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VOL. XXVIII NO. 226 | EUROPE | Friday - Sunday, December 17 - 19, 2010

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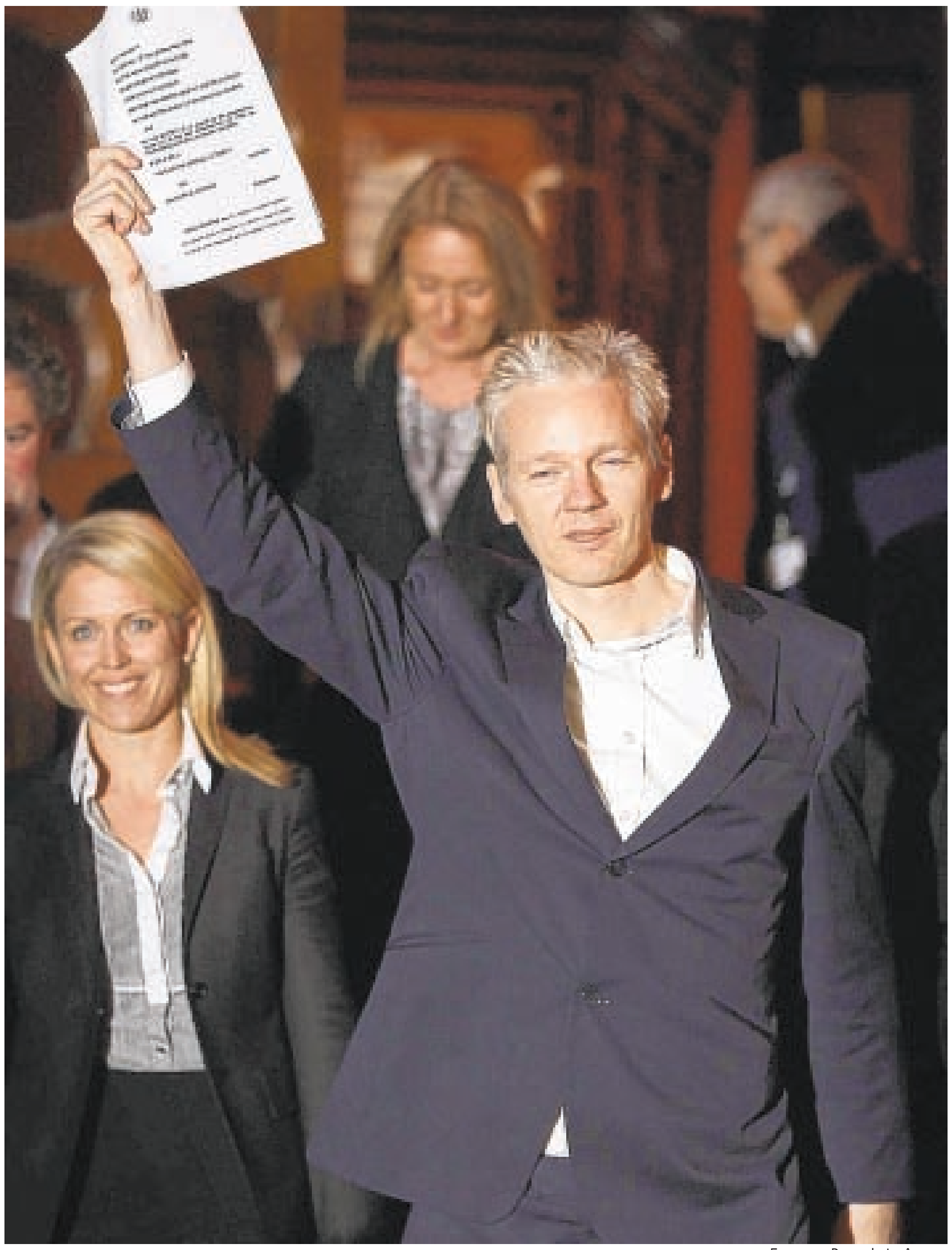
WikiLeaks founder out on bail



European Pressphoto Agency

Julian Assange was released from jail Thursday, as the U.K. decides whether to extradite him to Sweden over sexual-misconduct allegations. On the courthouse steps, he thanked supporters, his lawyers, those who provided bail money and the British justice system. **Articles on pages 3 and 19.**

EU endorses bailout fund, amid discord

By Marcus Walker

Europe's leaders endorsed plans for a new fund to rescue indebted euro-zone countries, but failed to resolve deepening disagreements over whether more radical action is needed to quell a debt crisis that has raged along the region's fringe for more than a year.

Meeting in Brussels for their final summit in 2010, European Union leaders agreed to replace the region's emergency rescue fund, which expires in 2013, with a permanent crisis-finance program. Yet the plan, which includes provisions that would force holders of euro-zone government bonds to bear losses in some cases, has done little to reassure markets about Europe's resolve to salvage its common currency.

Those pressures were apparent on Thursday as Spain was forced to offer significantly higher interest rates at a debt auction than it paid just a month ago. Bond markets fell across Europe. In a further sign that the region's woes could persist, the European Central Bank, citing "credit risk" and other factors, said it would nearly double its capital base.

By delaying development of a permanent and comprehensive crisis-management structure, Europe could be pushing its sovereign-debt and financial crisis to "the edge of the cliff," the head of the International Monetary Fund said.

In a discussion at a ThomsonReuters Newsmaker event in Washington, IMF Managing Director Dominique Strauss-Kahn said he is worried Europeans officials are "too much behind the curve," compared with how fast markets are moving, risking further contagion in the euro area.

"The risk is always to act only at the last minute," the head of the IMF said. "The institutions are still thinking too local when they're facing global problems."

After resolving their differences earlier this year to agree on a rescue for Greece and create a temporary bailout fund, Europe's leaders have reverted to the public squabbling that undermined the EU's early response to the crisis and set investors on edge.

In recent days, Luxembourg Prime Minister Jean-Claude Juncker and other leaders have proposed issuing common euro bonds as a way to alleviate the pressure on the currency area's weakest members. But the idea has been met with fierce resistance in Germany and other countries amid concerns that they could end up footing the bill for profligate neighbors.

The Continent's inability to halt the spread of the turmoil bodes ill for the coming year, when euro-zone countries are expected to need to raise $2 trillion of debt. If Europe's governments fail to put

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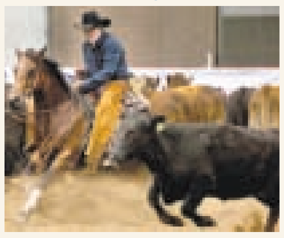

Rodeo drive: rich urban cowboys on fine horses best ranch hands. Page 29

Editorial & Opinion

Iraq gets a government at last—if it can keep it. Page 12

U.S. lays out charges in insider-trade case

Federal prosecutors unveiled charges against five people related to alleged insider trading on Thursday, in a sweep stemming from a three-year investigation that has shaken the financial world.

By Michael Rothfeld, Jenny Strasburg, Susan Pulliam and Gregory Zuckerman

The charges are the first major development in the continuing probe of insider trading on Wall Street, in which hedge funds and mutual funds have been raided and subpoenaed by federal investigators in recent weeks. More arrests are expected.

The charges announced Thursday involve four consultants and an employee for **Primary Global Research** LLC, a Mountain View, Calif., "expert-network" firm, in connection with the alleged tipping of confidential information.

The federal probe has examined whether material nonpublic information has been leaked from corporations to investors through expert-network firms, among other things. Hedge funds and mutual funds pay these expert firms to arrange consulting sessions with employees of public companies for market research.

"The information trafficked by the four 'consultants' went way beyond permissible market research," FBI Assistant Director-in-Charge Janice Fedarcyk said. "It was insider information."

According to prosecutors, the information shared included sales details about some of the most popular technology products, such as **Apple** Inc.'s iPhone, and some of the largest technology companies, such as **Dell** Inc., **Advanced Micro Devices** Inc. and **Flextronics International** Ltd.

Primary Global has marketed the ability to provide "actionable intelligence" to its investment firm clients through its GATE Network, which stands for "Global Advisory Team of Experts," in the technology, health-care and retail sectors.

Those arrested Thursday were James Fleishman, a vice president and sales manager at Primary Global; and consultants Walter Shimoon, a senior director of business development at Flextronics in San Diego; Mark Anthony Longoria, of Round Rock, Texas, a supply-chain manager with AMD; and Manosha Karunatilaka, of Marlborough, Mass., an account manager at **Taiwan Semiconductor Manufacturing** Co. They were charged with wire fraud and conspiracy to commit wire fraud.

A fourth consultant, Daniel Devore, a former supply manager at Dell, pleaded guilty to the same charges on Dec. 10, according to federal prosecutors. He is cooperating with authorities. His lawyer couldn't immediately be reached.

In its investigation, the

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Turkey has the potential to override risks from hot-money investments

[Agenda]

By Joe Parkinson

China may be grabbing the headlines, but one of the biggest winners of the financial crisis has been Turkey.

Its economy is surging—expanding 9% on the year in the nine months to October, powered by an industrial sector firing on all cylinders. The auto industry is emerging as an alternative production hub, while free-spending consumers are sucking up easy credit from comfortably capitalized banks, helping to fire the boom.

Emboldened by stellar statistics, Ankara's policy makers—joined by a growing number of economists—lambast ratings agencies for refusing to bump Turkey up to investment grade.

Istanbul, the booming metropolis driving the recovery, has developed into a fashion and tourism hub and recently ranked above four Chinese cities as the world's most dynamic metropolitan center, according to the Brookings Institution.

Gone, it seems, are the bad old days of the 1990s when squabbling coalition Turkish governments sidestepped structural reforms and triple-digit inflation erased savings.

Turkey still has deep political divides. Almost 200 top military officers, including three retired commanders, went on trial Thursday charged with plotting against the Islamist-leaning government of Prime Minister Recep Tayyip Erdogan in a case likely to strain ties between Ankara and the secularist armed forces.

The Erdogan administration has also ruffled feathers in Washington and Brussels with a more Islamic-focused policy platform.

Bloomberg News

Traders at their computer terminals in the Istanbul Stock Exchange.

But investors have embraced the unfamiliar stability of single-party rule. And with Mr. Erdogan widely expected to secure a third term at national elections due by the summer, stability—at least by recent Turkish standards—looks set to persist.

Underpinning that stability is economic potential; with a youthful population of 77 million and a relatively cheap labor force, Turkey looks a lot more like a BRIC than a bubble.

If only it were that simple.

Late Thursday the Turkish central bank cut interest rates by a half-point to a record low of 6.5%, opting for further stimulus despite this year's dazzling growth numbers and analysts' warnings that the economy could overheat.

Why would policy makers in a rapidly growing economy cut rates? Because, Turkey's success has caused a rapid inflow of hot money, or speculative investments, which magnifies the economy's key weakness: a mushrooming current-account deficit that depends on external finance.

Policy makers in Istanbul are gambling that cutting rates to dissuade speculative investors is less risky than firing a domestic consumer boom that some fear could see the economy overheat.

Turkey's growth model is most certainly driven by consumer demand, and is heavily dependent on imports, partly because it has few energy resources and it specializes in manufacturing partly finished goods.

Latest numbers show imports rising 35% on the year in October, while export growth slowed to 8.8%. That contributed to a current-account deficit of $36 billion in the January to October period—a huge 288% expansion from the year-earlier period.

Partly because of that model, the quicker Turkey expands, the quicker the deficit widens, leaving the economy vulnerable to shocks if investor sentiment turns negative.

That vulnerability is magnified by the fact that a rapidly rising proportion of that deficit is financed by hot money. This is the speculative demand that sweeps into rapidly growing economies as investors flee low interest rates in the U.S., the U.K. and the euro zone, to seek higher yields.

So far this year, some 70% of Turkey's current-account deficit has been financed by speculative portfolio investments, compared with just 14% of longer-term FDI, according to the "Emerging Markets Quarterly Report" published by Barclays Capital in early December.

For some economists, the starring role that hot money plays in funding Turkey's deficit is a red flag that could cause problems if another bout of risk aversion drives investors away from emerging markets and into gold, the dollar and other havens.

"The economy is exposed: sure, there's lot of cheap money flooding in, but if sentiment was to change, we have a yawning current-account deficit funded by bad finance—and that's making a lot of people nervous," said Murat Ucer, an economist at Global Source Partners, an Istanbul-based consultancy.

Ratings agencies say the current-account imbalance is the principal reason for keeping Turkey's rating below investment grade, while government ministers here warn with increasingly regularity that hot money could undermine the economy's gains.

But despite the imbalances and growing specter of risk, the strength of Turkey's rebound has shifted perceptions that the economy is a perennial underachiever. Incomes are expanding and inflation is historically low, boosting the credibility of policy makers who have overseen rapid growth and a fall in public debt.

The raw materials are in place: a strategic location between Asia and Europe, a democratic political system, and age-old tradition as a trading hub make Turkey's vast economic potential obvious.

There are possible pitfalls and Thursday's interest-rate cut is controversial. But with resurgent growth and growing credibility, policy makers can square sustainable expansion with concerns over hot money, meaning the growth story can continue.

What's News

■ **Banks world-wide** will need to come up with hundreds of billions of dollars in capital to comply with new regulatory requirements that will take effect over eight years, the BIS said. **17, 32**

■ **U.S. diplomatic cables** released this week suggest that BP narrowly averted potential disaster after a 2008 natural-gas leak at a field it operates in Azerbaijan. **19**

■ **The U.S. FDA** recommended Avastin no longer be approved for treatment of breast cancer, contrasting with a decision by the European Medicines Agency. **17**

■ **The U.S. called for** the creation of an office that would help develop an Internet "privacy bill of rights" for U.S citizens and coordinate privacy issues globally. **9**

■ **Fighting broke out** in Ukraine's Parliament after opposition lawmakers protested the opening of a case against Tymoshenko. **6**

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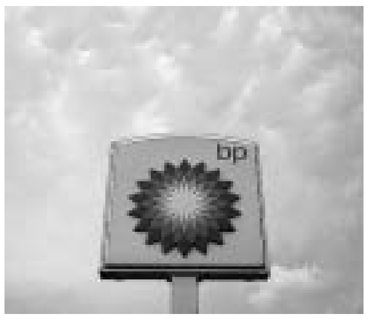
'Being sued for billions of dollars by the U.S. government is probably just another step on BP's road to recovery.'



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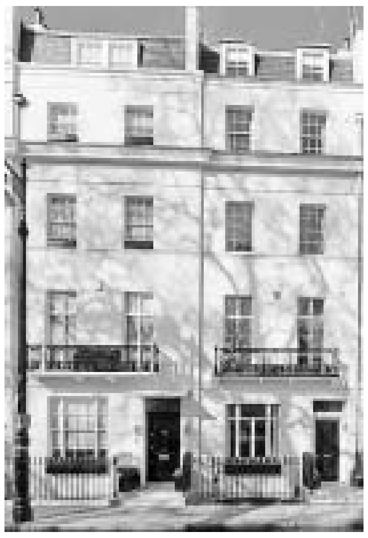

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Question of the day

Vote and discuss: What kind of momentum does the U.S. recovery have?

Vote online at **wsj.com/polls**

Previous results

Q: Should the European Union do more to address euro-zone debt problems?

Yes **60%**

No **40%**

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NEWS

Google's library yields cultural clues

By Robert Lee Hotz

Language analysts, sifting through two centuries of words in the millions of books in **Google** Inc.'s growing digital library, found a new way to track the arc of fame, the effect of censorship, the spread of inventions and the explosive growth of new terms in the English-speaking world.

In research reported Thursday in the journal Science, the scientists at Harvard University, Massachusetts Institute of Technology, Google and the Encyclopedia Britannica unveiled a database of two billion words and phrases drawn from 5.2 million books in Google's digital library published during the past 200 years. With this tool, researchers can measure trends through the language authors used and the names of people they mentioned.

It's the first time scholars have used Google's controversial trove of digital books for academic research, and the result was opened to the public online Thursday.

Analyzing the computerized text, the researchers reported that they could measure the hardening rhetoric of nations facing off for war, by tracking increasing use of the word "enemy." They also could track changing tastes in food, noting the waning appetite for sausage, which peaks in the 1940s, and the advent of sushi, the mentions of which start to soar in the 1980s. They documented the decline of the word "God" in the modern era, which falls sharply from its peak in the 1840s.

"We can see patterns in space, time and cultural context, on a scale a million times greater than in the past," said Mark Liberman, a computational linguist at the University of Pennsylvania, who wasn't involved in the project. "Everywhere you focus these new instruments, you see interesting patterns."

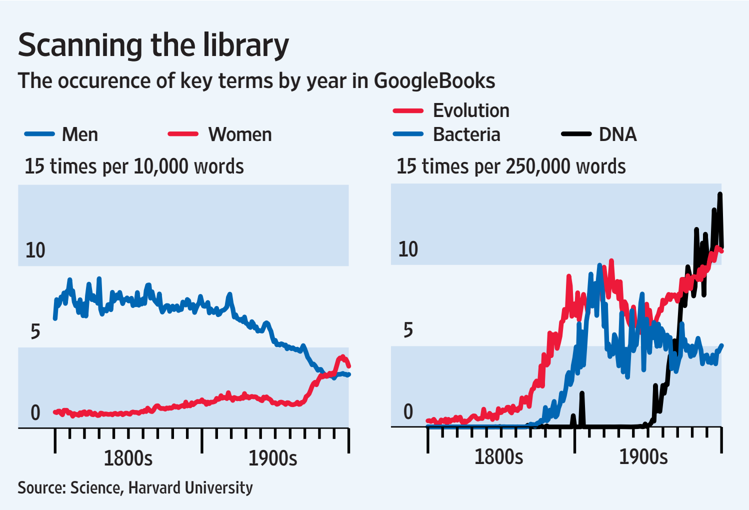
The digital text also captured the evolving structure of a living language, and almost a half-million English words that have appeared since 1950, partly reflecting the growing number of technical terms, such as buckyball, netiquette and phytonutrient.

"It is just stunning," said noted cultural historian Robert Darnton, director of the Harvard University Library, who wasn't involved in the project and who has been critical of Google's effort to digitize the world's books. "They've come up with something that is going to make an enormous difference in our understanding of history and literature."

All told, about 129 million books have been published since the invention of the printing press. In 2004, Google software engineers began making electronic copies of them, and have about 15 million so far, comprising more than two trillion words in 400 languages.

Associated Press

Mentions of Jimmy Carter jumped past those of Mickey Mouse beginning in 1974.



The online library project has been hobbled by lawsuits, copyright disputes and fears over the potential for the company to have an information monopoly. "There have been computational hurdles, scientific hurdles, organizational and legal hurdles," said mathematician Erez Lieberman Aiden at the Harvard Society of Fellows, who helped create the database.

To avoid copyright violations, the scientists are making available the vast catalog of frequency patterns of words and phrases, not the raw text of books. Google Labs posted freely downloadable data sets and a special viewer at http://ngrams.googlelabs.com Thursday. These data sets consist of short phrases—up to five words —with counts of how often they occurred in each year.

They currently include Chinese, English, French, German, Russian and Spanish books dating back to the year 1500—about 4% of all books published. The database doesn't include periodicals, which might reflect popular culture from a different vantage.

By calculating how frequently famous personalities appear in Google's digitized texts, the Harvard researchers discovered that people these days become famous at a younger age than in previous eras and reach unprecedented peaks of notoriety. "The flip side is that people forget about you faster," said Harvard lead researcher J.B. Michel.

Measuring occurrences of prominent names, Mr. Michel and his colleagues found that Jimmy Carter leapt from obscurity around 1974, at the onset of his run for the U.S. presidency, to overtake Mickey Mouse, Marilyn Monroe and astronaut Neil Armstrong in published mentions. Once out of office, Mr. Carter began an equally sharp decline in mention. By contrast, the cartoon character, the astronaut and the movie star have continued their steady rise up the slope of fame.

In the same way, they identified instances of censorship by charting the abrupt disappearance of controversial figures from the written record.

Mentions of the popular Jewish artist Marc Chagall, for example, virtually disappear from German literature during the era of Nazi power between 1936 and 1944, when his work was banned, but not from English books of the same period.

WikiLeaks founder Assange is freed on bail

By Paul Sonne

LONDON—WikiLeaks founder Julian Assange was released on bail Thursday night and headed for an English country estate, where he is set to remain under "mansion arrest" as the U.K. decides whether to extradite him to Sweden for questioning over sexual-misconduct allegations.

Mr. Assange's release was the latest development in an odyssey in which—amid criticism from the U.S. government over the release of thousands of classified documents—he has become enmeshed in sex-related allegations that ultimately led to his arrest in the U.K. last week.

The 39-year-old Australian had been held in U.K. police custody for nine days on a European arrest warrant issued by Sweden on the sex accusations. He was granted release from prison on £200,000 ($310,880) bail Thursday, after a U.K. court struck down an appeal that sought to keep him in custody as a flight risk.

"I hope to continue my work and continue to protest my innocence in this matter," Mr. Assange said after exiting the Royal Courts of Justice in London around 6:00 Thursday evening. He thanked his supporters, his lawyers, those who provided money for his bail and the British justice system.

"During my time in solitary confinement in the bottom of a Victorian prison, I had time to reflect on the conditions of those people around the world also in solitary confinement," Mr. Assange said after his release, advocating for the rights of fellow prisoners.

Mr. Assange had been held in U.K. police custody for nine days on a European arrest warrant.

Mr. Assange was initially granted bail on Tuesday, but British litigators acting for Sweden quickly appealed that ruling. In a hearing on Thursday, the U.K. High Court turned down the appeal.

As he awaits a formal extradition hearing early next year, Mr. Assange must wear an electronic monitoring tag, observe a curfew, check in with police every day and spend every night at the same location—an estate in the English village of Bungay, northeast of London. Mr. Assange is expected to appear in court next on Jan. 11.

The Georgian manor where Mr. Assange will be confined, Ellingham Hall, is owned by former British journalist Vaughan Smith and set on hundreds of acres. Mr. Assange's attorneys have jokingly referred to his confinement there as "mansion arrest."

Mr. Smith, a former captain in the British army, started the Frontline Club, an organization for journalists in London that supports freedom of the press and free speech. Mr. Smith met Mr. Assange for the first time in July before an event at the Frontline Club, according to the lawyer representing Swedish judicial authorities at Thursday's hearing.

The U.K. appeals-court judge on Thursday added further conditions to Mr. Assange's bail—requiring that he stay confined to the "bricks and mortar" portion of the country estate and necessitating that more people, known as "sureties" in the British legal system, be held liable for Mr. Assange's whereabouts.

Sweden's case against Mr. Assange comes as his website, WikiLeaks, continues to cause a firestorm by gradually leaking thousands of classified cables. Earlier this year it released thousands of classified files about the war in Afghanistan.

Swedish prosecutors have alleged that Mr. Assange raped one woman and molested another over the course of a single week in August, when he was visiting Sweden for a seminar, but they haven't filed formal charges against him.

One of the Swedish women alleges Mr. Assange forcibly held her arms and prevented her from moving, and had sexual intercourse with her without using a condom, despite knowing the prophylactic was a prerequisite for her. The other woman alleges Mr. Assange had sex with her while she was asleep, again failing to wear a condom despite knowing she required it.

Mr. Assange has denied the allegations and called them a smear attempt. His attorney, Mark Stephens, said in an interview last week that he believes the Swedish case is a "holding offense" that allows authorities to detain Mr. Assange while the U.S. builds a case against him. Sweden, however, has denied the case is politically motivated.

At Thursday's appeal hearing at the Royal Courts of Justice, Mr. Assange was expressionless as he sat in an iron cage.

Gemma Lindfield, the British lawyer representing Sweden, tried to paint a picture of a rootless Mr. Assange being able to easily abscond before extradition, thanks to access to cash from WikiLeaks supporters.

She also warned that the British residents vouching for Mr. Assange and offering money as collateral for his bail were fighting for a cause rather than giving personal assurances.

Geoffrey Robertson, the trial lawyer representing Mr. Assange, dismissed those claims. "There is not an iota of evidence" showing Mr. Assange is likely to flee, Mr. Robertson said.

EUROPE NEWS

Three possible scenarios for next big shift in Europe

By Marcus Walker

Reuters

Clockwise from bottom left, European Commission President José Manuel Barroso, Slovenian Prime Minister Borut Pahor, Portuguese Prime Minister José Sócrates, German Chancellor Angela Merkel and French President Nicolas Sarkozy take a 'family photo' during the European Union summit Thursday.

For the past year, Europe has sought to manage the financial crisis with stopgap measures. Now, with Greece and Ireland under the virtual stewardship of the EU and International Monetary Fund and Portugal threatened with a similar fate, there's a growing recognition across Europe that policy makers are running out of options.

As the crisis enters its decisive phase, the big question is what the endgame will look like. Will worsening market panic force the EU to take dramatic new steps? Here's a look at three scenarios: fiscal union, restructuring or breakup.

FISCAL UNION

Debt restructuring could be one part of the longer-term resolution of the crisis, together with a move towards deeper European integration to harness the region's collective strength.

The 16-nation euro zone is one of the financially healthier parts of the Western world if viewed as a whole. The bloc is on course for a budget deficit of just 6.3% of GDP this year, compared with 11.3% in the U.S. and 10.5% in the U.K. The euro zone's total public debts are headed for 92% of GDP this year, compared with 92% in the U.S. and 78% in the U.K. The euro zone has a negligible trade deficit and moderate household debt, unlike the U.S. or Britain.

But financial markets don't view the euro zone as a single entity, because its 16 national governments have chosen not to be a single creditor.

Germany in particular has resisted all proposals from EU authorities in Brussels and from Southern Europe to issue or guarantee debts collectively—a move that could swiftly reassure markets that it is safe to lend, say analysts.

"This is a political crisis, not an economic one, because European governments could put this crisis to bed," says Simon Tilford, chief economist at the Center for European Reform, a London think tank. "If you take the aggregate picture, the euro zone doesn't have a problem," he says.

German Finance Minister Wolfgang Schäuble says creating a full-blown fiscal union might prove necessary. But he admits selling the idea to skeptical European publics, whose loyalties remain largely national, will be difficult.

Some say an indirect route is more viable. "What the region really needs is a one-off fiscal transfer," says David Mackie, economist at J.P. Morgan in London.

If around €350 billion ($462 billion) were transferred to Greece, Ireland and Portugal, then these countries' debts would be reduced to a manageable 60% of GDP, while public debt in Europe's core economies would rise by only five percentage points, says Mr. Mackie, who excludes Spain from his calculation because it is in its own category, with a hefty budget deficit but moderate total public debt.

A fiscal transfer wouldn't remove the need for fiscal austerity to bring down budget deficits, nor the need for economic overhauls including lower wages to restore countries' competitiveness. But it would give such bitter medicine the chance to work, by freeing nations from unmanageable debt.

One route would be for the EU and the ECB to prolong and eventually forgive their loans to stricken euro members, which are steadily replacing private-sector lending to the euro-zone periphery.

German lawmakers wouldn't like it, but alternative may be an ever-worsening crisis for Europe. "We need to forgive our neighbor as much for our own benefit as for theirs," says Mr. Mackie.

RESTRUCTURING

A debt default by a euro member or two—also known as a restructuring when that is done after talking with creditors—requires much less fantasy to believe in, most observers agree.

Cutting the debt burden could haul drowning countries back onto dry land. Greece, Ireland and Portugal, demonstrably solvent again, could even return to bond markets, although they might have to pay higher interest rates than in the past to win back investors.

A restructuring wouldn't remove the need for painful budget overhauls. Governments would still have to stick to their austerity pledges, or else large new annual borrowing would land them in deep water again after only a few years. But at least austerity would offer more hope than at present.

But the scenario would cause two headaches for the rest of Europe, which explains why Germany, France and co. have denied the stricken countries any debt relief.

Big write-downs of euro-periphery bonds could expose the threadbare capital cushions of many banks in Europe's core economies. The last thing German Chancellor Angela Merkel and French President Nicolas Sarkozy want is another unpopular round of taxpayer bailouts for their country's banks.

Worse, EU leaders fear that even contemplating a debt restructuring in one country could trigger massive speculation about which other countries' debt won't be repaid in full. The crisis could spill over into new countries far more quickly and emphatically than at present.

Even the EU's limited proposal that new bonds issued after mid-2013—and only those bonds—will contain clauses that might, under some circumstances, allow a restructuring of a stricken country's debt was enough to unsettle markets in recent weeks.

Germany, which forced the idea on its EU partners, has repeatedly said existing debt won't be affected. But the proposal has convinced many investors that debt defaults by Western European governments—unheard-of in the postwar era—are no longer taboo.

They may be right to worry. One possibility is that European governments, despite their denials, will allow the crisis countries to restructure their debts in 2012 or 2013. By then, banks in Europe's core economies may be better able to take the hit, while shaky-but-solvent governments such as Italy's will have had time to improve their finances.

BREAKUP

Some economists are convinced that the euro zone will have to break up.

The fundamental problem, they say, is that some countries have become deeply uncompetitive inside the euro, because their labor and other business costs have risen faster than in more efficient economies such as Germany.

Reintroducing a national currency would allow a country to lower its exchange rate, making its goods more affordable in the rest of Europe. Then an export-led recovery could make it much easier to repair government and private-sector finances.

"Countries in the periphery might do well to consider the advantages of an early exit from the euro, which might facilitate the needed fiscal adjustment without provoking the deepest of domestic economic recessions," says Desmond Lachman, a fellow at the American Enterprise Institute.

If one country on the euro-zone fringe were to leave, markets would probably speculate against other countries with low growth and high debts, leading to the unraveling of the currency zone. Mr. Lachman predicts this will happen in the next 12 to 18 months.

There are huge risks in switching from the euro to a falling national currency, say analysts who have studied possible scenarios. The move would probably trigger the collapse of the banking system and bond market, as much of the local population as well as foreign investors moved their savings and financial assets out of the country to protect their wealth from being redenominated in a fast-depreciating new currency.

Sharply higher costs of servicing foreign debts that were still denominated in euros could lead to mass defaults by households and businesses as well as government. A sudden end to new foreign borrowing could force instant elimination of budget deficits because countries would lose access to capital markets. That, in turn, could push countries from recession into a full-blown depression.

"Attempting to exit the euro area would be the equivalent of burning down your own house in order to find a way out," says University of California at Berkeley economics professor Barry Eichengreen.

A rush for the exit in Greece could also trigger a stampede in other countries that were seen as at risk of dumping the euro.

Even Germany would pay a high price if it abandoned the euro. Its banks have lent heavily to the rest of the euro zone, and would face huge write-downs on assets that were suddenly in a weaker foreign currency.

EU endorses bailout fund but discord still remains

Continued from first page

their bickering aside, they risk triggering the unthinkable: the implosion of the euro.

Longtime supporters of European integration are pushing for bold political action to demonstrate that Europe will do whatever it takes to defend the euro. A failure of the currency, the most profound symbol of European unity, could harken the collapse of the EU itself, they argue.

"If the euro zone pulls apart—and there are people who now say that is thinkable who two years ago said it was unthinkable—the question is what the European Union then is," says Timothy Garton Ash, professor of European studies at the University of Oxford.

Such sentiments have evoked painful memories of Europe's exchange-rate mechanism, a system of currency bands between EU countries that nearly collapsed in 1992 after speculators forced the U.K. to withdraw by betting against the pound. The EU managed to overcome that setback and introduce the euro seven years later, but skeptics say that the same economic divergence that undid the ERM may eventually doom the euro.

Protecting Europe's historic experiment with a common currency "would require tremendous leadership and statecraft, which I do not see at the moment," Mr. Garton Ash says.

The ECB has relieved some of the pressure in recent weeks by purchasing billions of euros of bonds in those countries most exposed to the crisis. Yet ECB President Jean-Claude Trichet has made it clear that it is up to Europe's governments to devise a more permanent solution to the region's financial woes.

In the view of many observers, that can mean only one thing—fiscal union. The flaw in the euro zone's makeup is that the ECB sets monetary policy across the bloc, but each of its 16 member states issues its own debt and EU rules prohibit one country from subsidizing another.

Economists have long viewed the euro area's lack of fiscal coordination as its Achilles' heel, leaving it exposed to crises such as the current one. Yet for Germany and other countries at the area's economic core, the euro zone's fiscal delineation, which prevents poorer countries from leaning on healthier neighbors, is sacrosanct.

"In this crisis Europe will find steps toward further unification," German Finance Minister Wolfgang Schäuble said in an interview this month.

For the past year, Europe has sought to manage the crisis with stopgap measures. Now, with Greece and Ireland under the virtual stewardship of the EU and International Monetary Fund and Portugal threatened with a similar fate, there is a growing recognition across Europe that policy makers are running out of options.

Spain, a far larger economy than Ireland or Greece, is in jeopardy due in a part to unknown losses in its banking system as its housing bubble deflates.

—Ian Talley contributed to this article.

Fears grow over Spain's home loans

By Sara Schaefer Muñoz

For months, Spain's residential mortgage sector has performed an impressive feat: Despite tumbling home prices and sky-high unemployment, just a small portion of mortgage borrowers have fallen behind on their payments.

Now, some analysts and economists are wondering if Spain is set up for a wave of defaults in coming months amid further government job cuts meant to address the country's broader economic problems.

While banks' biggest problem now is loans to real-estate developers, "there are signs that the residential segment could become more stressed if unemployment remains high," said Luis Garicano, a professor at the London School of Economics. "And if interest rates go up, families could be really stretched."

The resilience of Spain's residential-mortgage sector has been a key plank in Spanish officials' defense of the country's financial system, which has faced increasing doubts about its health in recent weeks.

The €67.5 billion ($89.2 billion) international bailout of Ireland has investors worried that troubles in Spain's banking sector could require Spain to seek aid, too.

Last week, Spanish Finance Minister Elena Salgado told a group of European finance ministers that despite Spanish banks' exposure to the country's troubled construction sector—where about 11% of the loans are judged to be troubled—their residential loan operations are mundane.

Agence France-Presse/Getty Images

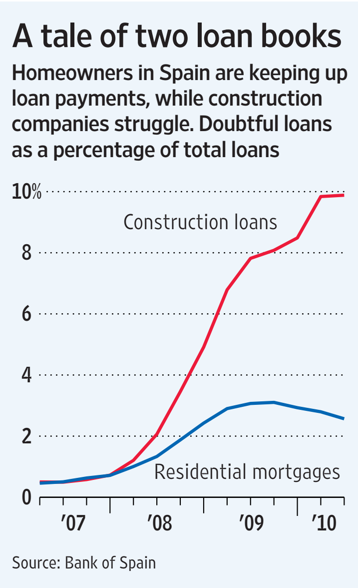
In Spain's housing crisis, homeowners have kept up payments on mortgages.

The "retail residential business in Spain is plain vanilla," read one slide shown at the presentation, noting very little lending in riskier segments such as buy-to-rent, as well as high loan-to-value ratios. "Stress tests show that hypothetical losses...are considerably lower in this portfolio than others."

Indeed, the percentage of "doubtful" mortgage loans—meaning loans more than 90 days past due or which are for some other reason unlikely to be paid in full—was just 2.6% of Spanish residential mortgage lending as of the second quarter, despite falling house prices and an unemployment of 20%. The ratio is down from 3.1% a year earlier, its peak since the start of the crisis.

There are valid reasons for Spain's loan-loss rate to be low. Most loans are on first homes, rather than vacation or investment properties, and if a debtor defaults, he or she carries that mortgage debt for at least 15 years—a powerful incentive to keep up payments, even if the home price has fallen below the value of the mortgage.

In addition, the average loan-to-value ratio on Spanish residential mortgages is low at around 60%, compared with the ratios of 100% or more on many of the troubled mortgages in the U.S. housing crisis.



Another explanation for the low amount of delinquencies is that Spain's actual unemployment is believed by some analysts to be much lower than the official 20% figure, thanks to a thriving black-market economy in sectors such as agriculture and services. And if people do lose their jobs, family members help each other out, and benefits are generous.

But there are indications that these rosy figures may not last. Any interest-rate rise to combat inflation will put pressure on households, which economists say already devote a large chunk of their income to mortgage payments. About 95% of Spain's mortgages are adjustable, and pegged to the very low Euribor, Europe's base interest rate.

Also, loans that have been modified or forgiven for a short period don't usually show up in the "doubtful" ratios. Banks and lawyers say lenders are increasingly willing to strike deals with struggling borrowers instead of foreclosing or accumulating more problem loans.

"I tell people to negotiate with the bank," said Maria Luisa de Castro, a property-lawyer in Spain's southern city of Algeciras who has worked with clients struggling to make payments. "The banks don't want more [foreclosed] properties," she said.

It is unclear how many of Spain's home loans have been modified. According to Spain's National Institute of Statistics, residential mortgages have been modified at an average rate of 25,000 per month, although banks aren't obligated to register all types of mortgage modifications.

These maneuvers let the banks avoid marking loans as delinquent, which eats away at profitability and can also increase their funding costs in the bond markets.

Analysts and economists say these moves make sense in the short term, though questions remain whether the vulnerable borrowers will be able to pay in the future and banks are kicking losses down the road.

ECB boosts capital in a warning on risk

By Brian Blackstone

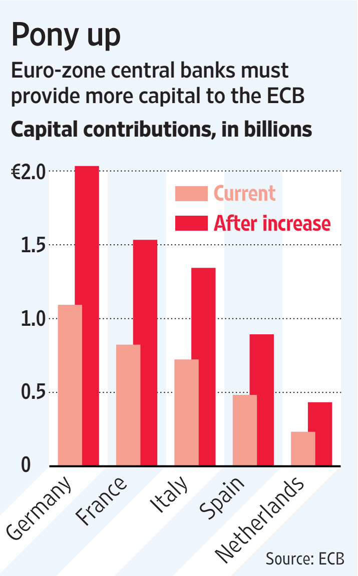
FRANKFURT—The European Central Bank covered its flank against possible future losses associated with its financial support measures, a stern reminder to government leaders that the ECB's unprecedented foray into government bond markets carries risk.

The ECB will nearly double its capital base, to €10.8 billion ($14.28 billion) from €5.8 billion, citing "increased volatility in foreign-exchange markets, interest rates and gold prices as well as credit risk." The ECB made the decision at its regular midmonth meeting.

The central bank has kept its capital base unchanged for 12 years, even as its asset holdings have ballooned to around €2 trillion since the onset of the financial crisis more than two years ago. The latest rise reflects the need for "adequate capital base in a financial system that has grown considerably," the ECB said.

Even a doubling of the ECB's capital leaves it highly leveraged. Still, the ECB has considerable resources at its disposal. It has vast holdings of ultra-safe assets such as gold.

However, by approving a capital hike, the ECB sends a powerful signal to government leaders meeting in Brussels Thursday and Friday that the central bank's generous loans to banks and its purchases of government bonds of the region's weakest countries "aren't without risk," says Carsten Brzeski, economist at ING Bank in Brussels.



ECB President Jean-Claude Trichet has pressed government leaders to buttress their own crisis-response capabilities, and on Monday called for "maximum flexibility and for maximum capacity" in the use of the EU's €440 billion rescue fund. Germany, in particular, has resisted increasing the size of the fund, and EU leaders show little interest in turning the fund into a vehicle that can intervene in markets. That leaves the ECB as the sole body that can quickly intervene rapidly to prevent contagion from spreading from Greece and Ireland to other at-risk countries such as Portugal, Spain and Italy.

Natalia Ablozhej for The Wall Street Journal

Poet Vladimir Niklyayev, one of nine candidates opposing Belarussian President Alexander Lukashenko's re-election, speaks on the campaign trail. Polls show Mr. Lukashenko winning at least 60% of votes.

Ruler feels pinch of lost Russian aid

BY RICHARD BOUDREAUX

MINSK, Belarus—Europe's longest-serving president staged a gala concert the other night to renew a paternalistic bargain with his people: another half decade of stability, order and growth, in return for acceptance of his authoritarian rule.

"I guarantee you and your families a secure and peaceful life in their land, an opportunity to study, work and live in safety," Alexander Lukashenko told the crowd of 15,000 people, most of them too young to remember any other leader of this former Soviet republic.

But as voting began this week in an election he is certain to win, the Russian largesse that has fueled years of rising incomes, welfare benefits and near-full employment is dwindling. The changes threaten a reversal of fortunes and a loss of faith in Mr. Lukashenko, who has run Belarus since 1994.

To offset his dependence on the Kremlin, the 56-year-old leader has started buying Venezuelan oil and courting the U.S. and European Union, which he had demonized for imposing sanctions on him and his officials years ago after the murders and disappearances of some of his opponents.

Western governments want to see Belarus as a buffer against Russian influence in Eastern Europe. But Mr. Lukashenko's hopes for their assistance, Western officials say, depend on how the election is judged: When balloting ends Sunday, international monitors who have accused him of rigging every previous vote his government has conducted must declare this one to be fair.

Many Belarussians are feeling the economic pinch already, and daring to air their complaints. Rising gasoline prices earlier this year ignited a rare protest in which dozens of motorists tied up a filling station for hours by buying half a gallon at a time and then lining up again at the pump.

Some single mothers earning the minimum wage say inflation has left them so short of cash that they must borrow to pay for medicine if a child catches a cold. Many retired people struggle on less than the promised minimum pension of $200 per month.

"We're like third-class citizens, we pensioners. Nobody needs us," Olga Alexandrova, a 75-year-old retired nurse who earns $170 a month, said Sunday at a town meeting with an opposition candidate in Soligorsk. Her doctor had ordered an ultrasound of her diseased liver, but because of medical service cutbacks, she said, she must wait 10 weeks for the procedure.

To be sure, most Belarussians are better off than they were the last time they re-elected Mr. Lukashenko, in 2006. Wages have nearly doubled in dollar terms, the economy has grown an average of over 7% per year, and every second household owns a car. With most of the economy in state hands and no stock market, Belarus' 9.5 million people were cushioned from the world financial crisis.

Economists say a crunch is soon to come. A pre-election borrowing spree has left the country with $11 billion in short-term debt, and hard-currency reserves have fallen to less than the value of two months' worth of imports. The Finance Ministry says the latest round of wage increases may be rolled back.

Russia has slashed its annual subsidies on oil and gas for Belarus from $13 billion, or about one-seventh of this country's gross domestic product, to $3.6 billion over the past four years.

Angered by the subsidy cutbacks, Mr. Lukashenko sparred publicly with the Kremlin for months before patching things up last week. He agreed to join an expanded economic union with Russia and Kazakhstan, paving the way for Russian companies to buy assets in Belarus. In return, Russia will stop charging Belarus customs duties for Russian crude oil, but start collecting export duties on the Russian oil Belarus refines and sells abroad.

The accord boosted Mr. Lukashenko with voters by enabling the state-controlled media to portray him as a pragmatic dealmaker. But while he staved off a halt in Russia's oil assistance, independent analysts say the deal reduced Belarus's oil subsidy to $1.5 billion next year, the lowest ever.

"Every Socialist country can be sustained only with outside help, and our help from Russia is disappearing," says Jaroslav Romanchuk, an economist running for president from the pro-Western United Civic Party. "Mr. Lukashenko can appoint himself president, but his populist approach is exhausted. It will be a pyrrhic victory."

The likelihood of a payoff for Mr. Lukashenko's opening to the West also seems limited, although some leaders there are encouraged.

Belarus backed the Obama administration's nuclear-disarmament campaign by pledging this month to give up its uranium stocks. Accepting recommendations by the Organization for Security and Cooperation in Europe, Mr. Lukashenko made it easier for opposition candidates to register for the election and to attack him on state television.

Polish Foreign Minister Radoslav Sikorsky said last month that Belarus could expect $3.5 billion in loans and credits from the EU if the election is free and fair—an estimate other EU officials say is high.

Oleg Manaev, an independent pollster, says Mr. Lukashenko could win 60% of the vote without cheating. But the Central Election Commission resisted demands for more-transparent ballot counting in the country's 6,830 precincts, and it limited to 183 the number of precincts where opposition representatives will take part in the count.

The commission ruled out independent monitoring of ballot boxes at night during the five days of early voting nationwide. Mr. Lukashenko has said he expects to win 70% to 75% of the vote.

Anticipating fraud, opposition candidates have called their supporters to rally Sunday night in defense of their votes. A similar demonstration after the 2006 election was crushed by the police and failed to shake what the Bush administration then called "the last true remaining dictatorship in Europe."

The opposition's weakness discouraged Svetlana Vetrova, a 42-year-old artist who had voted that year against Mr. Lukashenko and taken part in the protest. This time she's voting for him. "The opposition is just noise and nothing else," she says. "At least our president is getting us through the world recession. We need stability now, not change."

Agence France-Presse/Getty Images

Lukashenko addressed the national assembly in Minsk last week.

Staying power

Highlights of Lukashenko's rule

- **1994** Wins presidency thanks to voter frustration over post-Soviet hardships.
- **1996** Referendum expands his powers and extends his term.
- **2001** Elected to second term.
- **2004** Wins referendum to end presidential term limits.
- **2006** Re-elected. U.S. brands his regime 'Europe's last dictatorship.'
- **Dec. 14-19** Elections expected to seal a fourth term.

Fight breaks out in Ukraine Parliament

BY JAMES MARSON

KIEV, Ukraine—A fight in Ukraine's parliament Thursday left opposition lawmakers bloodied and with broken bones after they protested against the opening of a criminal case against their leader, former Prime Minister Yulia Tymoshenko.

Deputies from Ms. Tymoshenko's bloc had physically blocked the work of Parliament and hung signs reading "Stop the political repressions" a day after prosecutors filed the case. The opposition leader is accused of mishandling hundreds of millions of dollars when she was in office.

In the evening, scores of deputies from the pro-presidential Party of Regions stormed the podium and, after a fight involving fists and flying chairs, forced opposition deputies out of the parliament hall.

Five opposition lawmakers were taken to a hospital—one with a broken jaw, one with a broken hand, and three with concussions.

Ms. Tymoshenko and her allies have accused President Viktor Yanukovych of cracking down on the opposition since he defeated her in an election in February. A number of officials who served in her government have been detained or are under investigation for alleged abuse of office. The authorities say they are fighting corruption.

Prosecutors questioned Ms. Tymoshenko on Wednesday and banned her from leaving Kiev. She denied claims that as prime minister she used government funds raised in 2009 by the sale of carbon credits, which under international treaty must be used for emission-reduction projects, to pay pensions during a recession.

The fight was the third in the parliament hall in the past year. Eggs and fists were thrown in the chamber in April during a debate on an agreement to extend the Russian Black Sea Fleet's lease.


DOUBLE ISSUE
DECEMBER 27, 2010 / JANUARY 3, 2011
Person of the Year
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EUROPE NEWS

Turkish coup trial puts military on the defensive

By Marc Champion

SILIVRI, Turkey—Some two hundred Turkish generals, admirals and other officers crammed into a massive court room outside Istanbul Thursday, charged with attempting a coup d'état in a case that has split the nation and weakened its once all-powerful military.

The defendants are accused of creating a plan to overthrow the Islamic-leaning Justice and Development Party, or AKP, just months after it was voted into government in 2002. The alleged "Sledgehammer" plot was exposed earlier this year, triggering waves of arrests among the cream of the North Atlantic Treaty Organization's second-largest armed forces.

Whether the plot in fact existed is unclear. Discrepancies in the alleged coup documents raise doubt over whether they were written in 2002 as claimed, or after 2008, which would suggest they were fabricated. Yet the case has brought into the open the bitter struggle for power between the ruling AKP and determined opponents in the old secularist establishment, a struggle the government is winning.

On Thursday, Turkey's armed forces appeared to be on trial. The two hundred active-duty and retired officers from the army, navy, gendarmerie and air force faced the tribunal above them from within a pen at the center of a court the size of a basketball arena. It took three hours just to identify the suspects.

Reuters

Celal Ulgen, Gen. Dogan's lawyer, spoke to media earlier this year.

Among the 196 defendants are former commanders of the Air Force and Navy, as well as the alleged ringleader, then-commander of the 1st Army, Gen. Cetin Dogan.

The trial "is a campaign to erode everything the nation depends on," Gen. Dogan said in an interview at his elegantly furnished Istanbul apartment shortly before Thursday's trial opening. He denied taking part in a coup plot.

The alleged plot envisaged blowing up mosques during Friday prayers, random assassinations of Christian minority leaders and the downing of a Turkish jet, to be blamed on Greece. The alleged plans had names such as Beard, Thunderstorm and Chainsaw. All were designed to create the environment for a state of emergency and coup, according to the indictment.

"In 2003, all the military thought they were gods and that they could do anything they wanted," said Mehmet Baranasu, the journalist who says he was given the suitcase of documents and CD-ROMs that launched the case by a mole in the army. "I caught them."

To some Turks, Gen. Dogan personifies decades of military repression in the name of saving democracy.

"The military should have fired Dogan for breach of discipline," says Gareth Jenkins, an expert on Turkey's military and skeptic on Turkey's mass trials. "But there wasn't a coup plot."

The Sledgehammer trial was adjourned Thursday to Dec. 28, and is likely to continue for years. The presiding judge, who had been criticized in progovernment media, was replaced just days before the trial. Meanwhile, prosecutors last week said they seized nine new sacks of secret documents, some related to the Sledgehammer case.

Europe's debt crisis needs politically bold solutions

[Brussels Beat]

By Stephen Fidler

European Union leaders gathered Thursday night in Brussels for their last scheduled summit of the year amid little optimism that their extraordinary efforts over the past year have resolved the debt crisis that has enveloped the euro zone.

In a manner unthinkable 12 months ago, they have secured commitments of close to €900 billion ($1.19 trillion) to rescue countries in crisis. They have agreed on a €110 billion bailout for Greece and a €67.5 billion rescue for Ireland. They were expected at this summit to agree on a permanent rescue fund to deal with crisis-hit economies after 2013. But it doesn't look like enough to stop the rot.

According to the International Monetary Fund, most of the countries on the euro zone's periphery will need to issue bonds equivalent or greater than a fifth of the gross domestic product in the 15 months to the end of 2011. For Spain, it's 19%; for Portugal, 20.7%; and for Italy, 24.6%. (That's not unusually high: the U.S. equivalent is 27.2% and Japan's 59.1%. But it's a lot if investors lose confidence.)

Impressive as these numbers are, they don't tell the whole story. That's because of the object lesson provided by Ireland. Take the banks out of the picture, and Ireland's public finances looked great. But the 2008 decision by the Irish government to guarantee all the banks' depositors and most of their creditors resulted in intertwining the fate of the country and the banks whose financial health had been battered by a collapsing property market.

The big worry for 2011 is that Ireland isn't the only place where the financial destinies of governments and banks are intermingled. Not only do governments need to raise pots of money next year, but so do banks.

Spain's banks are a third the size of Ireland's in relation to the size of the countries' economies, and Spain's real-estate collapse doesn't look as bad. Yet, according to Moody's Investors Service, Spain's central government needs to raise €170 billion in 2011. But its regional governments also need to raise a further €30 billion and its banks must refinance some €90 billion of debt.

According to the Institute of International Finance, a trade group that speaks for big international banks, governments in Europe need to raise $2 trillion in 2011 and banks will need to refinance $1 trillion of debt. (The numbers for the U.S. are larger: $3 trillion for the government and $1 trillion for the banks. But the U.S. government as yet has seen only modest resistance to its debt sales, and there is more confidence that its banks are sound.)

"Weaker credits will continue to face wide spreads on their borrowings. In this situation of risk sensitivity, countries with relatively large refinancing requirements next year, or those dependent on external financing, are in a position of vulnerability," the IIF says.

Research published Thursday by Evolution Securities suggests that investor perceptions of bank risk are closely tracking perceptions of government risk not only in Ireland—but also in the rest of the countries on the edge of the euro zone, in Greece, Spain and Italy.

This suggests that a solution to the crisis now has to incorporate a convincing exit for governments—Willem Buiter, chief economist of Citigroup, has suggested a €2 trillion bailout fund is necessary to be big enough to cover Portugal, Spain, Italy and Belgium—but also for banks.

Ideas include pooling the euro zone's resources, coupled with a European version of the U.S. Troubled Asset Relief Program, to lift worries about the banks.

In a report also out Thursday, Thomas Klau and François Godement of the European Council on Foreign Relations say that the bickering among national leaders since the start of the crisis has undermined the euro zone.

"Even worse, the failure to agree on a genuine European plan for dealing with losses in the financial sector meant that individual member states had to take full liability for [bank] rescue operations they could hardly afford," they write.

The solution to this requires a pooling of the euro zone's resources, they suggest, to deal with governments' financing difficulties. Given the likely political resistance to devolving power to the EU itself, they suggest this is more likely to happen through a euro bond. That would combine the weight of the bloc's member states, potentially rivaling the U.S. Treasury market in size and liquidity, and sharply reducing the scope for speculation against individual countries.

This would need, they say, to be coupled with a European version of the U.S. Troubled Asset Relief Program to lift worries about the banks.

As EU leaders gathered Thursday, none of these ideas were on the official agenda. From the public statements of leading German government officials, it appears Berlin is not ready yet to discuss such proposals.

But in an interview with The Wall Street Journal last week, German Finance Minister Wolfgang Schäuble hinted that, with time, this resistance could soften. The question for 2011 is whether anything Germany is likely to see as politically acceptable will be enough to stop this crisis in its tracks.

U.S. urges Web privacy 'bill of rights'

BY JULIA ANGWIN

The U.S. called Thursday for the creation of a Privacy Policy Office that would help develop an Internet "privacy bill of rights" for U.S citizens and coordinate privacy issues globally.

The U.S. Commerce Department's report stopped short of calling directly for specific privacy legislation. Instead, it recommends a "framework" to protect people from a burgeoning personal data-gathering industry and fragmented U.S. privacy laws that cover certain types of data but not others.

The report marks a turning point for federal Internet policy. During the past 15 years of the commercial Internet, Congress and executive branch agencies have largely taken a hands-off approach to the Web out of a concern that a heavy government hand would stifle innovation.

The report cites comments from major technology companies, including **Microsoft** Corp. and **Google** Inc., expressing concerns about the current patchwork of rules and guidelines governing online privacy.

The 88-page Commerce Department report states that the use of personal information has increased so much that privacy laws may now be needed to restore consumer trust in the medium.

The report is preliminary and will be completed next year. At that time, the administration is expected to make more specific legislative recommendations.

The Commerce Department says privacy laws may now be needed to restore consumer trust in the Web.

The report rejects the current state of Internet privacy notices. It says people shouldn't be expected to read and understand the legal jargon contained in privacy policies "that nobody understands, if they say anything about privacy at all."

A better approach, the report suggests, might be for companies to conduct privacy impact assessments that would be available to the public. Such reports "could create consumer awareness of privacy risks in a new technological context," the report said.

The Commerce report says people should be notified when data about them is being used in a way that is different than the reason for which it was collected. "Consumers need to know that when their data are re-used, the re-use will not cause them harm or unwarranted surprise," the report says.

It calls for a Privacy Policy Office that would "serve as a center of commercial data privacy policy expertise." The agency wouldn't oversee government use of data or existing health- and financial-privacy laws. Instead, it would aim to help the personal data-gathering industry develop codes of conduct that could be enforced by the Federal Trade Commission.

The report also calls for the development of a national data-breach law that would make it easier for companies to navigate the current patchwork of state data-breach laws.

It also calls for strengthening the existing wiretapping law—written in 1986—to protect more types of data from government surveillance.

Bloomberg News

A U.S. report recommends a 'framework' to protect people from a growing personal-data-gathering industry. Above, a Google Street View car in California. The mapping service's data collection has raised concerns in several countries.

Spending bill tests Republicans' resolve

BY BRODY MULLINS AND COREY BOLES

A $1.1 trillion Senate Democratic plan to fund the federal government—a nearly 2,000-page document that includes about 6,700 earmarks—is drawing fire from conservative groups and some Republicans, setting up a test of GOP resolve to cut spending.

The proposal, made public Tuesday by Senate Appropriations Committee Chairman Daniel Inouye (D., Hawaii), contains billions of dollars of earmarks requested by lawmakers from both parties, challenging GOP vows to rein in federal spending.

Some of the conservative groups that fueled GOP gains in the midterm elections expressed outrage Wednesday at the Democratic bill, and some Republican lawmakers joined the chorus.

"Americans told Democrats last month to stop what they've been doing: bigger government, 2,000-page bills jammed through on Christmas Eve, wasteful spending," said Senate Minority Leader Mitch McConnell (R., Ky.). "This bill is a monument to all three."

Mr. McConnell is one of the lawmakers who requested earmark spending—funding for local projects that lawmakers insert in spending bills—including $650,000 for a genetic-research center at the University of Kentucky, according to information compiled by Taxpayers for Common Sense, a fiscally conservative group. Mr. McConnell has defended the requests, saying they were made before it became clear the appropriations process would end in a huge, end-of-the-year omnibus bill.

Associated Press

Republican Sens. John Cornyn, left, and John Thune oppose the $1.1 trillion omnibus spending bill.

Sen. Robert Bennett (R., Utah), a retiring member of the appropriations panel, said he would support the bill. In doing so, he defended earmarks, arguing it was Congress invoking its prerogative to direct how government agencies should spend money allocated to them.

"If the Congress doesn't say 'spend it here,' the president says, 'OK, I get to decide where to spend it,' " Mr. Bennett said.

Senate GOP leaders have pledged to fight the measure when it comes up for a vote, possibly over the weekend. While some Senate Republicans have said they would support the bill, it wasn't clear whether Democratic leaders had the 60 votes needed to push it through.

Sen. Claire McCaskill (D., Mo.) said she planned to vote against the bill because it didn't include a three-year cap on discretionary spending that she and others have sought.

In the House, GOP leaders have said they would oppose the Senate bill if it reached them. Democrats hold the majority in both houses until January. Passage would require a simple majority in the House.

Congress needs to approve the measure or an earlier spending bill passed by the House by Dec. 18. Otherwise, the federal government could be forced to shut down.

The bill contains an array of earmarks backed by Democrats and Republicans. The proposal also contains funding for many projects backed by corporate lobbyists, over the opposition of the Obama administration, including $450 million for **General Electric** Co. to build a second version of a jet engine for the Pentagon's next-generation fight jet, called the Joint Strike Fighter.

The fighter-jet-engine issue could be crucial to some lawmakers' votes. Connecticut Sens. Joseph Lieberman, an independent, and Democrat Christopher Dodd both expressed opposition to the GE engine appropriation.

Wednesday, Defense Secretary Robert Gates called on Congress to pass an omnibus spending bill rather than continuing current levels of spending, which would happen under the House bill.

Among the earmarks in the bill: $10 million from House Democrats to help establish the John P. Murtha Foundation in honor of the late House member and $8 million for an institute named after the late Sen. Ted Kennedy (D., Mass.).

Some earmarks in the bill were sponsored by Republican lawmakers who voted recently for a moratorium on earmarks, including Mr. McConnell.

House Republicans have adopted a ban on earmarks for the coming legislative session. But some Republicans say the earmark ban covered future spending bills, while the bill under debate funds the government for the current fiscal year.

Tea-party activists, fiscally conservative organizations and some GOP lawmakers say the earmark spending should stop now and are rallying opposition to the measure. "This is absolutely outrageous. Did these people forget Nov. 2 already?" asked Amy Kremer, the chairman of the Tea Party Express.

The fiscally conservative Club for Growth predicted that primary challengers will emerge for Republican lawmakers who vote for the legislation. A Club for Growth-backed candidate derailed Utah Republican Sen. Robert Bennett's re-election bid this year.

Rep.-elect Kristi Noem, a South Dakota Republican, said voters "kept telling me two things on the campaign trail this year: First, stop spending money we don't have and, second, stop passing these large omnibus spending bills that have something for everyone."

Jobless claims decline again

BY SUDEEP REDDY

New jobless claims fell again last week, providing the latest sign that the labor market may be picking up, while an uptick in housing starts offered a modest boost for a troubled sector of the economy.

Initial claims for unemployment benefits fell 3,000 to 420,000 in the week ending December 11, the Labor Department said Thursday. The four-week moving average of claims, a measure used to smooth weekly volatility in the data, fell 5,250 to 422,750—the sixth straight weekly decline. Continuing claims, reflecting benefits drawn for more than a week, rose 22,000 to 4.14 million in the week ending December 4.

New jobless claims are down to their lowest level since the summer of 2008, before the financial crisis sent layoffs surging. The figures suggest the government's report on December employment—due early next month—will be better than the disappointing November report, which said payrolls increased by just 39,000 last month.

The report on jobless claims "strengthens our expectation that the November payrolls figure will be revised higher or that the December reading will show a nice gain," RBS economists said in a note to clients.

Meanwhile, housing starts rose 3.9% in November to a seasonally adjusted annual rate of 555,000, the Commerce Department said. The gain was driven by a 6.9% increase in new construction of single-family homes to a six-month high. Multi-family construction, a traditionally volatile measure, declined.

The figures were only a modest positive in a sector that is struggling with a glut of supply.

WORLD NEWS

Violence flares in Ivory Coast

Several protesters were killed and dozens injured Thursday after the army and police fired on supporters of the man recognized internationally as the president-elect of Ivory Coast, Alassane Ouattara.

*By **John James** in Abidjan, Ivory Coast, and **Will Connors** in Lagos, Nigeria*

Supporters were trying to take control of state television, which was still in the hands of the president for the past 10 years, Laurent Gbagbo. He refused to give up power and says he won the Nov. 28 vote.

Army soldiers loyal to Mr. Gbagbo tried to disperse opposition supporters with tear gas, and chased unarmed supporters through the streets.

The opposition said 18 of its supporters had been killed, though only three deaths have been confirmed so far.

The Ivory Coast electoral commission—backed by the United Nations—this month declared Mr. Ouattara the winner of a late-November presidential runoff. Yet Mr. Gbagbo's allies nullified enough votes for the incumbent president to claim re-election.

The incumbent Mr. Gbagbo, in addition to controlling state television, maintains control of another key lever of state power: the security forces.

His challenger, Mr. Ouattara, has the support of former rebel leaders.

Thursday's clashes follow a pledge made by Guillaume Soro, the ex-rebel leader and prime minister, to take control of the state television broadcaster later in the week. Mr. Soro vowed to hold a cabinet meeting by Friday.


Agence France-Presse/Getty Images

Supporters of Alassane Ouattara protest in Abidjan. At least three demonstrators were shot dead Thursday.

The European Union has said it will bring sanctions and issue travel bans against some Ivory Coast leaders. The sanctions are almost certain to target Mr. Gbagbo and his supporters.

On Thursday, U.N. Secretary-General Ban Ki-moon said he was "deeply concerned" about the standoff in Ivory Coast and warned that protests and clashes "could have unpredictable consequences, including reigniting civil war," according to a U.N. statement.

Mr. Ban added that "those who incite or perpetrate violence, and those who use the media for this purpose...will be held accountable for their actions."

Meanwhile, opposition supporters voiced anger at Mr. Gbagbo, who they believed orchestrated the protest crackdown.

"A peaceful march and you shoot with live rounds on the citizens, and then the man talks about democracy," said Diakete Aboubacar, who was speaking from of Abidjan. "This is not a sign of democracy—this is violence!"

The northern-based rebel movement loyal to former Prime Minister Soro—and now aligned with the opposition leader Mr. Oattara—warned the crackdown would spark a broader conflict.

"The war has started, because Gbagbo has started killing people in the streets," said Cisse Sindou, a cabinet member of the rebel movement, called the New Forces.

Political tensions and fighting have weighed on the once-vibrant Ivory Coast economy. Growth in the world's largest cocoa producer had picked up last year, marking a recovery from a 2002-2003 civil war. The November presidential runoff was meant to solidify those gains by providing a ballast of political stability. But the first election in a decade produced two self-proclaimed winners, a divided nation and a weakened economy.

U.S. finds fragile Afghan progress

BY JULIAN E. BARNES AND ADAM ENTOUS

WASHINGTON—A much-anticipated White House review of the Afghan war finds that "components" of the administration's strategy are working but that gains are fragile because of concerns about insurgent havens in Pakistan and the challenge of developing independent Afghan security forces.

The White House said the findings, however tentative, set the stage for the U.S. to begin a troop drawdown, as planned, in July. Questions remain about the number of troops that will be withdrawn, and from what parts of the country. While many in the military would like to keep a robust number of troops in Afghanistan, some in the White House want a faster pullout.

"I want to be clear. This continues to be a very difficult endeavor," President Barack Obama told reporters at the White House. "But I can report that...we are on track to achieve our goals."

The report said Taliban momentum has been arrested in much of Afghanistan, and particularly in the south, but warned that those gains could be reversed, citing the threat posed by militants in Pakistan.

Mr. Obama mandated the strategy review when he announced a surge of 30,000 additional troops into Afghanistan in December 2009, in what was a defining moment of the president's foreign policy.

Built up

Approximate number of troops deployed in Afghanistan for May of each year. The White House gives the current U.S. troop numbers as 97,500, along with 48,000 (non-U.S.) NATO forces, according to the Pentagon.

Source: Brookings Institution Afghanistan Index

In recent weeks, some officials have tried to play down the significance of the review, saying it wasn't meant to be an opportunity to rewrite strategy.

The report stops short of proposing policy changes. Officials said the full effect of the troop surge has only recently started to be felt and that it would be premature to judge how the campaign will progress.

Much of the review focused on al Qaeda's central leadership in Pakistan. While the military campaign in Afghanistan is focused almost entirely on defeating the Taliban-led insurgency, the White House has insisted their overall strategy is focused on al Qaeda.

The report says that al Qaeda's haven in Pakistan is "smaller and less secure" than it was a year ago. The report doesn't say how that might have been achieved, but the Central Intelligence Agency has stepped up dramatically the number of drone attacks it conducts in the tribal areas of Pakistan.

The White House doesn't plan to release the full review, much of which remains classified. But even in the summary document, the administration's nervousness about Afghanistan's ability to provide governance and security is clear.

"We've had progress. The question is: Is it fast enough? Is it sustainable? Will we really be able to transition?" said a senior administration official involved in the deliberations. "You can clear an area of the Taliban, but then what?"

The report emphasizes the military's expanded special operations campaigns, both to attack insurgent leaders and train local village security forces, arguing both initiatives have reduced Taliban influence.

The summary of the report cites "significant development challenges" with Afghan security forces, but provides few specifics.

Officials said the full report contains concerns about the ability of the Afghan army and police to conduct independent operations.

On Thursday, Mr. Obama emphasized the limited nature of America's war aims, arguing U.S. forces were not trying to "defeat every last threat" in Afghanistan, nor were troops engaged in "nation-building."

"Rather, we are focused on disrupting, dismantling and defeating al Qaeda in Afghanistan and Pakistan and preventing its capacity to threaten America and our allies in the future," he said.

Secretary of State Hillary Clinton dismissed suggestions the review painted a rosy picture of the security situation in Afghanistan.

"We're very clear-eyed and realistic," she said.

The White House said issues raised in the report would be addressed in meetings of the National Security Council and top military leaders. Those meetings will determine the pace of the drawdown and could result in strategy changes.

Brunei prince loses court case to lawyers

Associated Press

NEW YORK—Two British attorneys won a multimillion-dollar tussle with Brunei's Prince Jefri Bolkiah on Wednesday after a trial that provided a glimpse into the prince's jet-set lifestyle as a member of one of the world's richest royal families.

Husband-and-wife legal team Faith Zaman Derbyshire and Thomas Derbyshire could come away with more than $21 million after Wednesday's jury verdict in a New York court although the prince's side plans to challenge its findings against him.

Although it became a tabloid staple, the case was mainly a dispute over competing claims in an attorney-client relationship gone awry.

The prince said the Derbyshires abused his trust to steal from him in various schemes. They said he underpaid them and had given his permission for everything they did. Mr. Jefri had hired them partly to help him fight efforts by his sultan brother's government to get him to surrender some of his assets after he was accused of embezzlement.

"For us, yes, this is huge vindication by real people," Ms. Derbyshire said after hugging her lawyers and even jurors outside the courtroom.

Jurors awarded Mr. Derbyshire, 43 years old, more than $10 million in one piece of the case. The jury also found for Ms. Derbyshire, 34, on another issue worth $11 million. Both sides had agreed to that amount if she prevailed on that matter.

The jury did side with Mr. Jefri on one of the myriad allegations in the civil case: that one of Ms. Derbyshire's brothers had improperly charged expenses to one of the prince's corporate credit cards. Jurors awarded the prince $54,000.

The prince, who is in his 50s, wasn't in court for the verdict, though he had been a steady presence and testified during the five-week trial. Officials at one of his properties, the New York Palace Hotel—where the Derbyshires were accused of helping themselves to a generous management deal and benefits—expressed disappointment at the verdict.

"We continue to believe that based on the facts presented, the hotel has been a victim of a crude fraud scheme, and we are confident that the verdict will be overturned on appeal," the hotel and its ownership company said.

The Derbyshires portrayed themselves as collateral in the rocky legal life of an imperious prince.

Mr. Jefri is the youngest brother of Sultan Hassanal Bolkiah, the supreme ruler of oil-rich Brunei. The tiny country is on the island of Borneo in Southeast Asia.

The prince once kept a stable of more than 600 properties and 2,000 cars, according to court documents.

He hired the Derbyshires in 2004 and gave them expansive power in his legal and business affairs. "Prince Jefri gave Zaman and Derbyshire total control, and the evidence shows he was taken advantage of," one of the prince's lawyers, Geoffrey S. Stewart, told jurors in a closing argument.