U.K. banks are giving charities their expertise as well as cash
EUROPE NEWS 6

Rusal claims 'blackmail' over Norilsk buyback plan
BUSINESS & FINANCE 19

THE WALL STREET JOURNAL.

VOL. XXVIII NO. 233 | EUROPE | Thursday, December 30, 2010

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Austria's Walchhofer hits new peak

European Pressphoto Agency

Austria's Michael Walchhofer added another victory to his farewell season Wednesday, becoming the first skier to win the World Cup downhill on the Stelvio piste in Bormio, Italy, three times.

Crop prices jump to two-year highs amid heat wave

Scorching summer heat in South America is cutting harvest forecasts in one of the world's critical farm belts, helping propel crop prices to fresh two-year highs and fueling concerns about tight global supplies.

Dry weather caused by the

By Liam Pleven in New York and Matt Moffett in Buenos Aires

La Niña weather pattern is already damaging fields in Argentina, which will be the world's second-largest corn exporter this crop year and third-largest soybean exporter, according to U.S. data. The weather is also threatening crops in southern Brazil and Uruguay, which declared a state of emergency last week for farmers in the north of the country. The region's key role in world food markets means any production problems there could be felt around the world.

Weather forecasters see more withering heat and little rain on the immediate horizon, which could limit production further as recently planted corn and soybeans have reached key stages of development.

"If we don't get rains by Three Kings Day [Jan. 6], we will be looking at even more severe problems," said Ernesto Ambrosetti, chief economist at the **Argentine Rural Society**, that nation's main farmers' organization.

Prices of corn, soybean and wheat crops remain well below their 2008 peaks. But analysts figure prices for some crops could rise further as the extent of any lost production becomes clear. The result could be higher consumer prices at grocery stores.

The rise in food prices could pose a threat to global growth if fast-growing nations try to slow their economies to contain food inflation. China has raised interest rates twice in just over two months to fight inflation.

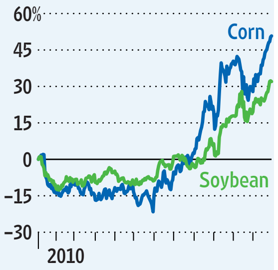
"Food inflation is becoming a problem in emerging markets," said Hussein Allidina, a commodities analyst at **Morgan Stanley**. He said corn prices could hit $7 per bushel in the first quarter of next year, compared with $6.24 per bushel on Wednesday, which he said would start to ration demand.

Smaller harvests also raise concerns that governments could limit crop exports rather than risk higher inflation or even food shortages, because of the threat of political unrest. Crop prices spiked several months ago when a drought led Russia to ban wheat exports, and Argentina

Please turn to page 3

Global threat

Change in corn and soybean futures prices front-month contract



Source: Thomson Reuters via WSJ Market Data Group

The Quirk

Boredom enthusiasts are discovering the pleasures of understimulation.

Page 29

World Watch

A comprehensive rundown of news and events from around the world.

Pages 30-31

Editorial & Opinion

What's changed in Belarus since 2006? Page 14

Holy See's new rules target money laundering

By Nathania Zevi And Sabrina Cohen

ROME—The Vatican plans to unveil new rules intended to counter financial crimes and make its financial activities more transparent, following a probe by Italian prosecutors into whether officials of the Holy See's bank broke Italy's laws against money laundering.

In a statement, the Vatican said that on Thursday it will create a financial watchdog, called the Authority of Financial Information, and set out regulations to prevent money laundering and terror financing.

"The norms that will be adopted tomorrow deal with antimoney-laundering and antiterrorism, and these are the things for which we are being prosecuted by the Italian state," said Vincenzo Scordamaglia, a lawyer representing the Institute of Religious Works, the Vatican's bank, which is known by its Italian acronym IOR.

"Tomorrow's law is proof that the Holy See has been working since 2009 towards entering the white list," added Mr. Scordamaglia, referring to a roster of countries deemed to have transparent banking and strong antimoney-laundering rules.

According to a person familiar with the matter, the new rules will come into effect on Jan. 1, and will apply to Vatican City and all worldwide locations of the Holy See where financial transactions can be made.

The head of the Vatican's new watchdog—who will be appointed by the pope—will be "a high-ranking prelate who will hire staff with the necessary know-how," this person said, adding that the new authority would supervise the IOR and any other Vatican institution that can make financial transactions, including charities.

Vatican officials have been working for much of the year with the Bank of Italy, the Or-

Please turn to page 5

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9 770921 986948

PAGE TWO

Cameron king of all he surveys, for now

[Agenda]

By Iain Martin

As last year closed, and David Cameron contemplated 2010, he was on course to win his party a parliamentary majority and become Britain's first Conservative prime minister in 13 years. He achieved the latter ambition, but not the former. Beyond his being a "lucky general" and skilled escape artist, why is that?

Senior members of the last government were amazed Mr. Cameron squandered his advantage ahead of polling day. One big beast Labour cabinet minister told me after the election that for months, early this year, he considered the Conservative campaign so poorly executed that he thought it must be an elaborate ruse, a double-bluff: "I kept waking up in the morning thinking, right, today is the day when they will get started on us. Up to now it's all been an attempt to lure us into complacency. But no, they never got going. They should have walked it, what were they doing?"

The Conservatives lacked definition. Britain was tired of Labour but unsure what it was being offered as an alternative. When a year ago next week the Tory campaign launched with a baffling poster—featuring a large picture of Mr. Cameron's head that appeared to have been airbrushed and an over-long slogan promising cuts to the deficit but protection for the NHS—the result was predictable: bafflement.

In the first ever British series of televised leaders debates during the campaign, Mr. Cameron won only the final one of the three. For all his energy in the hunt for votes, it was perhaps natural for voters to wonder if he could not adequately explain what he wanted to do with power then perhaps he really didn't know.

Bloomberg News

U.K. Prime Minister David Cameron at this month's EU summit in Brussels.

And then, from the wreckage, he boldly salvaged the premiership and made himself the dominant figure of the moment in Britain and the most interesting new leader in Europe for years.

Falling short of a majority, he dared to forge a coalition with the third party Liberal Democrats. It is possible to find those who will say it was primarily desperation or fear that his great ambition would go unfulfilled that made him do it. But with the bond markets bubbling and a euro-zone crisis swirling in May, Britain needed a government quickly. Those Labour big hitters who were contemptuous of Mr. Cameron's efforts as a campaigner were admiring of his abilities as a coalition builder and of the natural way he has inhabited Number 10.

In reaching out to Lib Dem leader Nick Clegg, Mr. Cameron opted for stability rather than minority government and in doing so transformed the narrative. The story was no longer that Mr. Cameron had failed to win an election the polls and circumstances suggested he should have won, it was that he had reached out—"in the national interest," as he puts it—across traditional boundaries.

In many other parts of Europe there is nothing unusual about this, coalition government is the norm. But in Britain—with its tribal traditions and first past the post voting system to match—it is a much rarer phenomenon. The last formal coalition arrangement, with seats for more than one party at the cabinet table, operated during World War II.

Mr. Cameron loves the coalition. He isn't merely tolerating it, until he can cut loose the Lib Dems and hold another election. He likes the situation as it is. Governing in partnership with another party means that the prime minister can blame compromises on subjects such as Europe and taxation on his need to hold the coalition together. In this way he avoids being beholden to his party's right wing, which he loathes.

Mr. Cameron also loves the business of being prime minister. His predecessor, Gordon Brown, was uncomfortable in the role, struggling to delegate and to deal calmly with ministerial colleagues and the civil service.

Mr. Cameron, officials report, works hard but is generally unflappable. He barely breaks sweat; he retains a sense of humor but can enforce his authority when required.

The prime minister is aided by the weakness of his Labour opponents and the limited options open to the Lib Dems. Having bound themselves to Mr. Cameron, the bulk of the Lib Dems in Parliament know that to break the arrangement now would be calamitous from the point of view of their own electoral prospects. Have they a better alternative—the "antibusiness" secretary Vince Cable included—than staying in and hoping for an upturn in their fortunes?

The consensus view is that Mr. Cameron is now heading for a terribly tough year and deep unpopularity. The coalition's honeymoon ended amid riots over student fees. Cuts to public spending are about to bite and living standards are under pressure. VAT will rise to 20% within days, inflation is stubbornly above target, and wages will remain static for many employees.

One wonders whether much of that hasn't already been priced in by voters. Of course the cuts will prove less popular in practice than they have in theory. But what is the Labour alternative? There is no sign that the party's new leader Ed Miliband has one, yet. So the polls may turn bad for the Tories, but that's government.

What is difficult to discern so far is anything serious from the coalition that might clear the regulatory undergrowth from the path of entrepreneurs and business. Number 10 has decreed across government that it wants "January to be about jobs" and growth but they cannot be produced by press release. Where, wonder free marketers, is the supply-side revolution that might facilitate the right environment for smart individuals and companies to create jobs?

There are shades of that failed election campaign again, the one that Mr. Cameron began this year fighting and wants to forget. One of its greatest weakness was the lack of a coherent explanation of how Britain would get back to the prosperous, sunlit uplands.

Mr. Cameron is much more interested in social policy—in his ambitious mission to devolve power from the state and create the so-called Big Society—but it won't keep him in the job he loves if it isn't eventually married to a dose of economic dynamism.

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Real Time Brussels

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'The puzzle for Merkel is why voters aren't giving her credit for running one of the EU's strongest economies.'

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Question of the day

Vote and discuss: Does the U.K.'s new Bribery Act go too far?

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

Previous results

Q: What is your favorite luxury property from our House of the Week poll?

Waterfront Marbella **37%**

Rhodes Villa **7%**

Lisbon Beach Home **17%**

Algarve Villa **39%**

What's News

■ **Authorities in Denmark** and Sweden arrested five men suspected of preparing a "Mumbai-style" terrorist attack on the Copenhagen offices of Jyllands-Posten, the newspaper known for publishing controversial cartoons of the Prophet Muhammad. 5

■ **European stocks** generally rose as benchmarks neared the end of one of the strongest months of the year. The FTSE 100 is set for its best month in over seven years. 23

■ **Swedish builder Skanska** is selling its 50% stake in a Chilean highway for a gain of $727.5 million. 20

■ **Lending to euro-zone** businesses picked up again in November, posting its strongest annual rate of growth in over a year, the ECB said. 4

■ **Russia's top prosecutor** singled out five airlines for apparent violations of passenger rights during a near-halt in air traffic at two Moscow airports this week. 6

Inside

Make it a year of great resolutions for family and friends. 27

After Ashes drubbing, Australians must give it a bash. 28

THE WALL STREET JOURNAL EUROPE
(ISSN 0921-99)
Commodity Quay, East Smithfield,
London, E1W 1AZ

SUBSCRIPTIONS, inquiries and address changes to: Telephone: +44 (0) 20 3426 1234. Calling time from 8 a.m. to 5 p.m. GMT. E-mail: subs.wsje@dowjones.com. Website: www.services.wsje.com

ADVERTISING SALES worldwide through Dow Jones International. Frankfurt: 49 69 29725 390; London: 44 203 426 1111; Paris: 331 40 17 17 01.

Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Basînevi.

Registered as a newspaper at the Post Office.

Editeur responsable: Patience Wheatcroft M-17936-2003.
Registered address: Boulevard Brand Whitlock, 87, 1200 Brussels, Belgium

NEWS

Champagne makers seek new fizz

By Amelie Baubeau

Life was easier for champagne producers before the 2008-09 financial crisis. A demand for premium products world-wide, especially from Russia's new upper class and the Far East, put French champagne houses in the driving seat.

Prestigious "cuvees" such as Roederer's Cristal or Laurent-Perrier's Belle Epoque were snapped up at prices above €100 a bottle.

But not only did sales volumes wither, it has now become increasingly difficult for producers to raise the prices, as consumers reel back spending and looked toward less-expensive brands and sparkling wines amid continued economic weakness and high unemployment in many Western countries.

In 2009, champagne sales tumbled 9.1% in volume and producer revenue from this product plunged 17%, according to the French-based Interprofessional Committee of Champagne Wines, or CIVC.

For full-year 2010 year, the CIVC reckons that the average selling price will be up, but only slightly, representing good news for consumers as they prepare to celebrate the New Year.

The CIVC forecasts an 8% growth rate for the champagne sales in volume, to 315 million bottles, and a 10% increase in value, to almost €4 billion.

"The price aggressiveness we had been observing since the beginning of 2009 has continued this year, and it should still be the case for Christmas 2010", Etienne Auriau, chief financial officer of French champagne producer **Laurent-Perrier** said in a recent interview.

"We will have to wait until 2011 to see the pricing environment improve," he added.

This development has been a hitch for leading champagne houses. This includes Moët et Chandon, the "M" of French luxury behemoth **LVMH Moët Hennessy Louis Vuitton**.

Mumm, owned by wine and spirits group **Pernod Ricard** SA, is one of several companies that have been relying for several years on a "premiumization" strategy to add value to their sales by pushing more upscale champagnes and by steadily increasing the selling prices.

This is based on the assumption that production of officially branded champagne, which is limited to a relatively small region of France, will keep supply tight.

However, the wave of heavily discounting prices of premium champagnes in French supermarkets, as happened during the Christmas selling season in 2009, is unlikely to repeat itself with as much intensity this year.

"The pricing environment has relaxed slightly", said Bruno Paillard, chief operating officer of **Lanson-BCC** SA, in an interview.

Indeed, the prices for lower-end champagnes are not as low as last year. For instance, the Hubert de Claminger brand, sold for €8.90 a bottle by French retailer **Carrefour** SA before Christmas 2009, is on the shelves for €9.60 this year.

By comparison, a mainstream premium brand like Pernod's Mumm or LVMH's Moët sells for around €30 to €35.

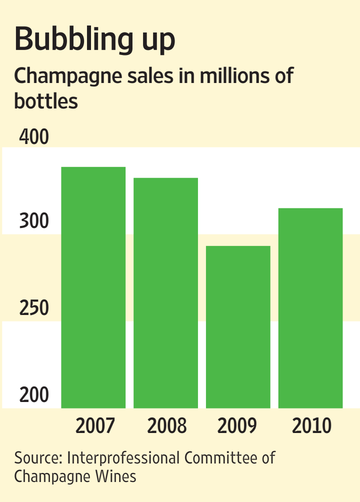
So is the golden age of finding it easier to sell more expensive bottles now a distant memory?

Daniel Lorson, spokesman for the CIVC, believes this will happen but not for a while yet.

"The recovery is much slower for expensive qualities," he said.

Agence France-Presse

A worker drives a grape-picking machine in a vineyard in September in Montgueux, northern France.



South American heat pushes up crop prices

Continued from first page

already controls some crop exports.

India this week announced plans to help consumers cope with high food prices by selling additional grains at subsidized rates and maintaining a ban on pulse exports. Food inflation in India surged to 12.13% year-on-year in the week ended Dec. 11, from 9.46% a week before.

Corn and soybean futures prices have both rallied amid the high temperatures in the southern hemisphere, rising 18% and 9.9% this month, respectively, to their highest levels since the financial crisis undercut commodity prices in 2008. Corn is up 51% year to date, and soybeans up 31%.

Wheat is also up 23% this month due in large part to excessive rain in Australia, though rains there recently eased, and Argentina's wheat crop, planted earlier in the year, appears strong. For the year, wheat is up 48%.

The latest price rises show how precarious the global food situation has become. Argentina's corn crop had been expected to surge this growing season because of an expansion in the planted area to four million hectares, from 3.25 million last season, according to the Agritrend consultancy in Buenos Aires. But the dry weather could reduce the crop by 16% from last year to 19 million metric tons, said Ramiro Castineira of the Econometrica consultancy in Buenos Aires. Analysts are also cutting their soybean forecasts.

Demand from China—a key agricultural trading partner of both Argentina and the U.S —and elsewhere is helping stretch supplies thin. Anything short of bumper crops raises the specter of inadequate supplies.

But the weather is limiting farmers' expectations.

"Some farmers haven't had enough rain to put in their second soybean crops and are seeing very poor development of their corn crops," said Martin Lorenzo, a subcontractor in the hard-hit northern Buenos Aires province. He said he feels fortunate that a small shower in recent days permitted him to plant a second soy crop after the wheat harvest. He said he has seen some farmers who have already given up on their withered corn crops and turned cattle loose to graze in the fields.

Argentina has maintained controls on exports of corn and wheat for the past several years, as the leftist Peronist government tries to hold down inflation by keeping the domestic market amply supplied. Inflation is currently running at around 25% annually.

Argentina isn't the only big agricultural producer in the region affected by La Niña. With Brazil, Paraguay and Uruguay also suffering from the heat, the soybean crop in South America could be 11 million to 12 million metric tons smaller than last year, which would represent a decline of around 8%, Mr. Lopez said.

—Banikinkar Pattanayak in New Delhi contributed to this article.

U.K. housing payments take rug out from other spending

By Ainsley Thomson
And Ilona Billington

LONDON—U.K. households continued to pay back equity into their homes in the third quarter of 2010, the Bank of England said Wednesday, reducing the amount available for homeowners to spend.

Homeowners injected a net £6.1 billion ($9.38 billion) in the third quarter of 2010, the 10th straight quarter when there has been a net injection. The figure was larger than the £5.8 billion repayment in the second quarter, a figure that was revised from an originally estimated £6.2 billion.

The third-quarter repayment accounted for a 2.4% reduction in homeowners' take-home pay, compared with a 2.3% reduction in the second quarter, the BOE said. The data measure the portion of borrowing secured on residential property that isn't invested in the U.K. housing market but is used to finance consumption or invest in financial assets.

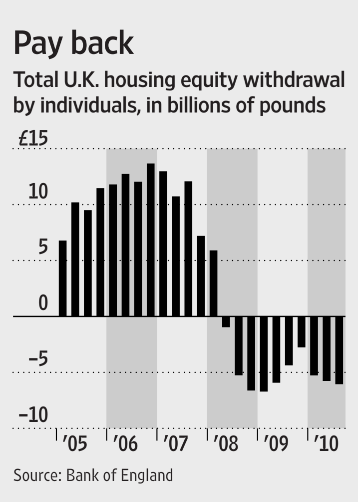
The Bank of England said home owners have injected £49.7 billion in equity back into their homes since the second quarter of 2008, which was when the measure turned from individuals predominantly borrowing against their properties to individuals predominantly repaying money into their properties.

Benjamin Williamson, senior economist at the Centre for Economics and Business Research, said he expects the consumer deleveraging to continue well into 2011 and beyond.

"Ultimately it will be to the long-term benefit of the housing market and the stability of the economy, although it will mean a shortage of finance for consumer spending in the short term," he said. When homeowners choose to repay money into their homes it reduces their capacity to spend.


Reuters

Households have put equity back in homes. Above, houses in Hastings, England.



Howard Archer, chief U.K. and European economist at IHS Global Insight, said the low savings interest rates has made it more attractive for homeowners to use any spare cash they have to reduce their mortgages, while the persistently tight credit conditions have made it difficult to increase borrowing on residential property.

"The 10th successive, and increased, net injection of housing equity in the third quarter indicates that there is an ongoing desire and perceived need of many people to improve their personal balance sheets given high debt levels and serious concerns and uncertainties over the economic situation," he said.

Consumer spending is also expected to be squeezed in the months ahead by the government's sweeping spending cuts, public-sector job losses, and as a result of January's 2.5 percentage-point increase in the U.K.'s sales tax.

Hungary plans to emphasize fiscal discipline

By Veronika Gulyas

BUDAPEST—Fiscal discipline will be a cornerstone of Hungary's European Union presidency, Eniko Gyori, minister of state for EU affairs, said in an interview Wednesday.

Budapest takes over the six-month rotating presidency of the EU in January, with stringent economic and fiscal policies and a pro-economic growth approach as its main target areas. Hungary targets cutting its own public debt from the current 81% of gross domestic product, the largest debt level in central and Eastern Europe, to under 78% next year.

Despite euro-zone jitters, euro adoption remains on the agenda for Hungary, Ms. Gyori said, even though a target date hasn't been set.

On other issues, Ms. Gyori said the widespread international criticism of Hungary's controversial media law "isn't a good start" for Hungary's EU presidency. She stressed that critics should read the details of the bill before disapproving.

Under the legislation, a new authority will have the right to regulate all media content and impose fines or shut down news outlets that flout rules.

Business lending bounces

By Geoffrey T. Smith

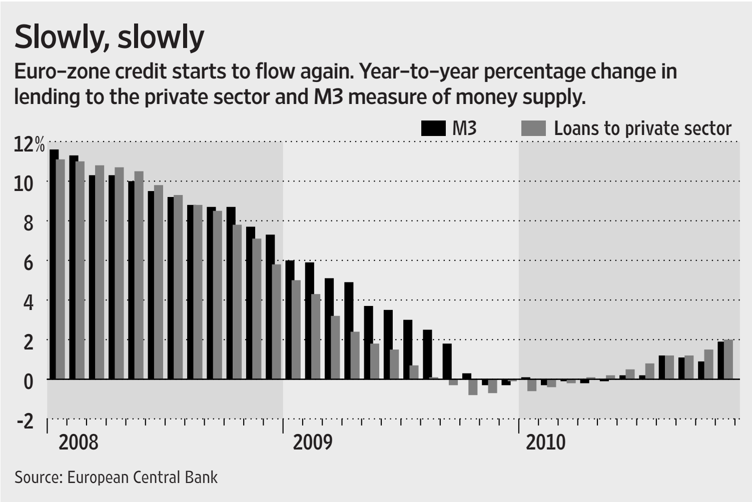
FRANKFURT—Lending to euro-zone businesses picked up again in November, posting its strongest annual rate of growth in over a year, the European Central Bank said Wednesday.

Analysts said the data are further evidence of a slow but sure recovery in private-sector credit trends, but provide only a modest counterpoint to the far greater concern of the sovereign debt problems that the euro zone will have to face in 2011.

The ECB said that lending to the private sector rose by a combined €21 billion ($27.55 billion) in November and was up 2% on a yearly basis, due to positive net flows of €10 billion to households and €11 billion to businesses.

Credit to households has been growing steadily, if slowly, all year, but the corporate credit cycle, which analysts see as a key indicator of the sustainability of the economic recovery, has struggled to establish anything that could be called a positive trend, growing one month and shrinking the next.

However, Michael Schubert, chief euro-zone economist at Commerzbank in Frankfurt, said it is looking increasingly likely that October's fall in corporate lending was an exception. "The trend is upwards, but slow—nothing more," Mr. Schubert said.



The ECB said that its M3 measure of money supply in the 16 countries that use the euro rose by 1.9%, up from a revised 0.9% in October and the highest year-to-year rate since August 2009.

This was, however, inflated somewhat by an atypical €51 billion monthly rise in net lending to non-bank financial intermediaries. This reflected, among other things, an increase in banks' propensity to lend to each other through central counterparties such as exchanges, a trend which new banking regulations are encouraging in the hope that this will reduce the risk that the collapse of a single bank could bring down the whole financial system. Measured on a three-month basis, which evens out of some of the short-term fluctuations in money supply, M3 was up 1.3% in the September-November period, up from 1.1% in August-October. By contrast, growth of the narrower M1 money supply measure continued to slow, falling to 4.6% annually from 4.9% a month earlier.

German consumer prices post sharp rise

By Geoffrey T. Smith

FRANKFURT—Consumer prices in Germany rose by more in December than in the previous eight months put together, according to a preliminary estimate released Wednesday by the federal statistics office Destatis.

Destatis said prices rose by 1.0% from October and were up 1.7% from a year earlier. That is up from a 0.1% rise in November, when the annual rate was 1.5%, and above economists' expectations of a 0.8% increase from a month earlier and 1.5% from a year earlier. Under the methodology used by Eurostat, the increase was sharper still, at 1.2% from a month earlier and 1.9% from a year earlier.

The uptick in inflation comes against the backdrop of Germany's strongest growth since its post-reunification boom in the early 1990s, which has generated historically high levels of business and consumer confidence.

As modest as the consumer-price increase is, it will still be unwelcome for the German authorities and for the European Central Bank. The ECB needs to keep interest rates low to support the frail economies of the euro zone's periphery, and can ill afford signs of inflation picking up in the region's largest economy.

However, German officials forecast a relatively benign view of inflation. The Deutsche Bundesbank predicts a consumer inflation rate of 1.7% next year and 1.6% in 2012. But at a European Union-harmonized rate of 1.9%, inflation in Germany has already effectively reached the tolerance threshold that the ECB applies to the euro zone in general.

Destatis said that on the basis of its preliminary estimate, inflation over the whole of 2010 will have averaged 1.1% in Germany. Destatis bases its preliminary estimates on reports from Germany's six largest federal states.

They had earlier reported monthly price increases of between 0.8% and 1.2%. The 1.1% increase in North Rhine-Westphalia was the largest monthly rise there since July 1991. The states' year-on-year inflation readings ranged from 1.4% in Brandenburg to 1.9% in Baden-Wuerttemberg, the last of which represented a two-year high for inflation there.

The states' reports were dominated by the seasonal rise in prices for package tours and holiday accommodation. All six states reported an increase of around 20.5% in package-tour prices from November, although compared to the year earlier prices were generally down. The North-Rhine Westphalian statistics office said that these two items accounted for two-thirds of the overall increase in prices during the month. The states also reported increases in the price of motor fuel, which rose between 4% and 5%, and in seasonal foods, which rose by an average of around 6% on the month.

In the overall indexes, these developments were partly offset by yearly declines in the prices of many consumer durables such as electronic goods and furniture.

Copenhagen attack is foiled

By Niclas Rolander
And Paul Sonne

Associated Press

Danish and Swedish authorities say they foiled an attack targeting the Jyllands-Posten offices, above, in Copenhagen.

STOCKHOLM—Authorities in Denmark and Sweden arrested five men suspected of preparing a "Mumbai-style" terrorist attack on the Copenhagen offices of Jyllands-Posten, the Danish newspaper known for publishing controversial cartoons of the Prophet Muhammad.

Wednesday's arrests, which saw four men apprehended in Denmark and a fifth taken into custody in Sweden, are the latest in a string of antiterrorism operations in Europe, which have come amid heightened concern about possible attacks on the Continent, particularly during the holiday season.

The Danish Security and Intelligence Service, known as PET, said that the suspects were planning to storm the Copenhagen building that houses the Jyllands-Posten newspaper and kill as many people as possible.

"Our assessment is that their plan was to try to get access to the Jyllands-Posten building and carry out a Mumbai-style attack," Jakob Scharf, PET's general director said at a news conference Wednesday, referring to the large-scale terrorist attacks in the Indian city in November 2008.

Danish authorities, who called the attack "imminent," seized a machine gun, live ammunition and plastic strips that can be used as handcuffs.

In a statement, Denmark's Minister of Justice Lars Barfoed said the plot constituted "probably the most serious terror attempt in Denmark so far," while Prime Minister Lars Lokke Rasmussen said the event "underlines that there is a serious terror threat against Denmark."

PET's Mr. Scharf said the security service regards the suspects as "militant Islamists with links to international terror networks."

Jyllands-Posten, a daily broadsheet, set off an uproar in 2005 when it published a series of cartoons depicting the Prophet Muhammad, whose visual portrayal is forbidden under Islamic tradition. Jyllands-Posten, along with other Danish newspapers, reprinted the cartoons in 2008 as a freedom-of-speech protest.

The drawings—including one by cartoonist Kurt Westergaard that featured Muhammad with a bomb in his turban—provoked outrage across the Muslim world. After their publication, a plot to murder Mr. Westergaard emerged, and a suicide bombing rocked the Danish Embassy in Islamabad.

Magnus Ranstorp, an expert on terrorist threats at the Swedish National Defense College in Stockholm, said the arrests on Wednesday marked the fourth Jyllands-Posten-related plot uncovered in the past year.

The operation foiled on Wednesday was "without question the most serious," he said, noting that the newspaper's Copenhagen office building had less security than the paper's main office in Viby, a town more than 100 miles west of Denmark's capital.

The arrests come days after British authorities charged nine men with terror-related crimes in a plot that allegedly targeted the London Stock Exchange, the U.S. Embassy in the U.K. and other high-profile British locations. Those charges were the result of a larger counterterrorism operation carried out by U.K. police last week.

Attention on the terrorist threat in Europe is growing. In October, the U.S. State Department issued a travel alert for Americans going to Europe, warning of possible attacks on Europe's public-transport systems and tourist attractions, but the alert stopped short of warning U.S. citizens against traveling to the Continent.

Meanwhile, fears are growing of possible attacks in Europe beyond major hubs such as London and Paris, which are typically seen as targets.

Earlier this month, an Iraqi-born Swede blew himself up in central Stockholm, injuring two bystanders, in the country's first major terrorist act in years. In November, police arrested 11 suspects in Belgium, the Netherlands and Germany, who authorities say were part of a terrorist cell plotting an attack on Belgian soil.

Of the five men arrested in Denmark and Sweden on Wednesday, three were Swedish nationals, one was a Tunisian citizen, and one was an Iraqi asylum applicant residing in Denmark.

The Danish Security and Intelligence Service said the arrests came after an extensive investigation undertaken with the Swedish Security Service, Sapo. Authorities became aware of the terror plans "a couple of months ago," Sapo's general director, Anders Danielsson, said at a news conference.

—Sven Grundberg and Charles Duxbury contributed to this article.

Northern Ireland hit by water shortage

Associated Press

Agence France-Presse/Getty Images

A child holds an empty bottle as people queue to receive water in Belfast.

BELFAST, Northern Ireland—Frustration and fears of disease mounted in Northern Ireland on Wednesday as 36,000 people were left without water, some for more than a week, after a deep freeze and a sudden thaw caused aging pipes to burst.

With reservoirs running low, water supplies were cut off in many towns and cities, and residents turned to emergency water tankers and bottled water for their cooking, cleaning and drinking needs.

Scotland said it was sending 160,000 liters of bottled water to help meet demand.

Northern Ireland's deputy first minister, Martin McGuinness, called the situation "a grave crisis," and said people had been let down by their water supplier.

The Northern Ireland government scheduled an emergency meeting for Thursday to discuss the crisis. Doctors warned of potential disease outbreaks if water wasn't restored, but officials said it would take several days or more to bring back all service.

"This may go on for another short period, but we are doing our best to keep it as short as possible to get those reservoir levels up and provide water to our customers," said Liam Mulholland, of Northern Ireland Water.

He said the shortage had been aggravated by burst pipes in vacant properties spewing water as technicians try to repair the problem.

The water company's website listed some 80 towns and cities with disrupted water supplies and advised customers where to find emergency supplies. There also was substantial flooding in the province, with some floodwaters contaminated by sewage, raising public health concerns.

Alison McCrystal, spokeswoman for the water company, urged consumers not to wash their cars, hose down their properties or do "anything unnecessary" to waste water during the shortfall.

She said emergency crews were working around the clock to restore service and ease fears that contaminated water could lead to a disease outbreak. Some families haven't had fresh running water for eight days, with officials predicting it will take several more days to restore normal service.

"People with young families have not been able to flush toilets and wash themselves, never mind get access to drinking water," said Peter Maguire, a general practitioner. "It's just not good enough. What's happening is really not acceptable."

Many cities have made recreation centers available to the public so they can use bathroom facilities and have a place to do washing.

Holy See aims to raise transparency in banking

Continued from page 1

ganization for Economic Cooperation and Development and other international institutions to get the Holy See to comply with international directives on antimoney-laundering and antiterror financing legislation.

The Vatican's efforts accelerated, according to a person familiar with the matter, after Italian prosecutors in September placed the IOR's chairman, Ettore Gotti Tedeschi, and its director general under investigation on suspicion that they failed to comply with Italian laws against money laundering.

Neither man has been charged. Mr. Gotti Tedeschi has denied wrongdoing, and said the bank operates with "absolute transparency." The Vatican has denied that its officials acted improperly and said the investigation is the result of a "misunderstanding" between the bank and Italian authorities.

Mr. Scordamaglia, who also represents Mr. Gotti Tedeschi, said Wednesday that he had no further comment on the probe.

The IOR has been the financial arm of the Holy See since it was created in 1942 to manage accounts held by priests, cardinals and bishops as well as religious orders.

Belgian priest admits abuse of a relative

Associated Press

A Belgian priest has confessed to a child sex-abuse accusation that came to light during a campaign to nominate him for the Nobel Peace Prize for his work fighting globalization's impact on developing countries.

The confession was published in a Belgian newspaper Wednesday and confirmed by the organization the priest founded, deepening a sex-abuse scandal that has rocked the Catholic Church in the country. After a spate of accusations this year, the church in September published the harrowing accounts of more than 100 victims of clerical sex abuse, some as young as two when they were assaulted.

In October, after supporters of 85-year-old Francois Houtart began working to nominate him for the Nobel prize, a woman contacted the nonprofit organization he founded and said that Father Houtart had abused her brother 40 years ago, according to its director, Bernard Duterme.

Father Houtart resigned the next month from the board of Cetri, which publishes reports critical of developed nations' actions in the Third World, Mr. Duterme said.

Father Houtart told the newspaper Le Soir that he twice touched "the intimate parts" of his cousin, an incident he called "inconsiderate and irresponsible."

Father Houtart is in Ecuador and didn't immediately respond to phone calls and e-mail Wednesday.

EUROPE NEWS

Banks' new take on giving

BY MICHAEL WEIR
AND ADAM SMALLMAN

LONDON—The financial crisis has changed the way global banks give to charity. The days of firms simply handing out lavish checks have given way to a more targeted approach to donations.

Banks have traditionally been among Britain's biggest corporate donors but tumbling profits have pushed down their donations relative to that of other sectors. Since the crisis broke in 2007, charity budgets in the City of London have tightened and companies have been applying business rules to their donations and are finding new ways to make their cash go further.

Figures for corporate charitable giving, also referred to as community investment or corporate social responsibility, appear static, according to analysts, who point out that the numbers mask an evolution in the way financial institutions support causes and in the way those causes pitch for support. Pinpointing exactly what those numbers are isn't always possible, the analysts add, because companies are shy about revealing such information.

For many banks, however, their relationship with charities needs to be based on sound business principles and identifying ways to get their own staff involved, such as using their skills to help schoolchildren progress in specific subjects or helping to run community projects. Banks may also offer pro-bono services as well as assistance with, for example, procurement or marketing.

The cash portion of the total donated from business to charities has fallen to 57% from 67% between 2008 and 2010, according to the London Benchmark Group, though this is skewed by the recent inclusion of big donations of drugs by pharmaceutical firms. LBG was formed by six leading companies in 1994 to improve performance measurement of their charitable support. Today the club is 200-strong. The group doesn't publish detailed data but Alison Braybrooks, its director, says members are more interested in evaluating community projects now than they were before the financial crisis.

She says that once "in-kind" support, such as donations of equipment or staff time, is taken into account, the value of the financial sector's community activities increased by an average of £1 million ($1.5 million) per firm from 2009 to 2010. "What companies are now really focusing on, particularly financial services companies, is the impact of their programs; whether that's the impact on the community, the group they're working with or on their own organization," Ms. Braybrooks says.

Professor Cathy Pharoah of the Centre for Charitable Giving and Philanthropy at Cass Business School in London says her research suggests overall community investment by the financial services industry has fallen since the financial crisis broke due, in part, to the disappearance of some givers and because of caps imposed at nationalized banks. According to a report published by Charitable Giving and Philanthropy, three big banks remain among the top 10 givers of U.K.-listed companies this year, though this doesn't reflect giving by banks based outside the U.K. Ms. Pharoah adds that variations in the way data are recorded make comparisons difficult.

George Downs for The Wall Street Journal (2)

Above, Nomura's Ahmed Patel volunteers at a school in London; at right, Francesca Marenghi of the Teenage Cancer Trust.

"I don't estimate that corporate cash giving has increased much at all for a decade," she says, "but figures for in-kind giving have increased. I'm pretty sure that in-kind giving is being used to offset a drop, or lack of increase, in financial giving but it's difficult to tell because many companies now report a single in-kind and cash figure."

British banking giant **Barclays**, which says its community support is worth £55 million a year to charitable causes, is among those whose cash giving has changed little but whose style of support has changed dramatically.

"We're not spending our own money," says Barclays' community investment director, Rachel Barber. "We're spending shareholder money so we probably are quite demanding, particularly in terms of measurement and evaluation, but you would expect that from a bank."

Some institutions are more transparent than others in reporting the precise level and composition of their charitable giving. Some simply report the literal amount of money donated while others report donations of staff time in cash terms. Furthermore, some firms include fund-raising activities by staff, which may not strictly be part of the company's own program.

South African bank **Investec** launched its U.K. community program in 2008 and restricts its support to five causes in London to achieve greater impact. One of those, Arrival Education, helps educate young people from disadvantaged communities. The benefits of the bank's involvement were clear to students attending a "Successful and Cool" workshop at its London offices. "It's good because we get to talk to professional people who can talk to us about their careers and help us make the right choices," says a young teenager from Kingsford Community School, East London.

Her classmate adds: "It's a good experience. It helps us to think about how we can get from where we are now to where want to be in the future."

The program also brings in business benefits, says Alison Gardner, Investec's social investment manager. "I think, quite rightly, people are cynical about companies that are just doing CSR [corporate social responsibility] as a PR exercise, but I think the majority of companies are doing it for the right reasons; to benefit the community and that it's the right thing to do," says Ms. Gardner. "We also feel there is a benefit to us. Our staff use our CSR in business pitches and have won business based on it."

Teenage Cancer Trust, which builds specialist treatment units for young cancer patients, has a desk in the London offices of Japanese investment bank **Nomura**, an arrangement that the charity says has been instrumental in helping it to raise £700,000 with Nomura over the past 18 months.

"We've had to get a lot more commercially focused," says Francesca Marenghi, the charity's corporate relationship manager, who works part-time in Nomura's office liaising with bank staff to develop fund-raising initiatives. "We have to think a lot more in terms of the benefit to their brand and having a win-win partnership."

Nomura, like Lehman Brothers before it, supports Oaklands School, a state secondary school that serves a poor neighborhood in London's East End, with £100,000 a year plus volunteers who provide a range of tutoring and activities that would otherwise be unavailable to the 600 pupils. A Nomura executive sits on the school board.

Head teacher Patrice Canavan says the financial crisis threatened a valuable line of support. "I remember the kids saying that some of them thought Oaklands would close because they saw Lehman as they now see Nomura, as down the corridor, as a department of our school. They're very much part of the furniture and it's not just money."

Ms. Canavan adds that the school has reading, math and science partners, who are volunteers from Nomura who come to work with the students on a weekly basis. "That's very, very big stuff in our school, for professional adults to give up their time to listen to a child read," she says.

"These kids see life at its rawest and some of them will not have the stability of a middle-class background and the stability of parents who work, or parents who may not even speak English."

Adults who give their time voluntarily fill a crucial role, Ms. Canavan says, adding: "I tell the volunteers who come here: I'm not sure that you'll ever know what you've done for these kids. With these kids, you touch tomorrow, you touch their lives, you influence them."

The benefits run both ways. Banks say community investment boosts their reputation and helps them recruit, retain and develop staff. Nomura, for example, says that the skills and experience its staff gains by volunteering in schools around London would cost £150,000 per year in total if they were instead delivered by private training providers.

WSJ.com

ONLINE TODAY: See a video report on the state of philanthropy and volunteering in the City, at **WSJ.com/Video.**

Putin bans holidays for airline officials

BY WILLIAM MAULDIN

MOSCOW—Russia's top prosecutor singled out five airlines Wednesday for apparent violations of passenger rights during a near-halt in air traffic at Moscow's two biggest airports this week, and Prime Minister Vladimir Putin warned officials against going on vacation over the New Year holiday.

An estimated 20,000 tourists faced delays often stretching to several days during the busiest travel period ahead of the much celebrated New Year holiday. Passengers crowded into Russia's busiest airport, Domodedovo, where they faced power outages and sewage smells, while a shortage of de-icing fluid delayed hundreds of flights at Sheremetyevo airport.

Russia's **Transaero**, which has an international hub at Domodedovo; **S7 Airlines**, a member of the OneWorld alliance with **British Airways**; **UTair**; **Vim Airlines**; and **Orenburg Airlines** were cited for multiple violations, prosecutors said.

Spokesmen for the five airlines couldn't immediately be reached by telephone, and representatives of UTair, Transaero and S7 didn't respond to email messages.

Transaero said on its website that it has made hotel rooms and food available to some 7,000 passengers.

"People weren't able to get drinks and hot food," the prosecutor's statement said. "The majority of citizens didn't have the ability to use a room for mothers and babies or hotels."

The country's biggest carrier, OAO **Aeroflot**, a member of the international SkyTeam alliance, wasn't cited for violations in a statement posted on the prosecutor general's website, but transport-focused prosecutors are working at the airline's hub at Sheremetyevo, it said.

Aeroflot said Tuesday it canceled at least 70 flights and countless others were delayed amid the shortage of de-icing fluid, leading to scuffles with passengers who chanted anti-Aeroflot slogans and complained of inadequate information.

Aeroflot's chief on Wednesday blamed the delays on freezing rain that coated planes with ice as thick as five or six centimeters.

The situation improved Wednesday, with Domodedovo apologizing to passengers and claiming operations were returning to normal, and Sheremetyevo saying a "majority" of delayed passengers were among the 22,000 that departed Wednesday. Still, heavy snow and the high number of travelers ahead of the 10-day New Year's break threatened further delays.

Russia's Audit Chamber, which oversees government financial control, will probe the week's aviation problems, which its chief called "havoc" that should lead to the punishment of those responsible, Interfax reoprted.

Meanwhile, in televised remarks, Mr. Putin banned certain officials from taking a vacation for the New Year's holiday and ordered bureaucrats and transport employees to "stop whining and start working."

Seeking to balance out corporate-tax cut

[Capital]

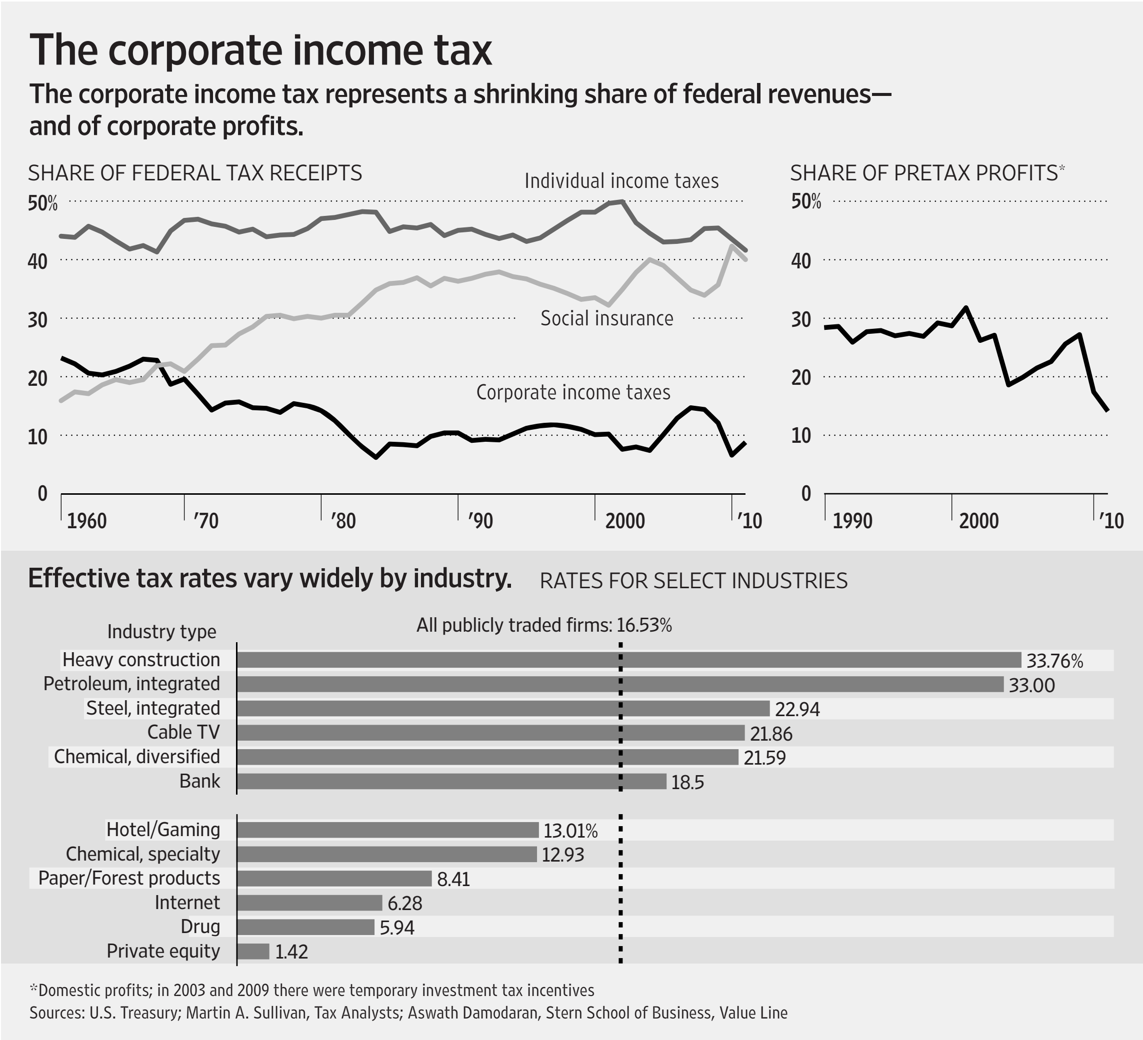
By David Wessel

All signs point to President Barack Obama pursuing far-reaching changes to the corporate income tax, seeking to lower one of the highest statutory corporate-tax rates in the world by eliminating deductions, credits and loopholes.

If he proceeds, the administration will insist that any changes raise as much revenue as the existing, 35% corporate tax. That's to constrain those who want to lighten the business-tax burden and those who want to get more money from business. But the constraint means that for every company that saves a dollar, another will pay a dollar more.

The White House says no decisions have been made and that the president has yet to have a session with his economic team devoted to corporate taxes. But Treasury tax technicians are sifting through options, CEOs are buzzing and the president has voiced his druthers: "We would be very interested," he said in October, "in finding ways to lower the corporate-tax rate so that companies that are operating overseas can so do effectively and aren't put at a competitive disadvantage." In a recent interview with National Public Radio, Mr. Obama talked about "a conversation over the next year" aimed at "simplifying the system, hopefully lowering rates, broadening the base."

Any Obama pitch, perhaps in his State of the Union address, will be that corporate-tax reform will make America more competitive, induce more companies to invest here, reduce costly complexity and improve long-term growth prospects. Truth be told, this won't do a whole lot to boost growth, but this is one of the options that is free and doesn't widen the budget deficit. Congressional Republicans say they're at least interested in talking.



Unlike income and payroll taxes, the corporate tax has been shrinking. From 3.8% of gross domestic product, the value of goods and services produced in a year, in the 1960s, it was down to 2% of GDP before the recent recession. "The corporate tax is a shadow of its former self," Congressional Research Service economist Jane Gravelle has said.

It's largely a big-company tax: Half of all business profits go to entities organized to be taxed as individuals, a way to pay less in taxes; 85% of corporate income taxes are paid by 0.5% of companies, fewer than 10,000 in all.

In the past 25 years, the corporate tax has grown barnacles, some crafted to encourage investment, others narrow provisions with little economic merit. With the capitulation of Japan and the U.K., the U.S. is the only major economy that tries to tax multinationals on world-wide income instead of profits made at home, an unsustainable perch. Although various deductions mean most companies pay far less than the 35% statutory rate, most estimates suggest that the actual U.S. federal-state corporate-tax rate in ordinary times (when the government isn't offering the temporary investment tax breaks it is now) is higher than in many, although not all, other big countries. Several others, most recently Japan and Canada, are moving to cut corporate rates, which could put the U.S. at a disadvantage at a time when capital moves across borders with increasing ease.

Before the financial crisis, the Bush Treasury was eyeing the corporate tax, arguing that it distorted decisions, fostered inefficiency and cost business $40 billion a year in compliance. Mr. Obama's Presidential Economic Recovery Advisory Board (Perab) picked up the baton, saying in August that the current corporate tax has "deleterious economic consequences," encourages borrowing and induces investment "for tax reasons rather than for reasons of economic efficiency."

In short, the corporate income tax has few defenders. But changing it without losing revenue is challenging. Each percentage-point cut in the existing corporate tax reduces revenue by about $120 billion over 10 years. Closing a few loopholes won't do enough to reduce the rate significantly: Taxing credit unions as corporations yields $19 billion over 10 years, for instance; taxing Blue Cross/Blue Shield yields $8 billion.

To make this worth doing, the rate probably needs to fall toward 25%. That means big changes. Take the 2004 tax break for "domestic production," described as a way to boost manufacturing but so broadly defined that it covers hamburger making. If it were eliminated, the corporate tax rate for all companies—from Wall Street to the Rust Belt—could be reduced by 1.4 percentage points. But to the one-third of companies that get the tax break today, the savings are the equivalent of shaving their tax rate by 3.5 percentage points. So if the tax break were wiped out, their taxes would go up unless some other popular deductions are eliminated, such as accelerated depreciation (which allows companies to write off investments for tax purposes more quickly than for accounting purposes).

Basically, there's a trade-off: Fewer tax breaks for companies to do what Congress has been convinced (either by economists or lobbyists) they should do, versus a lower tax rate. Deeper rate cuts may mean bigger changes, perhaps limits on the interest on debt that companies can deduct or forcing big businesses now outside the corporate tax to pay it.

Deficit hawks will say any savings should reduce debt, not tax rates. Some executives will say just cut the rate, forget the base-broadening. Some liberals will object to shielding business from paying more. And every loser will lobby hard. Ultimately, Mr. Obama likely will try to make this a problem for big business: If you want lower rates, he'll say, find us a way to pay for it.

Tax revenues still below peak

By Conor Dougherty

U.S. state and local tax revenues continue to recover as the economy improves, but remain below pre-recession peaks and are likely to face continued pressure in 2011.

Combined state and local tax revenues rose 5.2% to $284.3 billion in the third quarter of 2010 from a year ago, the Census Bureau reported Wednesday. That was a big reversal from the third quarter of 2009, when tax revenues fell by 5.4% from the year-earlier period.

"Revenue wise they're turning the corner," said William Fox, an economics professor at the University of Tennessee who specializes in state and local taxes. But, he said, "fiscal stress is likely to continue in many states because spending is still out of line with lower revenues."

This gain in third-quarter revenues was driven in part by increases in income- and sales-tax receipts, which have rebounded along with Americans' salaries and spending. Many cities and states have also passed income- and sales-tax increases to battle falling receipts during the recession. Personal income tax receipts rose 4.8% in the third quarter while sales taxes rose 4%, according to the Census. Corporate income tax collections, which are volatile, fell 3.3% in the quarter.

Property taxes, most of which are collected by municipal governments and school districts, rose 7.8% in the third quarter from the year-ago quarter. The third quarter is a light one for property taxes; most collections are in the first and fourth quarters. Property-tax revenues are growing despite the precipitous decline in real-estate values partly because of the delay in adjusting assessments to reflect recent values and partly because of legislated property-tax rate increases.

Also, many states have property-tax caps that limit how fast taxes can rise relative to values. That is welcome news for homeowners in good times, when their property values rise much faster than their taxes. But in a down market taxes often continue to rise because assessments are still below current market value.

Other reports show cities feeling the pinch. For cities, the National League of Cities predicts that property-tax receipts are expected to fall 1.8% this year and more in 2011 and 2012.

Among the states with the strongest increases in revenues are those with large stocks of natural resources, including oil-rich North Dakota and West Virginia, a coal-mining state, according to the Nelson A. Rockefeller Institute of Government at the State University of New York.

The worst-off states include those, many in the West, where the housing bust hit hardest.

Snowbound travelers get a measure of relief

By Susan Carey

The travel mess that has stranded thousands of passengers in the U.S. since the weekend's East Coast blizzard eased Wednesday as more airport runways were cleared of snow and extra planes were sent to pick up travelers waiting to get in or out of New York, Philadelphia and Boston.

Smaller numbers of flight cancellations continued Wednesday, the result of Tuesday winds that limited the number of planes landing in New York. Because airlines couldn't get all expected aircraft in on Tuesday night, they couldn't get all planned flights out on Wednesday.

A new challenge emerged Wednesday: Because of lingering snow and ice, the Federal Aviation Administration initiated "traffic management" programs at New York's John F. Kennedy International Airport and Newark Liberty International Airport in New Jersey. That was slowing Newark arrivals by 28 minutes on average and JFK arrivals by more than two hours, the FAA reported on its website. That came even though Newark's two runways and JFK's four are free of snow.

U.S. airlines have canceled more than 9,000 flights since Christmas Day. Domestic carriers typically operate about 26,000 flights daily. At least 28 international flights operated by non-U.S. airlines have landed in New York-area airports in the past two days without having arrival gates assigned. That has led to tarmac delays of as long as 10 hours, with passengers unable to disembark, said the Port Authority of New York and New Jersey.

U.S. NEWS

Faces of the home-foreclosure crisis

By Robbie Whelan

The foreclosure crisis that erupted four years ago has claimed more than five million American homes—about 10% of all homes with a mortgage. It began in lower-income neighborhoods and has spread to some of the most exclusive addresses in the U.S.

The seeds of the crisis were planted a decade ago when banks, discovering the high returns from selling bundles of securitized mortgages, relaxed lending standards and originated millions of adjustable-rate subprime mortgages. Such loans were designed to allow just about anyone to get a home loan.

When interest rates on the adjustable-rate mortgages finally climbed, many borrowers began falling behind on their payments, leading to the first wave of delinquencies and defaults. At the start of 2008, with the U.S. economy weakening, the defaults began to spread. In some cases, borrowers found they had paid inflated prices for homes they could no longer afford. Others got into trouble by or borrowing against the equity in their homes. According to the Federal Reserve, Americans withdrew more than $1.1 trillion of equity from homes in 2006 and 2007.

By the end of 2008, with home values plunging, one in six homeowners found themselves underwater—owing more on their homes than they were worth. Borrowers, even those with stable jobs, began to see such negative equity as a reason to stop making their payments. That triggered the third wave of the foreclosure crisis: the strategic default.

The Obama administration is working with banks to head off future defaults and stanch the foreclosure wave by modifying mortgages. The federal programs have so far disappointed. Here are stories of people caught in the foreclosure crisis.

Jason Henry for The Wall Street Journal (Mr. Banner); Brandon Sullivan for The Wall Street Journal (Mr. Hanson); Amanda Koster for The Wall Street Journal (Ms. Thomas)

Clockwise from top, Sidney Banner lost his company and then his home in Boca Raton, Fla.; Fysah Thomas in the home she and her fiance bought in foreclosure; Chris Hanson is 'strategically' defaulting on his Scottsdale, Ariz., home.

Lost: A business, then a house

Like other people whose fortunes were tied to real estate, Sidney Banner has suffered a one-two punch from the downturn.

In 2008, he lost his small, family-run commercial-mortgage brokerage business, when tighter lending requirements made it difficult to finance sales of commercial properties. This month, the 84-year-old and his wife lost their 3,200-square-foot home in an affluent section of Boca Raton, Fla. They've moved into an 880-square-foot rental apartment in a modest neighborhood of Palm Beach County, cutting monthly housing expenses from $2,600 to $400.

Mr. Banner bought his house 22 years ago for $296,000. By 2007, the house was valued at $429,000. Like many other homeowners at the time, Mr. Banner tapped the equity in his home by taking out a $250,000 loan. He used the money to try to keep his business afloat as the real-estate market unraveled. A year later, Mr. Banner defaulted on his first and second mortgages; the value of his home fell to $350,000. It is now scheduled for auction in January at a foreclosure sale.

"When things were good, making payments was easy," Mr. Banner said. "But now I've cut down to the bone, to the point that we can live on Social Security payments."

Many former mortgage brokers have been able to find new jobs working for banks and other companies. But Mr. Banner typifies one problem facing older Americans: the difficulty of finding employment. Only about 6.1 million of the 38 million Americans aged 65 or older were employed in 2009, according to the Bureau of Labor Statistics.

For two years, Mr. Banner and his wife received $1,200 a month in unemployment payments, in addition to their $3,200 social-security checks. The unemployment payments have now run out, so Mr. Banner said he was going back to work. He hopes to start a company brokering small commercial-real-estate loans to borrowers he finds through online advertising and Craigslist.

Mr. Banner said the foreclosure may have been a blessing in disguise: "My wife and I are both very much more relaxed now that we walked away from this enormous responsibility, and all these people calling us every day, looking for something they're not going to get."

—Robbie Whelan

Seeing the allure of 'can pay, won't pay'

When Chris Hanson bought his $875,000 condominium in Scottsdale, Ariz., four years ago, he could afford the $90,000 down payment.

He said he had no difficulty paying the $5,000 monthly mortgage on the three-bedroom unit, which has floor-to-ceiling windows and views of Camelback Mountain.

And, true to his word, he didn't miss a single payment—until last month. Concluding that the home, now worth about half of what he paid, won't recover its value for at least 10 years, Mr. Hanson decided to walk away. "It's a no-brainer once you do the math," said the 27-year-old real-estate investor.

He plans to let the lender foreclose on the home and rent an even nicer unit in either the same complex or one nearby, which he figures will cost less than half of his monthly mortgage payment.

Borrowers like Mr. Hanson represent the latest—and for lenders the most troubling—wave of the foreclosure crisis. Mr. Hanson's case illustrates the growing risk that borrowers in hard-hit housing markets will "strategically" default, even when they can afford to stay in the homes. Nearly one-third of homeowners in Arizona, and half of those in Nevada, owe more than 125% of the value of their homes, according to **CoreLogic** Inc., a real-estate data firm.

Mortgage-finance giant Fannie Mae has threatened to withhold credit for up to seven years from people strategically defaulting and to pursue their assets in states that allow for deficiency judgments.

Mr. Hanson said that he felt little moral obligation to make his payments because he felt banks' shoddy lending practices were primarily responsible for fueling the housing boom and bust.

Mr. Hanson runs an investment firm that buys up foreclosed properties and resells them. He said the company buys two to three homes a week at prices ranging from $15,000 to $1 million; they've recently expanded into distressed multifamily homes. He said he realized months ago his home would take years to recover its value but decided only six weeks ago to stop making payments.

He worried that wrecking his sterling 800 credit score would make it harder to run his business. But, in the end, he said he decided it was worth the risk. "It's actually really relieving," Mr. Hanson said.

—Nick Timiraos

Falling value ruled out refinancing

Kelli Kobor and her husband thought they were making a safe investment in 2004 when they made a $350,000 down payment on the $1.3 million purchase of their five-bedroom Dutch colonial in Kenilworth, Ill., a wealthy suburb on Chicago's North Shore.

Ms. Kobor and her husband have no other debt. They never refinanced or took out a second mortgage. But like many other Americans, they ran into trouble making their mortgage payments last year after Ms. Kobor's husband lost his job and later found a new one that paid much less.

Their home had fallen in value, wiping out any equity and making it impossible to refinance. Ms. Kobor wasn't eligible for the government's loan-modification programs because her loan was too large; her mortgage servicer offered a six-month interest-rate reduction that tacked the payment shortfall onto their loan.

Tired of feeling "strung along," they ultimately surrendered the home to the bank in what's known as a deed-in-lieu of foreclosure, and moved out in August. They now rent a three-bedroom ranch-style home in Deerfield, about 10 miles away.

Moving her family was a "very difficult choice, a very difficult transition," says Ms. Kobor, 43. She still takes her son to play with his best friend and former neighbor. "Every time I drop him off," she says, "I have to look at my house." The home was listed for sale last month at $749,000.

Ms. Kobor and her husband are saving to buy another home, although this time they'll approach home ownership differently. They will take out a smaller loan, one they can repay within 10 or 15 years. "We will never leverage up like that again," she says.

But the biggest surprise over losing her house is that "our lives are so much better now," Ms. Kobor says. "The relief of knowing that we are not in a bottomless hole... psychologically, it has been great."

More borrowers need to "wise up," she says, and realize that the government and the banks aren't likely to help them. "People who are in our situation, we're told, 'Save your house,' " she says. But the crisis has taught her that "what's much more important is saving your family, saving your sanity, saving your financial future."

—Nick Timiraos

Housing nightmare is a dream for some

Last year, Bret Sands and his fiancee, Fysah Thomas, shared a cramped $600-a-month studio apartment. Today, they're living in a Seattle lakefront property with three bedrooms, hardwood floors and a spiral staircase.

If there's an upside to the foreclosure crisis, it is largely enjoyed by people like Mr. Sands and Ms. Thomas: They can now afford to buy. He's a surveyor of marine vessels and she's the lead vocalist in a band. Both watched the mid-decade housing boom pass them by, thinking they'd never be able to join.

Then the bubble burst. According to the Case-Shiller Home Price Indices, prices in Seattle through October were about 25% off their July 2007 peak—with single-family homes now selling at a median price of $481,000, according to the local multiple listing service.

In 2008, Mr. Sands, age 34, started to see the stock market falter and grew worried about his retirement savings account. He took $60,000 out of the account, and with an eye on plummeting home prices, he and Ms. Thomas decided to buy a house.

They never intended to buy a foreclosure but nothing else fit their budget. After two months and about 30 tours with **SeattleHome.com** real estate broker Sam DeBord they found their house. It went into foreclosure when its owner's restaurant went belly up. Ms. Thomas saw it during a random web search. The couple paid $232,000 for a house that in 2007 had been appraised at $300,000. One of its main attractions: It sits among much larger, half-million-dollar homes along Angle Lake.

"We wouldn't have been able to afford a house if the market hadn't dropped," Mr. Sands said.

With help from friends and Ms. Thomas's carpenter father, they have embarked on renovations. Because the house needed so much work, Mr. Sands kept a lot of his cash to pay for refurbishments. He put about $9,000 down under a loan insured by the Federal Housing Administration.

"It should be an inspiration to any other people like us," Ms. Thomas said. "Being able to buy a home is one of the most important decisions you can make."

—Mitra Kalita

WORLD NEWS

South Korea's Lee walks tightrope on North talks

By Evan Ramstad

SEOUL—South Korean President Lee Myung-bak, in efforts to shape a policy toward North Korea for next year, hinted at the South's willingness to return to the diplomatic process called six-party talks.

Mr. Lee said he wants to see North Korea agree to nuclear disarmament in the talks, but officials later said Seoul isn't yet ready to rejoin the negotiations.

China, the host of the talks, has been pressing for months to restart the talks that broke down two years ago. North Korea, which formally quit the process in 2009, has said it is willing to talk.

But South Korea, the U.S. and Japan say they want assurances that the North is serious about negotiating and not using the process, which also includes Russia, for the sake of improving its international image.

In meetings with ministry leaders Wednesday on foreign and defense policy for next year, Mr. Lee tried to articulate a balance between openness to dealing with the North's authoritarian regime and wariness of being dragged into lengthy negotiations that produce no outcome.

He listened to presentations from the ministries of defense and foreign affairs as well as the Ministry of Unification, which handles affairs with North Korea. Before the foreign-affairs session, Mr. Lee said there is "no choice but to resolve the problem of dismantling North Korea's nuclear program diplomatically through the six-party talks."

The remarks were aimed in part at assuring the other countries in the talks that South Korea remains open to the process despite North Korea's recent provocations against it.

Later, presidential aides and officials at the Unification Ministry said South Korea isn't ready to rejoin the six-party talks immediately. But they said South Korea remains open to direct discussion with North Korea.

U.S. officials have said they would like to see inter-Korean talks held to resolve the extreme animosity created this year by the North's attack on a South Korea-controlled island and sinking of a South Korean warship, incidents that resulted in the deaths of 50 South Koreans.

In a news conference, Unification Minister Hyun In-taek said South Korea has "no prerequisites" to North-South government talks. But he added, "North Korea should take responsibility for its actions."

Responding to local media reports that South Korea was changing its unification policy to focus on absorbing North Korea, Mr. Hyun said the government plans to stick to its current policy of seeking a peaceful resolution of the Korean War, then forging economic ties and then pushing for reunification. "It is a very long-term initiative," he said.

Mr. Lee's administration, nearing the end of its third of five years in office, changed Seoul's course on North Korean policy by linking the South's economic assistance to steps taken by Pyongyang to end its pursuit of nuclear weapons.

Previously, South Korea provided hundreds of millions of dollars a year to North Korea with few questions asked. North Korea continued its weapons program. When Seoul cut off the aid, it reacted with a steady, angry stream of criticism in its state media and a series of increasingly violent provocations.

Over the past year, South Korea's government has grown more direct in criticizing the North's government, though officials rarely mention dictator Kim Jong Il by name. The parliament, for instance, passed legislation that calls for North Korea to improve its human rights and provide more freedoms to its citizens.

Mr. Lee and other government leaders have more frequently stated that North Korea should follow China's course of gradual economic opening. And they have said that South Koreans should begin to talk about the prospect of uniting with North Korea, despite the likelihood that it may not happen for years and will be very expensive when it does.

Such steps, though relatively small by some measures, underline the broader policy change in the Seoul government's approach to the North. And they regularly provide fodder for criticism by North Korea's state media. For instance, North Korea over the past week has issued several statements lashing out at Mr. Lee for calling the North "bellicose" in an interview last month.

In his news conference on Wednesday, Mr. Hyun said something new that, while relatively mild or obvious on its surface, may antagonize the North because he directly mentioned Mr. Kim's signature policy, called "Seongun" or "Military First."

"North Korea should abandon its 'Military First' policy," he said. "Rather, it should put its own citizens first. That would be good for North Korea's future."

Agence France-Presse/Getty Images

President Lee Myung-bak, left, with Prime Minister Kim Hwang-sik, right, met with ministry leaders on foreign and defense policy in Seoul on Wednesday.

Israeli settlers seek to repel Palestinian

By Joshua Mitnick

TEL AVIV—A leading Palestinian businessman is bidding to take over an ill-fated real-estate venture in an Arab neighborhood of East Jerusalem, upsetting Israeli settlers who are scrambling to put together a counteroffer.

Nof Tzion, Hebrew for Zion View, is a half-built project located in a mostly Arab neighborhood of East Jerusalem, marketed two years ago to wealthy U.S. Jews as a luxury residence with a panoramic vista of Jerusalem's Old City. Though the 91 units of the first phase of the development have been sold and occupied, Israeli developer **Digal Investment & Holdings** Ltd. couldn't complete the project or repay its bondholders, mostly Israeli institutions. Representatives of Digal weren't available to comment.

Jewish residents of the project are now livid at the idea that the project could be turned over to a Palestinian. The Palestinian businessman, Bashar Masri, said that if his bid is successful he plans to offer houses in subsequent phases to Palestinians. His bid was discussed at a meeting of bondholders in Tel Aviv on Tuesday afternoon.

Mr. Masri, a U.S. citizen who grew up in the West Bank, is offering to repay 80% of bondholder debt totaling $17 million, according to a person close to the bidder. Digal also owes some $20 million to **Bank Leumi** Ltd. of Israel for project financing.

Mr. Masri, who leads an investment company building a separate, massive Palestinian development in the West Bank, is the scion of a Nablus family that controls **Arab Bank** PLC and the Palestinian phone monopoly, **Palestine Telecommunications** Co.

Though Israelis consider all of Jerusalem their capital, the international community considers the Arab neighborhoods annexed to the city in 1967 as part of occupied Palestinian West Bank. Jewish neighborhoods there are deemed settlements. Continued Israeli building in East Jerusalem has triggered U.S. protests and prompted the Palestinians to refuse to participate in peace talks.

Unlike most Jerusalem building projects, which were initiated by the government, Nof Tzion was the first Jewish development in East Jerusalem to be financed by a public offering on the Tel Aviv Stock Exchange. Situated on a hillside facing north toward the walled old city and the golden Dome of the Rock mosque, the project originally envisioned a hotel and a shopping mall, in addition to 400 residences.

Bemunah Ltd., an Israeli builder that specializes in housing for Orthodox Jews, said it is preparing its own offer to compete with Mr. Masri's. The company declared on its website that it is trying to stop the "hostile takeover" of East Jerusalem and called for the "rescue" of Nof Tzion.

"Of course the purpose is to keep the territory Jewish," said Israel Zeira, chief executive of Bemunah.

WORLD NEWS

Placid Somali enclave seeks business

By Sarah Childress

HARGEISA, Somaliland— Southern Somalia is wrestling with virtual anarchy, but entrepreneurs and officials in this relatively stable, autonomous part of the north are touting their gains as a model for leading the region toward stability.

Somaliland has operated in relative peace since it declared independence in 1991, holding four democratic elections, fostering private businesses and building universities and hospitals—though the region still lacks official international recognition as an independent state.

In July, Somalilanders elected a new government of technocrats from educated diasporas in the U.S., Canada and the U.K. to run the dusty territory, which is home to about 3.5 million people, most of whom tend herds of cattle, goats and camels, or else have settled in the capital, Hargeisa.

Associated Press

A customer pays his bill at Somaliland's water and power ministry. The region is seeking development funding.

Somaliland relies heavily on private businesses to employ its people, import equipment, invest in the economy and donate to the government.

The relative stability here has spurred new thinking from donors. "I'm impressed by what does go on in Somaliland," said Mark Bowden, the United Nations' resident and humanitarian coordinator. Mr. Bowden said international aid—currently about $100 million annually—could double next year.

The U.S. has boosted funding to $26 million from $7 million in 2009. The top U.S. diplomat on Africa, Johnnie Carson, recently said the U.S. would pursue a "second track" policy in Somalia that would include more engagement with Somaliland. The U.S. pledged about $40 million in aid to the Somali government in Mogadishu last year, but channels much of its support to the African Union peacekeeping force there, and to groups that provide food aid to the region.

"The U.S. for some time has been wasting taxpayers' dollars on a place called Mogadishu," said Hussein Abdi Dualeh, the newly appointed minister of mining, energy and water resources in Somaliland, who had been working until recently in California. Unlike the Somali capital, he says, "We're the part of Somalia that's functioning. The aid they give here won't be torn up by shrapnel."

Because Somaliland lacks recognition as an independent state, it can't secure loans from international banks, enter agreements with other governments, or provide the legal stability demanded by foreign investors.

The international community fears that recognition of Somaliland could lead to further border disputes in Africa. But as the Somali government to the south borders on collapse, that thinking has begun to change.

In the meantime, Somaliland officials have focused on luring back overseas Somali entrepreneurs with low taxes, light regulation and political stability. "There's a lot of opportunity in Somalia, we have to champion that," said Abdirashid Duale, the 36-year-old chief executive of Dahabshiil Group, and one of several members of the diaspora who have built booming businesses in agriculture, water bottling and telecommunications.

Mr. Duale went to high school in London, then joined the family business, a money-transfer service that sent funds in and out of Somalia. Dahabshiil has since become the largest money-transfer service in the Horn of Africa, handling much of the estimated $1.6 billion transferred home each year to Somalia, including Somaliland.

The company was started by his father in the early 1970s to help Somali workers in Gulf states get money home. When civil war broke out in Somalia in 1989, the business collapsed and the family fled to the U.K. The business was revived there, and now operates in 144 countries, including several U.S. states.

In a sign that Somaliland isn't beyond the reach of militants, the violent extremist group al Shabaab, which dominates much of southern Somalia, has said it will ban mobile-phone money transfer services as of Jan. 31. The services, a recent innovation here, have become a popular way to conduct business transactions in a mainly cash-based economy. In a statement in Arabic, Somali and English, al Shabaab said the mobile money-transfer services had been set up by the West to exploit Muslims.

The government in Mogadishu said the move was an effort by al Shabaab to undermine the private sector's hard-won economic gains. The Somali government, because it only controls part of Mogadishu and nothing else in the country, is largely powerless to stop it.

Al Shabaab militants, who control much of southern and central Somalia, govern by fear. In the past, they have beheaded those who defied them.

Al Shabaab has a presence in Somaliland, according to African Union and Somaliland government officials. The Somaliland government has been aggressive about monitoring the militants, with help from a largely cooperative population. But the group and other militants still manage at times to disrupt the region's calm.

Mr. Duale, whose company has a share in a mobile-transfer service, declined to comment on the al Shabaab decree, saying he was concerned he might antagonize the militants.

Mr. Duale divides his time between London, Dubai and Somaliland, and still runs the family business out of Hargeisa, with simple headquarters on a dusty street, where donkey carts compete with cars and women in colorful headscarves run small kiosks selling household goods.

Shortly after the new Somaliland president came to power this year, he called a meeting with several major businessmen, including Mr. Duale. The previous government had borrowed "tens of millions" of dollars from the private sector, according to one government official. Now it was asking for more.

Mr. Duale said the business owners agreed to help, as long as the government didn't try to impede their growth. In addition, Mr. Duale said he gives about $1 million each year to hospitals and universities in the community.

Probe into Afghan 'Malign Actors' stalls

By Matthew Rosenberg

KABUL—U.S. officials in Afghanistan have spent thousands of hours over the past few years charting what they call "Malign Actor Networks"—webs of connections between members of President Hamid Karzai's family, businessmen, corrupt officials, drug traffickers and Taliban commanders.

Using intelligence drawn in part from informants and a powerful wiretapping system, these officials say they have found an economic and political order—underwritten by billions of dollars in aid, reconstruction and logistics funds from the West—that is undermining the Afghan government from within and aiding a Taliban insurgency that is trying to topple it from without.

The officials and their Afghan allies have had less success, however, breaking these bonds.

The futile attempts so far at prosecuting one individual—a banker named Haji Muhammad Rafi Azimi—illustrate the depth of the problem.

Mr. Azimi has bribed senior officials, moved money for drug traffickers and kept the Taliban flush with cash, say several current and former Afghan and U.S. officials who described what they say are hours of wiretaps, information provided by informers and financial documents connected with the bank where Mr. Azimi works.

In an interview, Mr. Azimi denied any wrongdoing.

Mr. Azimi features in several of the scores of PowerPoint slides drawn up to chart the Malign Actor Networks, officials say, with its squiggly lines that represent family ties, business partnerships or other links that connect people from spheres across Afghanistan.

In November 2009, Afghan prosecutors issued a warrant for Mr. Azimi's arrest after he was allegedly heard on a wiretap discussing bribes paid to the country's then-Islamic affairs minister. Such payments would secure government contracts for Mr. Azimi's travel business to take Muslims on the annual Hajj pilgrimage to Mecca in Saudi Arabia,

Joël van Houdt for The Wall Street Journal

Haji Muhammad Rafi Azimi in his office in Kabul.

Afghan and U.S. officials say.

The minister fled Afghanistan before he could be arrested.

Almost immediately, President Karzai asked Afghanistan's Attorney General to quash the warrant against Mr. Azimi, according to a former Afghan prosecutor involved in the investigation. The action was taken because of Mr. Azimi's connections to top officials, said a senior adviser to President Karzai.

Mr. Karzai's office denied meddling in the investigation.

In an interview, Deputy Attorney General Rahmatullah Nazari said prosecutors didn't charge Mr. Azimi because they lacked evidence. He said wiretaps aren't admissible in Afghan courts and that authorities felt it "unfair that a minister [who allegedly took bribes] should be free while another man sat in jail."

Yet a lower-ranking Islamic Affairs Ministry official connected to the case was convicted in May, in part because of a wiretap recording in which Mr. Azimi was heard discussing the alleged bribes. The recording prompted the judge to ask why Mr. Azimi wasn't on trial, said Afghan and U.S. officials who have seen a videotape of the proceedings.

Mr. Azimi denied giving bribes. Regarding the wiretap, he said: "It is not my voice."

Officials say the case against Mr. Azimi exemplifies how a major, two-year campaign to cut Taliban funding and clean up President Karzai's corrupt administration is floundering, in part because of resistance from the president himself.

"Everyone's got protection here," said a U.S. official in Kabul involved in the investigations. "No one's afraid of getting caught so no one's got to take a fall."

Mr. Azimi said talk of his Taliban ties are "rumors" and dismissed corruption accusations. "In business, you have rivals," he said in an interview in his office at the Kabul headquarters of Afghan United Bank, where he is vice chairman.

He added that he is widely trusted in Kabul's business and political community. "In Afghanistan, there is no business without trust," he said.

Going after corruption is seen as a crucial facet of the U.S. surge strategy, needed to restore the government's credibility with Afghans in areas retaken from the Taliban. Yet with President Barack Obama's July 2011 deadline to start withdrawing U.S. forces approaching, many Afghan and U.S. officials say the efforts have so far yielded few results.