles Rangel took to the House floor Tuesday to defend himself against ethics charges.

Mr. Rangel beseeched the House ethics committee hearing his case to give him a trial before the November election as a way to give him a chance to present his own evidence.

At the end of his speech, a number of Democrats and a few Republi-

cans applauded.

Mr. Rangel stands accused of 13 violations of congressional rules. The charges against Mr. Rangel, 80 years old, relate to his solicitation of donations for a City College of New York center named in his honor.

He was also charged with using a New York rent-stabilized apartment as a campaign office; failing to report income from a vacation rental in the Dominican Republic; and for a "pattern of submitting inaccurate and incomplete financial disclosure statements" to Congress.

Mr. Rangel was charged in late July during a rare public hearing by the ethics panel, a major blow to his 40-year legacy as a congressman. At the time, Mr. Rangel said he embraced the public trial because he didn't intentionally break any rules.

Any possible settlement would need to win approval from a majority on the 10-member ethics panel. Membership on the committee is divided evenly between the two parties, giving Republicans the ability to block any plea agreement and force a politically damaging ethics trial for Democrats in the months before the midterm congressional elections.

Fed makes shift in strategy to spur economy's recovery

Continued from first page with a larger balance sheet for longer, said Dan Greenhaus, economist at Miller Tabak & Co.

Some Fed officials have reservations about restarting full-blown asset purchases because they aren't sure they can drive down long-term rates further from already low levels. Average rates for a 30-year mortgage fell last week to 4.49%, according to Freddie Mac, the lowest rate since the 1950s. Holding many more securities could also cause problems further down the road.

In response to the economic crisis, the Fed bought roughly \$1.7 trillion in mortgage and Treasury debt in 2009 and earlier this year. The program is estimated to have cut long-term rates by around half a percentage point, although Fed officials are divided on its effect.

The Fed had an incentive to move early because deflation is harder to fight than inflation, especially now that short-term interest rates are already close to zero. When there's inflation, a central bank can at least raise rates as high as needed to counter rising prices.

A new Wall Street Journal survey out Tuesday found that, by a 2-to-1 margin, Wall Street economists see deflation as a bigger threat to the U.S. economy over the next three

years than inflation. The previous April survey found economists were split 50/50 over whether inflation or disinflation posed the bigger risk over the next year.

The Fed also reiterated that it expects the benchmark short-term interest rate—which it uses to steer the economy—to remain close to zero for an extended period as a result of low inflation and high unemployment.

Kansas City Fed President Thomas H. Hoenig was once again the only dissenter out of the 10 voters at the Federal Open Market Committee meeting. He voted against the central bank's decision for the fifth time this year, arguing that the economy is recovering modestly and that the pledge to keep rates near zero for an extended period limits policy flexibility.

Fed Vice Chairman Donald L. Kohn participated in what is likely to be his last FOMC meeting. He has been the second-highest-ranking Fed official since June 2006 and has been working at the U.S. central bank for some 40 years.

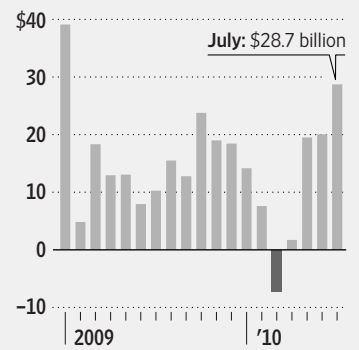
Mr. Kohn is due to be succeeded by San Francisco Fed President Janet Yellen, who was nominated by the White House but is awaiting confirmation from the Senate, along with two other Fed board members.

WORLD NEWS



Stepping up

China's trade balance, in billions of U.S. dollars



Source: China's General Administration of Customs via Thomson Reuters

A worker at the iron and steel plant in Huaibei, east China. China's trade surplus has widened on weak imports.

China trade surplus widened in July

BY AARON BACK
AND ESTHER FUNG

BEIJING—China's trade surplus for July widened to its highest level in a year and a half, government data showed Tuesday, likely adding to the pressure on Beijing to allow faster yuan appreciation.

A sharp slowdown in import growth sent China's trade surplus to \$28.7 billion in July from \$20.02 billion in June, far surpassing expectations for a \$19.6 billion surplus in a poll of economists. July's surplus was the highest since January 2009, when it was \$39.11 billion.

The Chinese data come ahead of U.S. trade figures for June, due out Wednesday and expected to show a trade deficit of more than \$40 billion.

"This contrast in the trade position of the two most important economies in the world will likely increase the pressure from Washing-

ton for Beijing to allow further currency appreciation, particularly in the lead-up to midterm elections in November," wrote Royal Bank of Canada economist Brian Jackson in a note.

The weak imports growth weighed on stock markets in Asia and around the world as investors worried about the implications for the global recovery.

The Shanghai Composite Index fell 2.9% to 2595.27, reversing early-morning gains. The Dow Jones Industrial Average and the Stoxx Europe 600 declined in early trading. Commodity producers were especially weak; crude-oil futures fell below \$80 per barrel in New York.

July's figure is the latest sign that economic activity in China is slowing as the impact of stimulus spending, which created a construction boom resulting in massive demand for imports of raw materials

and equipment, has faded. Government measures to cool property-market speculation and to phase out polluting, energy-intensive industry have added to the headwinds.

Property-market figures also out Tuesday illustrate the slowing construction activity is leading to lower demand for imported raw materials. China's National Bureau of Statistics said investment in real-estate development, one of the main forms of private investment in China, rose 33% in July from a year earlier to 411.8 billion yuan (\$60.85 billion), but slowed from June's year-to-year 46.3% increase to 583 billion yuan. Analysts expect a further slowdown in property investment in coming months.

Nationwide property sales fell 15.4% to 64.7 million square meters (696.4 million square feet) in July from the year-earlier period. July's sales were down 29.4% from 91.6 million square meters in June.

Despite the decline in sales, urban property prices in 70 Chinese cities were unchanged in July from June, and 10.3% higher than a year earlier, highlighting the challenges Beijing faces in keeping asset inflation in check and dashing any hopes of a potential easing in the sector's tightening measures.

Analysts said the resilience of property prices indicates Beijing won't be eager to loosen its measures to cool the sector, including higher mortgage downpayment requirements for second and third homes. They see prices and sales dropping further in coming months.

Exports grew 38.1% in July from a year earlier, China's Bureau of Customs said, slowing from June's 43.9% rise, but beating economists' expectations of a 36.3% increase.

The data showed no signs that exports to the European Union have been weakening, as some analysts

had expected. Exports to the EU rose 5.4% to \$28.67 billion in July from \$27.2 billion in June, and were up 38.3% from July 2009.

Imports rose 22.7%, down from June's 34.1% increase and well below expectations of a 30.2% rise.

Analysts argued that the higher trade surplus makes yuan appreciation more likely in the coming months.

"China says it will allow market supply and demand to determine the exchange rate. Well, the balance of payments is the most important factor in the market supply-and-demand picture," said Morgan Stanley economist Wang Qing.

The yuan has risen 0.77% against the dollar since Beijing's June 19 announcement it would increase the exchange rate's flexibility, effectively ending a two-year peg to the dollar.

—Liu Li contributed to this article.

Japan apologizes to Koreans

BY TAKASHI NAKAMICHI

TOKYO—Japanese Prime Minister Naoto Kan apologized to South Korea for Japan's past colonization of the Korean peninsula, in what is the latest national effort to repair the two countries' sometimes thorny relationship.

In a statement released Tuesday, ahead of the 100th anniversary of Japan's annexation of the peninsula, Mr. Kan said he wanted to express "deep remorse and heart-felt apology" for the great pain and damage caused by Japan's colonial rule.

"The people of South Korea were deprived of their sovereignty and culture, and their ethnic pride was deeply hurt" because of Japan's actions, Mr. Kan said.

The prime minister also said Japan will return some cultural artifacts brought to Japan from Korea during the colonial period. Japan's annexation treaty with Korea took effect on Aug. 29, 1910, and lasted until 1945.

Japan has issued official apologies in the past. But the latest comes as the ruling Democratic Party of Japan seeks to play a greater leadership role in the Asian region, where the memory of Japan's wartime aggression runs deep.

Mr. Kan emphasized that cooperation between the U.S., Japan and South Korea is central to achieving stability in the region, and that Tokyo



Japanese Prime Minister Naoto Kan makes an apology to South Korea ahead of the 100th anniversary of Japan's colonial rule over the country.

wants to build a forward-looking relationship with Seoul. The statement was written "with a feeling that we will reflect on what we should reflect on regarding the past 100 years, and to express that we want to cooperate and walk together with [South Korea] in the coming 100 years," Mr. Kan said at a news conference.

The government of South Korea said it sees the statement by the Japanese government "as its will to

overcome the miserable history between the two nations and develop a brighter relationship," South Korea's Ministry of Foreign Affairs and Trade said on its website.

Political commentators said Mr. Kan didn't diverge much from apologies by his two predecessors, having been warned by conservative Japanese politicians that too much of an apology could rekindle demand in South Korea for compensation.

Hot Singapore economy shows cooling-off trend

BY P.R. VENKAT
AND GAURAV RAGHUVANSHI

SINGAPORE—Singapore's economy grew at a marginally slower pace than previously estimated in the second quarter, the government said Tuesday, warning that growth momentum will moderate in the second half of the year due to a slacker global economy.

The Ministry of Trade and Industry said gross domestic product expanded 24% from the first quarter in seasonally adjusted, annualized terms, slower than growth of 26% reported last month in preliminary data and a sharp slowdown from a red-hot 45.7% expansion in the first quarter. GDP rose 18.8% from the year-earlier quarter, less than 19.3% growth reported earlier.

The government kept its projection of 13% to 15% growth for 2010.

Singapore was among the hardest hit economies in the 2008 global financial crisis, but was quick to recover as a revival in Chinese demand powered an upturn region wide, helping to drive the island-state's export-dependent economy.

The brisk recovery has stoked inflation, and the Monetary Authority of Singapore tightened policy aggressively in April following news of the economy's startlingly fast ex-

pansion in the first quarter.

The central bank, which uses the exchange rate rather than a policy interest rate to maintain price stability, raised its undisclosed trading band for the Singapore dollar and said it would seek a modest and gradual rise in the currency, an unprecedented double-barreled tightening.

The central bank said Tuesday its policy stance remains "appropriate" and kept its inflation estimate of 2.5% to 3.5% for 2010.

Ravi Menon, permanent secretary in the Ministry of Trade and Industry, said he expects to see a "sharp slowdown in the sequential growth for the second half" but added that the possibility of a double-dip recession for Singapore and the U.S. remains low. "Weak fundamentals weighing down the U.S. economy have now reassured themselves," he said. However, Mr. Menon said, "downside risks to growth from the European debt crisis appear to have eased somewhat."

The latest numbers didn't come as a surprise. Singapore Prime Minister Lee Hsien Loong said Sunday the economy expanded 17.9% in the first half of the year, slower than a 18.1% rate previously estimated, suggesting the second-quarter data would be revised downward.

WORLD NEWS



Agence France-Presse/Getty Images

A woman mourns her missing relatives in Gansu province after the deadliest mudslide in decades devastated the area.

China mudslide points to costs of deforestation

BY SHAI OSTER AND DINNY McMAHON

BEIJING—Rescuers continued to pull bodies from the site of a massive mudslide in northwest China that has so far killed more than 700, while questions began to rise about what triggered the massive wall of mud and dirt that carved a path of destruction through the remote area.

The official death toll of the weekend mudslide in Gansu province's Zhouqu county increased sharply Tuesday to 702—far more than the 127 first reported dead on Sunday—with more than a thousand people still missing. As torrential rains continued to take a heavy toll on the country, the disaster points to the grim cost of China's fast-paced development in ecologically fragile regions such as Gansu's mountainous valleys.

On Tuesday, Vice Premier Hui Lianguyu exhorted rescuers to step up their efforts before the window for finding survivors closed. Beijing has mobilized army and paramilitary police units to the area to aid in the rescue.

State media have highlighted the

efforts of the emergency services, and given prominence to a visit to the scene by Premier Wen Jiabao.

Some Chinese activists seeking answers to what caused the side of a mountain to cave in concluded that the Gansu mudslide was a disaster waiting to happen after unchecked development in the region, and that more tragedies could be in store in other parts of China where nature's balance has been upended.

Officials described the mudslide as a natural disaster set in motion by unremitting rains. The rains caused the Bailong River in the southwest of Gansu province to break its banks, causing widespread devastation across Zhouqu county.

Flooding plagues China annually, but this year the problem has been particularly severe, affecting 28 provinces. Prior to the disaster, the People's Daily, the official mouthpiece of the Chinese Communist Party, set the death toll from the rains this year at 1,072. The mudslides in Gansu have been by far the most deadly incident from the flooding.

That official version was fast falling under question as activists collated government and media reports that for years have warned that

overexploitation of the local rivers and forests would trigger landslides.

By Tuesday evening, Internet links to at least some of those research papers had been removed. China's Internet is heavily censored and Chinese websites routinely take down content deemed sensitive, for fear of punishment.

The flooding that led to the Zhouqu disaster "is certainly resulting from decades of deforestation in the headwater region of the Bailong river," said environmentalist Wen Bo, a senior fellow with U.S.-based Pacific Environment.

An overreliance on dams further contributed to the situation, he said. "This all shows that the law of nature has to be respected and the government should realize if they do not take the ecosystem seriously, then it will eventually cost more in the end," he said.

Scientists have already linked deforestation and dams to landslides in at least one other place. In 2003, shortly after water levels on the Yangtze River started rising when part of the giant Three Gorges Dam was completed, a slice of mountainside collapsed into the river, killing 13 farmers.

Flooding reignites Indus dam debate

BY ZAHID HUSSAIN AND TOM WRIGHT

ISLAMABAD—The devastation from Pakistan's worst floods in a generation has sparked renewed debate about a controversial mega-dam project that some believe could have helped mitigate the disaster.

Prime Minister Yousuf Raza Gilani this week said Pakistan's government would look at reviving plans to build a dam on the Indus River at Kalabagh in Punjab province, a project that has been on the drawing board for four decades. The dam's proponents say it would help reduce flooding and provide an extra source of water for the dry season.

"The present destruction and calamity could have been prevented," said Shams-ul Mulk, a former chief of Pakistan's Water and Power Development Authority, who has championed the dam's construction. "If the Kalabagh dam had been built, this flood could have been tamed in the reservoir."

The issue provides a window into the politics of water use, a hot-button topic both domestically and regionally. The Kalabagh project has been consistently delayed amid fears from those downstream that it would give Punjab, Pakistan's richest and most politically powerful province, too much control over water resources. Even as many in Pakistan agitate to build the dam, the country's government is seeking to prevent India from building its own large dam further upstream, on the Indus River system's upper reaches.

Renewed controversy over Kalabagh added to tensions surrounding the response to the past two weeks of flooding, which began in the north and spread south along the course of the Indus, killing an estimated 1,500 people.

President Asif Ali Zardari returned to Pakistan Tuesday after a 10-day trip to France and the United Kingdom, an absence that sparked intense criticism from the media and opposition parties. Mr. Gilani has said he is the head of government and is leading rescue efforts.

Relief work, meanwhile, has taken on an ideological dimension. Pakistan's army and foreign donors continued to ferry aid to flood survivors Tuesday, as Pakistan's weak civilian government has requested more aid from foreign countries as it seeks to battle the influence of Isla-

mist groups.

The U.S. on Tuesday announced it would provide an additional \$20 million in emergency flood assistance in Pakistan, bringing its total commitment to \$55 million in outreach to a country whose people strongly oppose the U.S.-led war in neighboring Afghanistan. Six U.S. helicopters on Tuesday delivered food, water and medical supplies to stranded communities in the northwest of Pakistan.

Islamist charities have been active delivering aid as well. A spokesman for the Pakistan Taliban urged the government not to accept Western aid, the Associated Press reported Tuesday.

The United Nations says the flooding has affected 13 million people, damaged or destroyed 300,000 houses and left thousands of acres of crops wiped out. The U.N.'s World Food Program says destruction of wheat and rice crops could leave some 6 million people short of food.

"Needs are huge and still rising. The humanitarian effort needs to be scaled up," said John Holmes, U.N. under-secretary-general for humanitarian affairs and emergency relief coordinator.

Mr. Gilani told local reporters Monday that the government would build the Kalabagh dam if it could reach political consensus over the issue. He gave no time frame.

Three-quarters of the water that runs through Pakistan's river systems annually flows in just 70 days during the monsoon, when rainfall is high and Himalayan glaciers that feed the Indus River system are melting, said dam advocate Mr. Mulk, who is not Punjabi. Two other major dams built in the 1960s—Tarbela and Mangla—are insufficient to help Pakistan control water flows in the Indus River system, he said.

The Kalabagh project faces opposition from landowners south of Punjab province, who fear a large new dam could be used to withhold water in times of drought.

In June, politicians in Pakistan's southernmost Sindh province complained that filling the Mangla dam in Punjab had led to a 60% reduction in water availability and delayed rice and wheat crops.

A Pakistan army spokesman said Tuesday that rising water threatened to break three major barrages in Sindh province that regulate irrigation systems fed from the Indus.

South Africa mulls media curbs

BY PETER WONACOTT

JOHANNESBURG—South Africa's ruling political party, the African National Congress, has thrown its weight behind tighter controls for the media, sparking a noisy debate over the role of the press in the country's 16-year-old democracy.

The ANC, which came to power in the country's first multiracial elections in 1994 and has dominated the political landscape since, has floated a series of proposals that could reshape South Africa's media industry and backed a controversial bill to safeguard government information. The fracas has sapped some of the euphoria that followed South Africa's successful hosting of the World Cup, and reignited animosity

between the nation's press and its ruling party.

The measures have spotlighted the fractious relationship the ruling party has come to have, in particular, with the nation's freewheeling newspapers.

Several publications have zealously reported stories of official corruption and the opulent lifestyles of leading politicians, stirring public anger against the ANC—and selling newspapers, too.

The ANC proposes a press watchdog that would answer to the ANC-controlled parliament. The so-called Media Appeals Tribunal would hear complaints against the print media and decide punitive measures against guilty parties.

Jackson Mthembu, an ANC

spokesman, said the media's effort to police itself—through a press ombudsman and other measures—haven't been effective.

In a separate development, South Africa's parliament is reviewing a "Protection of Information Bill" that sets fresh guidelines for classifying information for what can be defined as the "national interest."

Those who disclose classified information—either whistleblowers or reporters—may face as many as five years in prison.

The ANC-controlled parliament is expected to approve the bill, although critics argue it violates South Africa's constitution guaranteeing press freedoms and won't withstand a court challenge.



Source: United Nations Office for the Coordination of Humanitarian Affairs (flood area)

WORLD NEWS

Liberian's trial shifts to atrocities

By CHARLES FORELLE

Gone was Naomi Campbell, supermodel, in her bangs and sheer cream-colored top. Gone was Mia Farrow, movie star.

In their place on the witness stand Tuesday at the trial of Charles Taylor was Issa Sesay, a convicted war criminal in an ill-fitting gray sport coat.

Judges in the Dutch courtroom trying Mr. Taylor, Liberia's former president, are continuing the slow, methodical task of assessing his responsibility for nearly six years of horrors during Sierra Leone's civil war.

Prosecution witnesses have testified to gruesome violence and sexual terror when rebels swept in—men and boys executed with axes, the lucky ones having their hands cut off, gang rapes of girls, orders to burn villages to the ground.

Mr. Taylor isn't charged with committing atrocities himself. He is accused of directing and supporting those who did, under the principle that leaders high in the hierarchy can be held responsible for the actions of their underlings.

Elise Keppler, senior counsel for the International Justice Program at Human Rights Watch, says a key point for the prosecution has been testimony of "insiders" who say Mr. Taylor was indeed in charge, even indirectly, of the fighters. "The real issue in the case is not so much whether the atrocities occurred but Taylor's link to them," she says.

Before Ms. Campbell took the stand at the court in Leidschendam, prosecutors trying Mr. Taylor had called 91 witnesses; his lawyers have so far summoned 19. Mr. Taylor took the stand in his own defense for 13 weeks. The trial has run three years.

Ms. Campbell, Ms. Farrow and Carole White, who was Ms. Campbell's agent and who testified Monday and Tuesday, were hardly the most crucial of witnesses. But they served another cause—drawing global attention to a trial whose purpose is in part for the world to reckon with the brutal fighting.

"From my perspective, more attention to this trial is a good thing," said Ms. Keppler. The prosecution is "an important chip in the chipping-away of impunity for these kinds of crimes."

The three women were called to establish that Mr. Taylor regularly dealt in so-called blood diamonds; prosecutors allege he used the trade in diamonds to arm and support rebel factions in Sierra Leone while he was president of neighboring Liberia. Mr. Taylor denies trading in diamonds, or doing anything in Sierra Leone other than acting as a



Charles Taylor is seen at his trial, during which Naomi Campbell, top right, said she got a bag of 'dirty-looking stones' after meeting him, testimony actress Mia Farrow, center, and Carole White, the model's former agent, contradicted.



peace mediator.

The celebrity testimony was contradictory and at times befuddling. Ms. Campbell said she received a few "dirty-looking stones" for no apparent reason from two strangers after a 1997 charity dinner in South Africa at which she met Mr. Taylor. Ms. Farrow says Ms. Campbell gushed over breakfast the next morning that she got a diamond from Mr. Taylor overnight. Ms. White said she heard Ms. Campbell and Mr. Taylor discussing the delivery of diamonds, and that she was in Ms. Campbell's room later when a few uncut stones were delivered.

The celebrity disagreements pale next to the other evidence presented.

Among the early prosecution witnesses was an unidentified man who worked as a radio operator for the rebels. He testified that in 1998, Sam Bockarie, a leader of a rebel group called the RUF, turned up in new fatigues and a jeep, saying he was just back from Liberia and "had been promoted by the chief, Charles Taylor, to the rank of a general." Mr.

Taylor, the witness said, gave Mr. Bockarie the jeep.

He testified that the contacts grew. The radio operator said he relayed messages between Mr. Bockarie or other rebels, and Mr. Taylor and his aides. The witnesses said the rebels would arrange to deliver diamonds to Mr. Taylor in exchange for arms.

Another witness said he saw Mr. Sesay return from Liberia with a jar full of diamonds.

One witness testified, as an indictment of Mr. Taylor's character, that he and Mr. Taylor together ate the liver of a Liberian rival alleged to have been killed on Mr. Taylor's orders.

In court on Tuesday, Mr. Sesay testified that "the RUF had no contact with Mr. Taylor." Mr. Sesay was sentenced in 2009 to 52 years in prison.

Judges determined that he commanded forces that slaughtered civilians and killed peacekeepers, and that he was instrumental in assembling an army of child soldiers, a coterie of whom were his personal

bodyguards.

Mr. Bockarie, who was also indicted by the Special Court, was killed in 2003.

On the stand, Mr. Taylor broadly denied involvement with the rebels. His lawyers called a witness who disputed the liver-cooking incident.

A verdict won't come this year. Before Tuesday's testimony got under way, prosecutors urged the court to order Courtenay Griffiths, Mr. Taylor's lawyer, to wrap things up by the end of September, pointing out that Mr. Sesay alone had already testified for more than 85 hours. Mr. Griffiths said he had as many as seven more witnesses; the judges gave him until mid-November.

There is no jury, and the three-judge panel will issue a judgment with its verdict. It won't be simple to write. In the trial that convicted Mr. Sesay and two other rebel leaders, the judgment ran 824 pages.

The gravest penalty is a long term of imprisonment. The U.K. agreed to take Mr. Taylor to serve his sentence in a British prison if he is convicted.

German soldiers expand mission in fall offensive in Afghanistan

Continued from first page

For the Germans, shifting to what Col. von Blumröder calls a more "aggressive" posture is politically controversial. Germany's military presence in Afghanistan, its first major combat mission since World War II, is deeply unpopular among the German public, and Berlin has presented the endeavor as more humanitarian than martial.

That image was shattered last year when a German officer called in a U.S. airstrike on two fuel tankers hijacked by Taliban in Kunduz. It turned out that the hijacked trucks had gotten stuck at a river crossing, and civilians had gathered around to steal fuel, when the jets attacked. The North Atlantic Treaty Organization concluded in a confidential report that more than 140 people died, including many civilians.

In the uproar that followed, the German army's top officer, a senior Ministry of Defense official and the labor minister, who had been defense minister at the time of the airstrike, lost their jobs.

Last month, the military faced a new round of criticism after documents released by the Web site WikiLeaks showed that German troops had helped identify targets for coalition special forces.

German commanders are splitting the two battalions off from the 4,400 troops currently in Afghanistan that until now had largely conducted small-scale operations, reacted to emergencies or secured economic-development efforts.

The second German battalion, based in Mazar-e-Sharif, will take on its new role at the end of October, according to a Ministry of Defense spokesman in Berlin. The new battalions will have enhanced capabilities, such as reconnaissance technology and combat engineers, along with access to artillery support.

German government officials hope the public's desire to see Afghan forces take control of the country—and therefore allow Germany to withdraw—will temper resistance to steps that could put German troops in greater jeopardy.

Since 2004, Germany has been in charge of NATO operations in northern Afghanistan, an area that was relatively peaceful until two years ago. In recent months, security in the outlying districts of Kunduz has deteriorated, with a spate of suicide attacks, roadside boobytraps and ambushes hitting Afghan, German and U.S. troops.

The new offensive is intended in part to address the declining security situation in the north and to move toward a handover of security tasks to Afghan forces. The German government informed parliamentarians of the new strategy in April.

Yet the German troops operate under strict rules that require them to remain close to their base hospital at all times, or travel with a doctor. Those rules have limited the ability of German forces to range deeply into Taliban strongholds outside of the provincial capital.

Some German officers chafe against the rules that limit their mobility and the sense at home that they are on a charity mission instead of fighting a war.

—Patrick McGroarty in Berlin contributed this article.

Afghan civilian death toll increases 21%

By MARIA ABI-HABIB

KABUL—Afghan civilian deaths surged 21% in the first half of 2010 from the same period last year as insurgents planted more roadside bombs and stepped up attacks on Afghans working with government and international forces, according to a United Nations report released Tuesday.

In the first half of this year, insurgents and U.S.-led coalition forces killed 1,271 Afghan civilians, the report said. The number of casualties caused by the Taliban and other insurgent groups rose to 76%

of total fatalities, with rebel homemade bombs alone accounting for 557 deaths.

The number of Afghan civilians killed by the U.S.-led coalition and Afghan forces in these six months shrank by 30% to 223, the U.N. said.

"The devastating human impact of these events underscores that, nine years into the conflict, measures to protect Afghan civilians effectively and to minimize the impact of the conflict on basic human rights are more urgent than ever," said Georgette Gagnon, the U.N.'s director for human rights in Afghanistan.

The U.N. attributed the decline in the number of Afghans killed by the coalition forces to new tactical directives implemented last year by allied commander U.S. Gen. Stanley McChrystal, who restricted the use of air strikes and tightened the rules of engagement during fire-fights. The new commander of coalition forces, U.S. Gen. David Petraeus, confirmed this commitment to reducing civilian casualties after he arrived here in July.

Coalition officials acknowledge, however, that even as the number of Afghan civilians killed by the foreign troops declines, the coalition is

still ultimately blamed for any violence in the country, no matter the perpetrator.

"Every Afghan death diminishes our cause," Gen. Petraeus said in a statement following the U.N. report. "We know the measure by which our mission will be judged is protecting the population from harm by either side."

The U.N. reported that assassinations and executions of Afghans working with the government or coalition forces rose 95% in the first half of this year, as intimidation tactics were increasingly adopted by the insurgents.