White House chief of staff draws fire as Obama falters

THE BIG READ 18-19

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THE WALL STREET JOURNAL.

Trichet backs U.S. plan to curb biggest banks

By Brian Blackstone And Matthew Karnitschnig

FRANKFURT—European Central Bank President Jean-Claude Trichet offered qualified support for a U.S. plan to rein in the size and activities of large banks, though he stressed such proposals should be coordinated globally.

DAVOS 2010
World Economic Forum

In an interview with The Wall Street Journal at his office on the 35th floor of ECB headquarters in downtown Frankfurt, Mr. Trichet also urged U.S. lawmakers to confirm Ben Bernanke for another term as Federal Reserve chairman, saying he holds Mr. Bernanke "in very great esteem," an unusual public backing from a central banker who zealously guards his independence from politics.

The bank-reform plans the White House outlined last week "go in the same direction of our own position, namely ensuring that the banking sector focuses on financing the real economy," Mr. Trichet, 67 years old, said in his first public remarks on the proposal.

Under U.S. President Barack Obama's plan, limits would be placed on the market share of the largest U.S. financial firms and put restrictions on proprietary trading by banks.

Several European countries including Germany and France have pushed for international consensus on a new regulatory framework for the banking system. The European approach has emphasized forcing banks to increase their

Please turn to page 4

Reuters

ECB President Jean-Claude Trichet said the U.S. bank-reform plans 'go in the same direction of our own position.'

Security chief's death is probed

By Roman Kessler, Goran Mijuk and Marietta Cauchi

DAVOS, Switzerland—The World Economic Forum's chief of security, Markus Reinhardt, was found dead in his hotel room, one day before the official start of the annual gathering of the world's business and political elite, according to officials in the Swiss canton of Grison.

Authorities said the 61-year-old police chief may have committed suicide, but that there was no clarity as of yet as to what caused his death.

A government spokesman said Mr. Reinhardt, who since 1984 acted as head of the cantonal police of Grison, will be replaced by his second in command, Marcel Suter, as head of WEF security, and added that security at Davos remained intact at all times.

Meanwhile, the canton's chief prosecutor said the office has started an inquiry into Mr. Reinhardt's death. It will try to find out whether the veteran lawyer committed suicide or died because of a third-party fault. Neither the government nor the prosecutor named the hotel where he was found.

Security has been a major issue at Davos for years as the gathering gained in importance and drew a growing number of antiglobalization activists. In a worst-case scenario, the Swiss government can mobilize up to 5,000 army troops to protect Davos.

The Quirk

Don't call them resorts: Hotels find trick to business bookings Page 33

Editorial & Opinion

Stop the trial of Geert Wilders. Page 17

S&P lowers Japan's outlook to negative

By Alison Tudor And Kenneth McCallum

TOKYO—A credit-ratings firm issued a warning to Japan's new government unless the country's borrowing, threatening to downgrade the nation's sovereign debt unless policy makers find a way to pull the economy out of its deflationary spiral while curbing public spending.

The statement from Standard & Poor's on Tuesday was the first formal declaration of concern from a ratings company about Japanese borrowing in the months since investors began to raise questions about the sustainability of government debt, estimated to have reached the size of the country's entire economic output for the year ending in March—the highest level in the industrialized world.

S&P's warning also smacks of a vote of no confidence in the four-month-old administration of Prime Minister Yukio Hatoyama, who took office amid high hopes of reforming Japan's long-stagnant economy, but has since struggled to articulate a path to recovery.

The agency specifically cited the new administration's focus on social spending and a seeming lack of concern for Japan's borrowing as a reason for its threat to knock Japan's long-term sovereign debt a notch below its current double-A rating.

"The policies of the new Democratic Party of Japan [DPJ] government point to a slower pace of fiscal consolidation than we had anticipated," the agency said. That, "combined with other social policies that are not likely to raise medium-term trend growth," led the firm to forecast the debt level continuing to rise to 115% of GDP "over the next several years."

The warning—announced after the Tokyo stock market close—revived memories of the time in 2001 when Japan lost its top-notch triple-A rating and suffered a series of downgrades that briefly put the country's debt below Botswana's. S&P upgraded Japan's outlook through the decade, before Tuesday's formal revision of Japan's prospects

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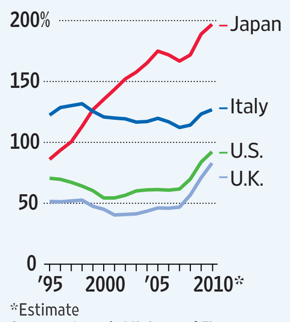
Government debt
As a percentage of GDP



*Estimate
Sources: Japan's Ministry of Finance

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PAGE TWO

An East-West rebalancing act is essential to spur global recovery

[Agenda]

By Michael Geoghegan

It's hard to believe the term BRIC—now a shorthand at the heart of every business-development strategy—is less than 10 years old. But it is a sign of the speed with which the global economy is changing that it is already out of date.

I'm sure the experts are working to coin the new watchword for the 2010s. My own favorite is the BRITVICs: adding Taiwan, Vietnam and Indonesia to the equation. Take the last of these: At 112 million, Indonesia's work force is now the fifth largest in the world, and another 22 million will be added during this decade, equivalent to the entire population of Australia.

The prospects for the CIVETS also look strong—Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa—so-called after the cats found in many of these countries. They may lack the scale of the BRICs (Brazil, Russia, India and China), but all have proved robust during the crisis, and they will help to accelerate the global shift from West to East.

This is why, as the world's leading emerging-markets bank, HSBC has made the decision to move the Group CEO's principal office to Asia. As we seek to build our presence at the heart of the action, we need more than one base, and from next week, I will run our global business from Hong Kong. The view from there is exhilarating and the opportunities are huge. China's GDP per capita is rising fast, but is still only an eighth of that in the U.S. Meanwhile, the Asia-Pacific region will soon be home to the largest number of high-net-worth individuals in the world.

China's change has been the most remarkable. According to the IMF, China accounted for more than half of global economic growth over the past three years of crisis. But this isn't some recession-driven blip. The path toward reform is irreversible: 79% of Chinese people now agree that they are better off in a free-market economy, more than in either the U.S. or the U.K.

European Pressphoto Agency

People in China now agree that they are better off in a free-market economy

Whatever form it takes, protectionism never helps in the long term.

Crucially, so-called "south-south" trade flows are also growing fast. Across Asia, car sales are now buoyant from India to Vietnam, and manufacturing output is rising to meet growing demand. In services, where recovery is less firmly rooted, expectations have also improved to their highest levels for a year and a half. The establishment of a new free-trade agreement between ASEAN nations and China makes sense: South-East Asia now does more business with China than with the U.S.

As emerging nations begin to develop deeper and more sophisticated financial and capital markets to support economic development, the opportunities for leading financial centers such as London and New York are growing too. Through the sharing of expertise, and the building of new strategic relationships, both West and East can benefit.

After the collapse of Lehman Brothers, business confidence fell off a cliff. The latest HSBC Emerging Markets Index shows that it has now returned to pre-Lehman levels in emerging markets. But global recovery is not yet a given.

In many developing economies, recovery outside the manufacturing sector is less firmly rooted. Furthermore, unlike past economic cycles, the upturn in emerging markets hasn't been matched elsewhere. Sluggish growth forecasts for many developed economies tell us how uneven recovery will be.

One of the greatest successes of our response to this recession was that countries didn't close up their borders and pull up the drawbridge. At this critical stage in the recovery, it is now more important than ever that we support and stimulate trade. We must resist public and political pressure for trade barriers: Nothing would threaten the rhythm of recovery.

Whatever form it takes, protectionism never helps in the long term. It only ever prolongs the painful death of industries no longer efficient enough to compete on a global stage. Most important, it could cause lasting damage to those important East-West relationships on which our collective future now depends. We must keep our borders open and we must take the long-term view.

Less than a decade after the term BRIC was coined, emerging markets are setting the economic agenda. Caught up in the unsustainable bubbles of the "noughties," it was all too easy to miss the signals.

Yet as we take our first steps into the new normal, we know the world has changed.

For all of us, our prospects for long-term success are now more closely bound with the fortunes of the emerging world. And in the short term, global recovery depends upon the free flow of trade between West and East.

—Michael Geoghegan is Group CEO of HSBC Holdings PLC

What's News

■ **The IMF warned** that the divergence in growth in advanced and developing economies is complicating management of the economic rebound. The IMF upgraded its outlook for this year, forecasting the world economy to expand at a 3.9% pace. **4**

■ **GM reached a deal** to sell its Swedish Saab unit to Dutch sports car maker Spyker. **22**

■ **Kraft's takeover** of Cadbury has led U.K. politicians and a discontented public to question a once-accepted wisdom there: Britain's openness to foreign takeovers is a good thing. **21**

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NEWS

Villepin trial nears end

Former prime minister sets sights on 2012 presidential election

By David Gauthier-Villars
And Alessandra Galloni

PARIS—A French court is expected to deliver on Thursday a verdict in a long-running slander trial involving two of the country's best-known politicians—President Nicolas Sarkozy, the plaintiff, and former Prime Minister Dominique de Villepin, the defendant.

The decision should end a four-year war of words between the rivals over a complex case involving secret documents, secret agents and allegations of secret bank accounts.

But the end of the legal battle could mark the beginning of a new political one: If the charges against him are dismissed on Thursday, Mr. de Villepin has set his sights on the 2012 French presidential election. That would entail challenging Mr. Sarkozy's domination of France's conservative political camp.

"I could represent an alternative," Mr. de Villepin said in an interview one recent morning as aides bustled around him, hanging photos on the walls of his new two-room office on Paris's right bank. "My aim is to serve France and the French."

Mr. de Villepin, whose defining political moment came in a 2003 United Nations speech in which he urged the U.S. not to invade Iraq, left office two years ago, shortly before Mr. Sarkozy was elected with a resounding majority.

The end of Mr. de Villepin's tenure was marred by a failed attempt to pass a bill to allow young people to enter the job market by giving companies incentives to offer them short-term contracts. The proposal caused such a popular uproar that then-President Jacques Chirac backtracked and dropped the bill.

Mr. de Villepin has often been criticized for reaching one of France's top offices without ever having been elected to a political post—a criticism he brushes off, saying it makes him a fresher alternative. In the past year, Mr. de Villepin has begun planning his return. He organized a series of trips across France to "meet with ordinary people", he says, worried by what he sees as "a widening gap between the French and the elite".

Mr. Sarkozy, whose approval rating in a recent survey stood at 42%, hasn't yet said whether he will seek a second mandate in 2012.

A presidential bid by Mr. de Villepin could cause a rift within France's ruling UMP party. It would put Messrs. Sarkozy and de Villepin on a collision course, 15 years after their mentors—former Prime Minister Edouard Balladur and Mr. Chirac, respectively—fought in the 1995 election.

"French conservatives have often been divided," says French historian Jean-François Sirinelli. "But we have rarely had such a clash of personalities, in which the two leaders exploited their opposition instead of toning it down."

French conservatives have traditionally split along two main veins: One heralds Gen. Charles de Gaulle's heritage of heavy government intervention and the other, closer to other European Christian Democratic parties, favors more laissez-faire policies.

The creation of the UMP in 2002 was an attempt by Mr. Chirac, soon after his re-election, to unite all the families that form France's right.

The slander case set to close Thursday began in 2006, when dozens of businesspeople, lawyers and politicians, including Mr. Sarkozy, filed generic libel complaints with Paris prosecutors, saying they wanted to find out who had falsified and disseminated a list of banking records claiming they held secret bank accounts in Luxembourg.

Investigators looking into the claims said Mr. de Villepin knew of the existence of the list as early as 2004, and he was put on trial on charges of complicity in slander and complicity in forgery.

Prosecutors have called for a suspended prison sentence of 18 months for Mr. de Villepin and a fine of €45,000 ($64,000). Mr. de Villepin has said he knew of the list as early as 2004. But he added that he only learned that Mr. Sarkozy's name was on it and that the document was actually a fake when the case became public. In court and during the interview, Mr. de Villepin denied participating in a plot to discredit Mr. Sarkozy.


Agence France-Presse

Nicolas Sarkozy, left, with Dominique de Villepin in 2007.

IMF warns of a multitrack recovery

Developing countries will drive the global economy while also having to deal with extraordinary inflows of capital

By Tom Barkley

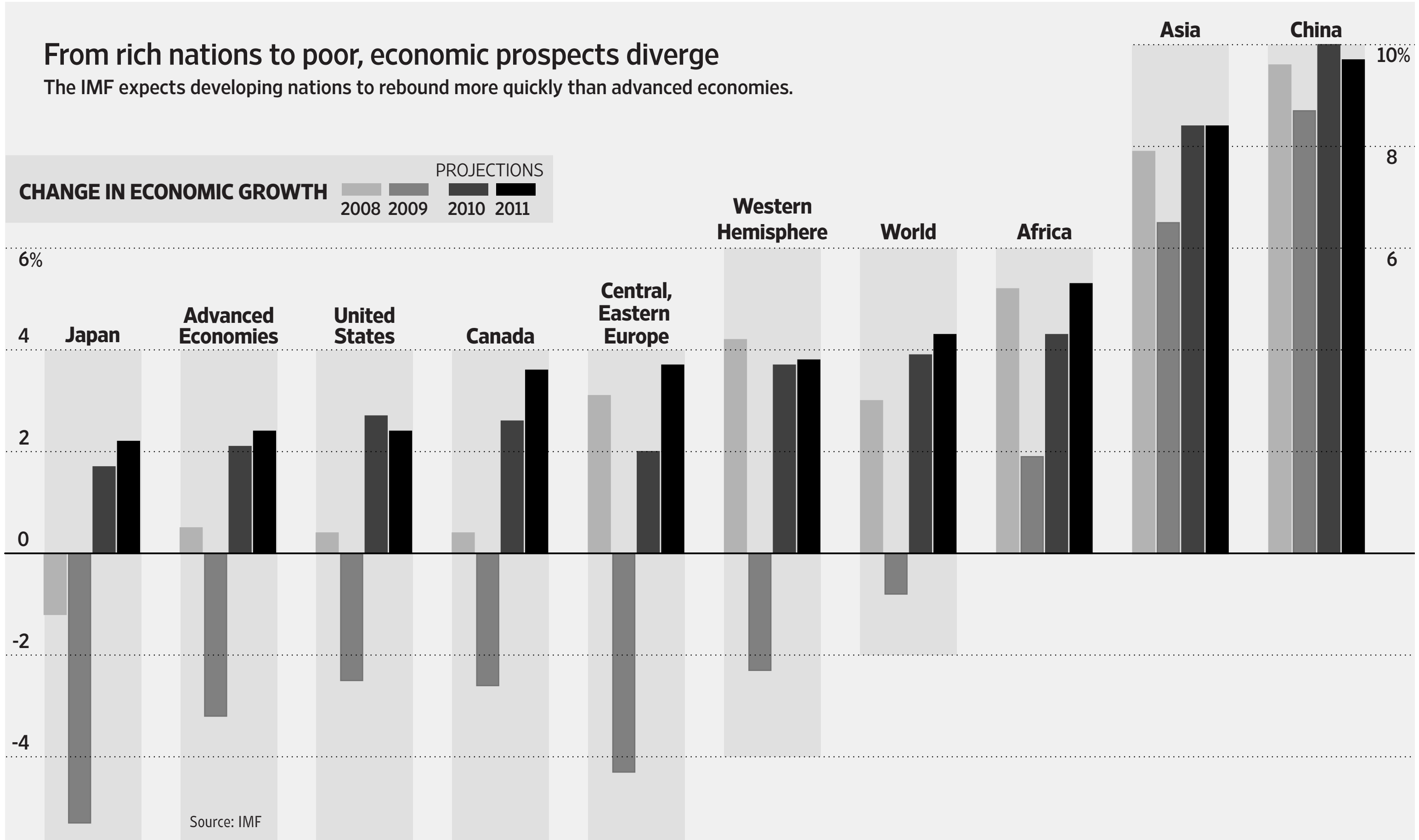
WASHINGTON—Countries around the world have emerged from recession more quickly than expected, but the International Monetary Fund warned Tuesday that managing postcrisis growth is becoming complicated by the diverging fortunes of advanced and developing economies.

The IMF presented a much brighter outlook for this year, with the world economy forecast to expand at a 3.9% pace instead of the 3.1% estimate given in October. Global growth is expected to continue to pick up in 2011, with the forecast edging up to 4.3% from 4.2%.

The rebound will increasingly be driven by developing countries as public stimulus measures recede, the IMF said, trimming some advanced-economy forecasts for next year given continued weak private demand and credit constraints.

The divergence raises policy challenges: Some developing countries are facing the risk that surging inflows will cause new asset bubbles while many advanced economies continue to rely on extraordinary monetary, fiscal and financial support measures.

Emerging economies could temper these bubbles by tightening fiscal policy or allowing currency appreciation, the fund said. But it also reiterated that some buildup of reserves or capital controls may be appropriate to address large and transitory movements.



Given growing concerns about public debt levels, the fund recommends that countries fully implement fiscal stimulus for this year, while devising credible fiscal-sustainability plans. Medium-term fiscal consolidation should protect spending on the poor and foreign aid while overhauling entitlement spending, it said.

Growth in the U.S. is expected to reach 2.7% in 2010 and 2.4% next year. The fund said new U.S. policies to create jobs could boost growth there and globally.

The euro area is forecast to grow 1% this year and 1.6% in 2011, while the U.K. is seen expanding 1.3% this year and 2.7% next.

Jose Vinals, an IMF official, said that despite the recent improvement in market conditions, "the repair of the financial system is by no means complete, and financial stability remains fragile."

Trichet backs U.S. banking plan

Continued from first page

capital cushion instead of restricting their business activities.

Though Mr. Trichet said the ECB was "examining [the Obama proposals] with great care," some analysts question whether Germany and France, the euro zone's most influential members, would endorse reforms that could diminish their own universal banks, **Deutsche Bank** AG and **BNP Paribas** SA.

Mr. Trichet, who arrives Wednesday for the World Economic Forum in Davos, Switzerland, admonished bankers to remember their role in generating the biggest financial crisis since the Great Depression, and who got them out of it.

Some at financial institutions see a return to normalcy "and have forgotten that governments put over 25% of GDP of taxpayer risks on the table and that major central banks have engaged in nonconventional measures, which have been absolutely extraordinary," Mr. Trichet said.

Banks, he said, need to restore their balance sheets by issuing new shares when possible, setting aside a "significant" portion of profits and fixing compensation practices so the financial sector can "do its job, which is financing appropriately the real economy."

Addressing the fiscal and economic crisis in Greece, Mr. Trichet said he believed the country's government would make good on its recent promise to quickly rein in its ballooning budget deficit, despite the painful public spending cuts such a course would entail.

"It is what the government has committed to do," Mr. Trichet said when asked whether a country with Greece's massive public-sector spending could meet its deficit-reduction targets. "I trust it is not only realistic but also necessary in the present demanding circumstances to take the right decisions to meet the goal."

Greece has said it will shrink its deficit from almost 13% of GDP in 2009 to less than 3% by 2012.

Many investors and economists doubt that ambitious timetable is possible and yield spreads between Greek sovereign debt and safer alternatives such as German government bonds, have skyrocketed.

Greece accounts for only a fraction of the euro-zone economy, but its turmoil has raised concerns that its troubles could spread to countries with exploding budget deficits, including Ireland, Spain and Portugal. Germany and other healthier euro-zone members have pressured Athens to repair its finances.

In response to the Greek crisis, Mr. Trichet called for "all data, facts and figures" to be audited nationally and "when judged necessary" by Europe's official statistics arm. He said he expects the European Commission to take up the issue soon.

He also called for "rigorous" application of budget rules under the euro zone's stability and growth pact that call for deficits to be less than 3% of a country's GDP.

The former Bank of France governor rejected growing worries that governments would seek more influence over monetary policy in the aftermath of the financial crisis.

"I don't trust this is serious," and the need for independence is now greater than ever, he said.

Mr. Trichet offered strong support to Mr. Bernanke, who is battling to secure enough votes to stay on as Fed chairman for another four years amid criticism by some over his handling of the financial crisis. Unlike the Fed, ECB presidents can only serve one term.

"I do hope and am confident that he will be confirmed by the U.S. Senate," Mr. Trichet said.

Mr. Trichet has generally received high marks for steering Europe through the financial crisis. Though the ECB has drawn fire for increasing interest rates only two months before the 2008 collapse of Lehman Brothers, the bank quickly shifted course, slashing rates to a record-low 1% within a few months.

Mr. Trichet also advocated pumping hundreds of billions of euros into banks to stave off their collapse, a largely successful effort from which the ECB is slowly withdrawing this year as banks stabilize.

Mr. Trichet, who is due to retire at the end of his eight-year term in October 2011, reflected on 30-plus years at the highest levels of global policy making. Much of his career has been spent battling economic disaster, he said, from Latin America to Africa, Russia, Mexico and Asia.

The Frenchman's secret for handling crises: an ability to make rapid decisions and a dose of "sangfroid."

BOE chief praises 'radical' U.S. plan

By Natasha Brereton

LONDON—Bank of England Gov. Mervyn King said that U.S. government proposals to curb the size and activities of commercial banks make it clear that radical reforms are now on the table.


Mervyn King

Mr. King told lawmakers that it isn't realistic to pretend a financial structure could be designed that would prevent future crises from occurring, and the more sensible approach is to make any new system resilient enough so that troubles in one section can't bring down the rest.

Even before the financial turmoil, the U.K. banking sector was highly centralized, and the crisis has exacerbated that trend.

The central bank has been pushing for discussion of more drastic changes to Britain's financial architecture, and Mr. King urged lawmakers not to dismiss options before they have been given thorough consideration.

Mr. King said he would like to see the development of a network of smaller, more specialist banks. U.K. authorities could unilaterally move to break them up if they were unable to reach international agreement on the issue, Mr. King said.

"The system that has the least to be said for it is the present system, the status quo. That's the one that's brought us financial crises of ever-growing severity," Mr. King said.

"That's why looking deeply at the structure of the financial sector and asking radical questions about the structure is the right way to conduct the debate," he added.

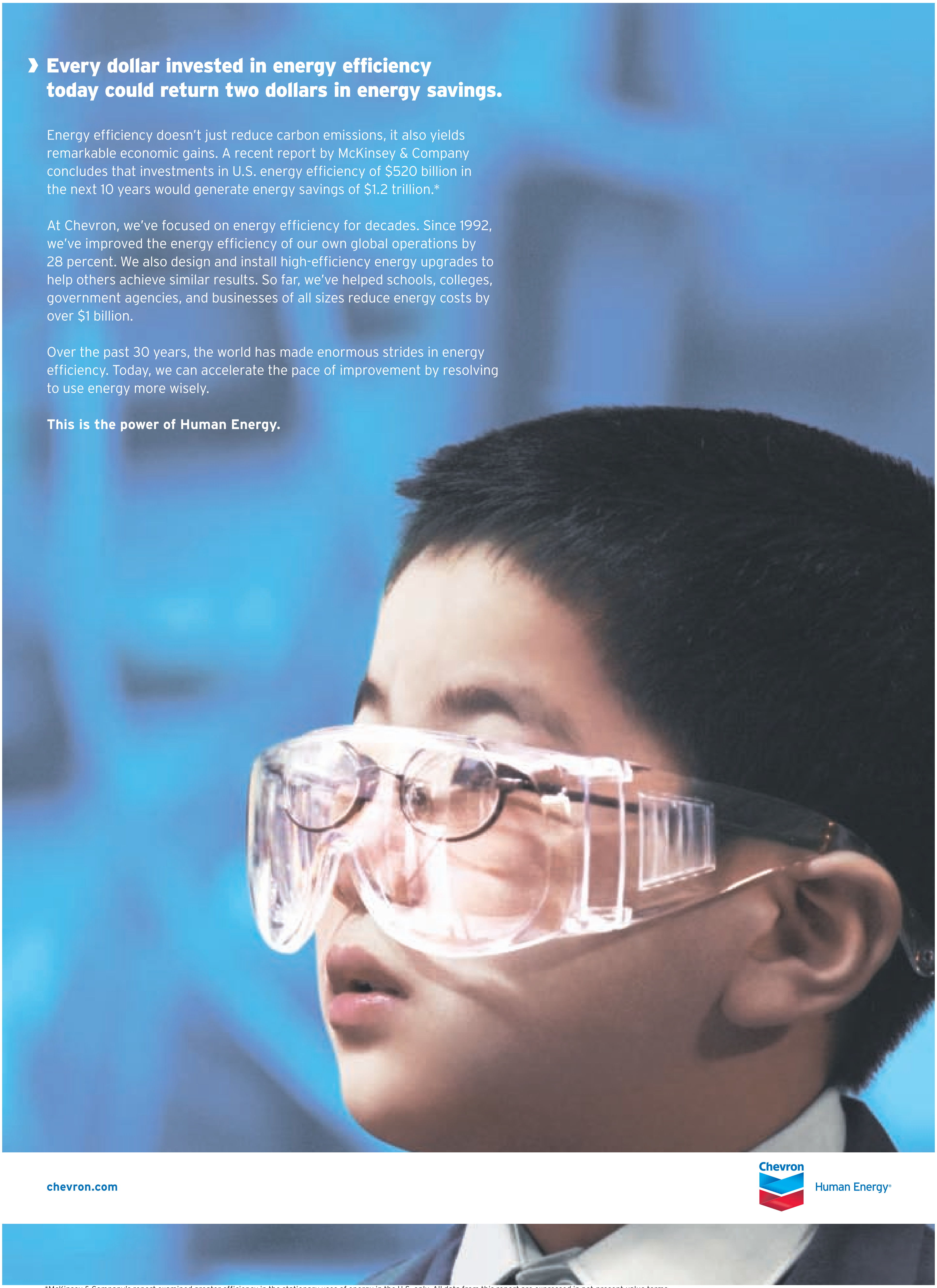
The U.K. government has said it is taking actions that are appropriate for its own markets and won't copy the U.S. bank proposals. But the U.S. plans bring the idea of such measures into the mainstream and will give impetus to the BOE's calls.

U.S. President Barack Obama's plan would prevent commercial banks, and institutions that own banks, from owning and investing in hedge funds and private-equity firms.

It would also limit the trading they do for their own accounts, and seek to curb the size of any financial firm in relation to the sector.

The BOE governor said policy makers could afford to take their time to make the right decisions on reform, since banks aren't rushing out to take on more risk.

It is important not to choke off lending, Mr. King said, adding that now wasn't the time to raise capital requirements.



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U.S., China to take stage in Europe

By Marcus Walker
And Andrew Batson

The setting may be European, but the U.S. and China will be central to many of the discussions when global business and political leaders meet at the World Economic Forum in Davos, Switzerland, which opens Wednesday.

The global financial crisis and the stumbling efforts to tackle climate change have highlighted the mounting evidence that China is becoming the world's second-most influential country after the U.S.

A growing number of policy makers, economists and political analysts argue that the U.S.-China bilateral relationship is now the most important of all—and that the chances of managing the globalized world successfully will be slim unless these two powers, as different as yin and yang, can cooperate.

Although the U.S. and China may be the two most powerful countries for years to come, many analysts and officials doubt they can, or should, form a de facto Group of Two to set the global agenda.

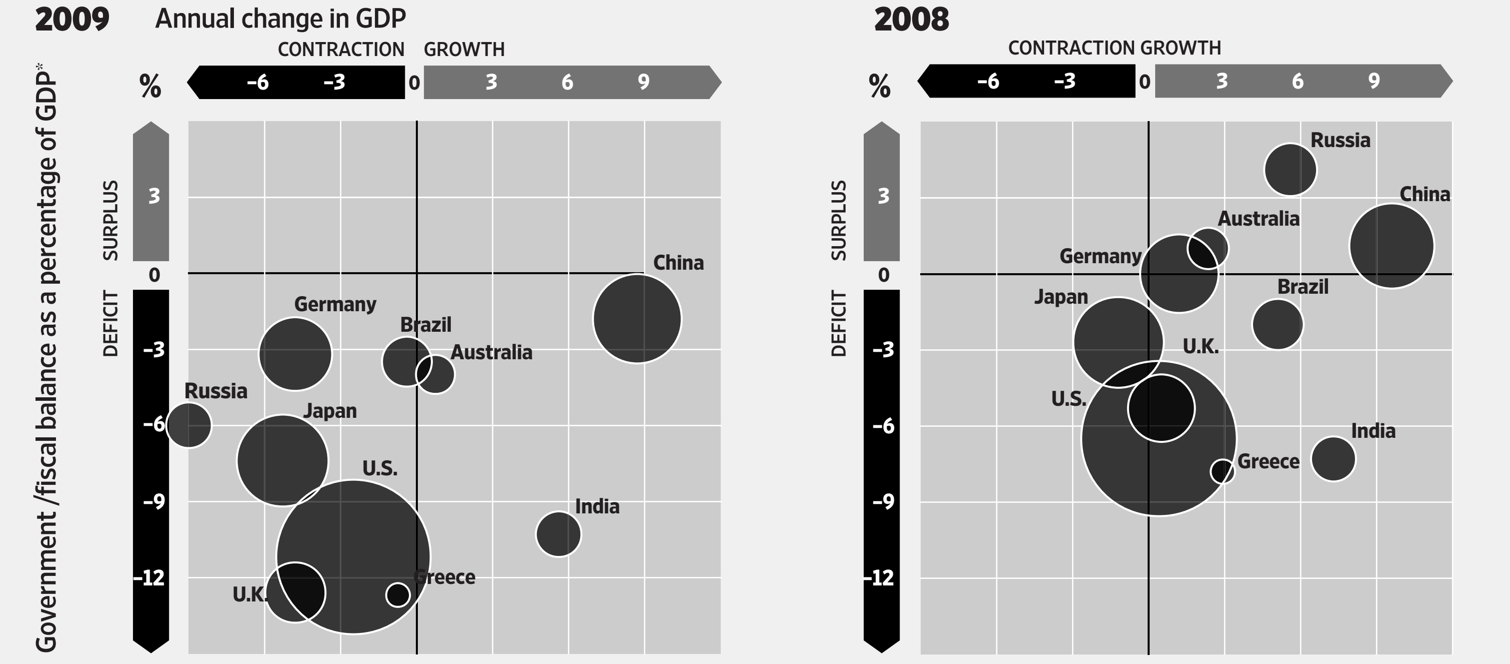
History suggests a partnership between an established power and a rising one is a stretch. From ancient Sparta and Athens to Britain and Germany a century ago, hegemons and upstarts have tended to collide, rather than cooperate.

Despite the challenges, Fred Bergsten, director of the Peterson Institute for International Economics in Washington, argues that a G-2 partnership should manage the global economy, acting as an informal "steering committee" to facilitate broader deals within multilateral institutions, including the Group of 20 and the World Trade Organization.

Beijing fears a global leadership role would force it to take on responsibilities that it isn't ready for, such as doing more to cut carbon emissions, say analysts.

The difference a year makes

Growth has slowed, or more often, stopped, and government finances are on shakier ground as damage from the financial crisis, and the cost of the stimulus packages aimed at combatting it are being felt in many major economies.



*Developing economy figures are fiscal balances; Advanced countries are general government accounts, which are consolidated central, state and local government accounts, social-security funds and nonmarket nonprofit institutions controlled and mainly financed by government units.

Sources: International Monetary Fund (GDP; growth figures are from January World Economic Outlook update, except for Greece and Australia, which are from October.); Organization for Economic Cooperation and Development (government balances)

EU sees its influence wane as 'G-2' rises

By Marcus Walker

BERLIN—This year, the 27-nation European Union was supposed to come of age as an actor on the world stage, bolstered by the Lisbon Treaty, which streamlines the EU's cumbersome institutions. Instead, Europe is starting to look like the loser in a new geopolitical order dominated by the U.S. and emerging powers led by China.

When the world's policy and economic elite gather Wednesday in Davos, Switzerland, for the annual World Economic Forum, much of the talk will be about the rise of a "G-2" world where the U.S. and China are the most important players.

A growing number of European policy makers and analysts say the EU's international influence may have peaked thanks to a combination of political divisions and poor long-term prospects for its economy.

"The EU's attempts to be a coherent international actor seem to be decreasingly effective," says Charles Grant, director of the Center for European Reform, a pro-EU London think tank.

Europe's hope of playing a leading role in a multipolar world got a cold shower in Copenhagen last month, at the United Nations-sponsored talks on climate change. EU countries view themselves as leaders on the issue.

But no Europeans were invited when U.S. President Barack Obama and Chinese Premier Wen Jiabao held the make-or-break meeting on Dec. 18 that brokered the modest Copenhagen accord. The Chinese invited the leaders of India, Brazil and South Africa.

That meeting and Europe's absence was "the seminal image of 2009," says a senior European diplomat. "It was a signal that we are becoming more and more marginalized and peripheral" in the new balance of global power, he says.

EU countries haven't helped their own cause lately. The Lisbon Treaty, which entered into force in December after eight years of struggle, was meant to make the EU a more coherent actor, in part by creating two new jobs—a president to lead EU summits and a high representative to present a united foreign policy.

Last fall, however, national leaders decided they didn't want powerful figures overshadowing them. They appointed Belgium's low-key premier, Herman Van Rompuy, to head up summits, and a previously obscure U.K. official, Catherine Ashton, to lead a common foreign policy.

Europe, of course, remains a major global player. Its $16 trillion economy accounts for 28% of global output, more than the U.S. The EU's integrated consumer market is the top destination for Chinese goods. Its industrial engine, Germany, remains the world's fourth-largest national economy and exports nearly as much merchandise as China.

Britain and France can still deploy significant military power abroad, and have permanent U.N. Security Council seats. Europeans are well represented in global institutions and committees, including the International Monetary Fund and the Financial Stability Forum, where EU officials are influential in negotiating new banking rules. Europe also has "soft power" to attract others by offering EU membership to neighbors.

Yet many of those measures of influence may have peaked, say foreign-affairs scholars.

"Europe has undersold its soft power because of its own confusion: Should it project its economic model, or should it adopt the one from across the Atlantic," says Rajeev Kumar, director of the Indian Council for Research on International Economic Relations.

The EU suffered a deeper economic contraction than the U.S. in 2009, even though the U.S. was the epicenter of the economic crisis. It faces a slower recovery thanks partly to onerous public debt in many countries.

Economists at Goldman Sachs—who coined the term "BRIC" for Brazil, Russia, India and China—project the leading emerging economies will steadily overtake Western Europe's leading nations in coming decades, and that the U.S., Chinese and Indian economies will dwarf all others by midcentury.

Many Europeans have long dreamt of a multipolar world, in which diplomacy and international law replace American dominance and military muscle-flexing. But EU-style soft power is turning out to be less useful than expected in dealing with China and other rising powers.

"China and Russia see the world in totally realist, zero-sum terms," says Mr. Grant, adding: "If we want China to take us seriously we have to have hard power," or the ability to twist arms through economic, military or other means.

The EU is inherently unsuited to wielding hard power "because it is not a state," says Francois Heisbourg, special adviser at the Foundation for Strategic Research, a Paris think tank.

EU members such as Germany, Britain and France retain their own foreign and security policies, which are often at cross purposes, analysts say. China and Russia have each exploited such divisions to play off EU members against each other on issues such as human rights and energy supplies.

Last fall, U.K. Foreign Minister David Miliband called on EU countries to drop their foreign-policy differences in a widely noted speech, saying that "the choice for Europe is simple: Get our act together and make the EU a leader on the world stage, or become spectators in a G-2 world shaped by the U.S. and China."

Greater unity would help the EU to deal more effectively with China, Russia and others, but the EU's rapid expansion in recent years has also made unity harder to achieve. That hasn't gone unnoticed in other regions.

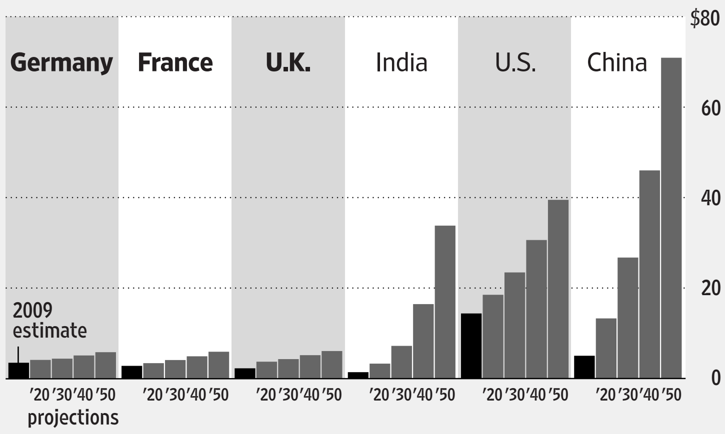
When India's foreign ministry commissioned Mr. Kumar and other scholars to identify India's strategic interests for coming decades, the experts concluded India could ignore the EU's pretensions to be a world player.

"A more diverse and divergent Europe will remain quite involved with itself, rather than being able to project power," says Mr. Kumar.

The EU has one "silver bullet" that could boost its external influence, Mr. Kumar says: Admitting Turkey. "That would change the EU's demography, make it seem like less of a Christian bloc, and raise its acceptance" in Asia and the Middle East, he says.

However, Turkey's EU membership talks have stalled amid growing mistrust on both sides.

Left behind | Gross domestic product, in trillions



Note: 2009 estimates are in 2009 dollars, projections in 2007 dollars
Source: Goldman Sachs

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REUTERS/Yuriko Nakao

Dubai dodges spotlight

No senior representatives plan to attend Davos conference

By Andrew Critchlow
And Mirna Sleiman

Dubai's sheiks will be largely absent at this year's annual meeting of the World Economic Forum in Davos, Switzerland, as negotiations with banks to freeze $22 billion of debt owed by part of the emirate's tarnished corporate empire reach a critical juncture.

A government official told Zawya Dow Jones that no senior representatives from the emirate will attend this year's corporate jamboree in the Swiss Alpine resort.

Notable absentees are likely to include regulars at the forum's annual meetings, Mohammed Gergawi, chairman of **Dubai Holding** and Sultan bin Sulayem, head of **Dubai World**. A spokesman for Dubai World didn't respond to requests to comment on whether officials from the company, once seen as a jewel in Dubai's corporate crown, would attend the Davos meetings. A spokeswoman at DP World, Dubai World's largest business unit, said that none of its senior executives will attend the meetings this year. The spokeswoman didn't provide a reason for their absence.

Mr. Gergawi and Mr. Sulayem have come under pressure as the sheikdom begins the uphill struggle of coping with debts.

Dubai representatives "want to keep out of the firing line and at an international forum like Davos they would be too much in the spotlight," Christopher Davidson, author of the book "Dubai: The Vulnerability of Success" and a professor of Middle East politics at Durham University in the U.K. told Zawya Dow Jones.

In the past, Dubai used the forum to market itself to the world as a liberal Arab economy of choice for international investors and the media.

Dubai government-owned **Emirates Airline** said it won't have a presence at this year's meeting after not renewing its corporate membership. "The forum has lost a bit of its relevance," said executive vice chairman of the largest Middle East passenger carrier, Maurice Flanagan, who canceled plans to attend at the last minute.

—Stefania Bianchi contributed to this article.


Associated Press

Sheik Mohammed bin Rashid Al Maktoum, the ruler of Dubai.

Glitz is gone at downbeat gathering

[Davos Notebook]

Reports from blogs.wsj.com/Davos

Several years ago, the World Economic Forum was as much about rock stars and glitzy parties as about business and diplomacy. Naomi Campbell, Bono and Angelina Jolie gave a jolt of celebrity excitement to what once was a buttoned-down event. Would-be gate-crashers scrambled for tickets to the hot parties thrown by Google and McKinsey.

But when this year's meeting gets under way on Wednesday, the mood greeting the 2,500 global leaders, corporate executives and central bankers scheduled to attend the annual jamboree will be far more downbeat, as the world still grapples with the fall out of the credit crisis and the economic downturn. Indeed, the theme of this year's event—"Improve the State of the World: Rethink, Redesign, Rebuild"—reflects the sober mood. It is a far cry from the full-throated celebration of globalization and capitalism that marked Davos just three years ago.

Bankers, keen to avoid more flak for their eye-popping bonuses, are keeping their cocktails and dinners deliberately low-key as they quietly lobby regulators who are currently mulling tough new rules on financial institutions. Stubbornly high unemployment and sluggish growth are sure to be recurrent talking points for chief executives and world leaders. And the themes of many panels—"Germs and Globalization," "The Next Global Crisis," and "Rebuilding Trust in Business Leadership" are just a few—will remind guests of what is keeping political and corporate leaders awake at night.

Finally, the sparse U.S. contingent also takes a bit of shine off the proceedings, particularly after the top-level participation in the Bush years.

—Deborah Ball

World Cup plays ball at World Economic Forum

The South Africans are flooding the zone at this year's World Economic Forum, hoping to drum up interest in this year's World Cup in June (do they really need any help?). President Jacob Zuma is leading the South African delegation. And tucked into Davos goers' goodie bags is a scarf sporting South African colors—which several participants seem to have quickly donned. The nation also took over part of the lobby of the famed Belvedere Hotel, complete with African art and soccer balls made out of beads. One momentary hitch to the big plans, according to the bartender: a delay in the arrival of the all-essential South African plonk, which got held up in customs. The cabernet sauvignon-merlot and sauvignon blanc made it just in time for the stream of guests who made their way over to the South African corner.

—Emma Moody

DAVOS 2010: WORLD ECONOMIC FORUM

Coordination needed

IIF says mismatched reforms risk fragmenting the financial world

BY STEPHEN FIDLER

ZURICH—Go-it-alone moves by governments to regulate big banks are in danger of fragmenting the global financial system, according to a leading organization that speaks for international banks and other financial institutions. In comments aimed to coincide with the start Tuesday of the annual meeting in Davos, Switzerland, the Institute of International Finance said global leaders' professed support for the need to coordinate their responses to the financial crisis hadn't been followed by actions.

The warning came days after some governments were taken by surprise by the Obama administration's announcement of a plan aimed at stopping retail banks from making big bets in financial markets.

The U.S. moves ensured that financial regulation will be at the forefront of public and private discussions in meetings over the next five days at the Alpine ski resort.

William Rhodes, senior vice-chairman of **Citigroup** and a leading figure in the IIF, said there was a real risk of fragmentation caused by governments taking uncoordinated measures to regulate financial institutions. "Almost every day now, we are seeing policy decisions and announcements that are not being coordinated and that have the potential of doing systemic damage," Mr. Rhodes said.

'Almost every day now, we are seeing policy decisions and announcements that are not being coordinated.'

He said he didn't know whether the Obama administration's proposals announced last week had been flagged to other governments.

Charles Dallara, IIF managing director, said examples of poorly coordinated initiatives included rules introduced about a year ago by the U.K. to ring-fence British banks as well as different initiatives by the U.S. and Europe to curb bankers' pay.

The Group of 20 leading economies is the global body that is supposed to coordinate international regulation, and has made a series of announcements and guidelines since 2008 mandating a coordinated approach to financial regulation. "But, so far, action has not followed rhetoric," Mr. Rhodes said.

He said it was important to move quickly lest momentum for change was lost and said the group needed to move toward implementing guidelines by G-20 summit in South Korea scheduled for November. "That will be a test of the whole G-20 process," Mr. Rhodes said.

The Korean meeting will be the second G-20 summit of the year, following a midyear meeting to be held in Canada.

The institute reiterated past warnings that regulators should be aware of the cumulative costs of all their separate initiatives—such as boosting bank-capital buffers, increasing the amount of cash and other liquid assets banks must hold, and special taxes—which could combine to constrain bank lending.

In a separate analysis, the institute said it expected private capital flows to emerging economies to rise sharply this year—bringing with it the danger that the early stages of another global financial bubble may be in the making.

Philip Suttle, the IIF's chief economist, said prospects for investment in the developing economies have probably never been so good, mainly because the outlook in more mature economies looks very weak.. "It looks to us as if emerging market assets offer every prospect of higher returns but not [in many economies] of higher risk," he said

It forecast private capital inflows would rise to $721.6 billion in 2010 from $435.2 million in 2009, and $667.1 billion in 2008.

Next year, flows could rise even further to close to $800 billion, the institute said.

Some of these flows would be generated by "hot money"—investment funds moving from place to place attracted by higher interest rates. This could encourage countries to follow the example of Brazil which last year imposed taxes on short-term capital inflows, the IIF officials said.

However, Mr. Suttle said some hot-money flows could be reduced because banks are no longer as willing as they once were to lend money to hedge funds, which are responsible for much of this so-called carry trade.

Bloomberg
William Rhodes in New York in September

EUROPE NEWS

German and Israeli leaders face the Iran nuclear problem with a united front

Fabio Bensch/Reuters

Israel's President Shimon Peres and German Chancellor Angela Merkel shared a common agenda in Berlin on Tuesday, as she called for early talks on sanctions against Iran to halt its disputed nuclear program. Ms. Merkel also announced that Germany will send 500 more troops to Afghanistan. See article on page 13.

U.K. economy rises, barely

Weak exit from recession increases fears of uneven recovery; political implications uncertain

By Neil Shah

The British economy barely crawled out of recession late last year, highlighting the country's lagging position compared with major rivals and amplifying fears of a potential relapse this year.

In its preliminary estimate Tuesday, the Office for National Statistics said economic output rose 0.1% in the fourth quarter of last year from the third, and fell 3.2% from the year-earlier period. The anemic gross domestic product reading officially ended a recession that began in the second quarter of 2008, but economists had expected a rise of 0.4% from the previous quarter.

Peaking through

■ German business confidence hit an 18-month high in January 24

The U.K. economy, heavily dependent on the financial sector and fueled by high levels of consumer debt, continues to lag behind the U.S., France and Germany in recovering from the global recession. The U.S. will report its own estimate of fourth-quarter GDP on Friday.

Many economists said the U.K.'s initial fourth-quarter GDP reading could still be revised upward, but the weaker-than-expected report has heightened fears that the U.K. recovery will be uneven, at best. Indeed, economists said the U.K. could struggle with only tepid growth as various stimulus efforts, especially a temporary cut in the national sales tax, come to an end.

The bad news hammered the U.K. pound, which sunk 0.7% against the U.S. dollar to $1.6143 , after rising a day earlier on expectations of a stronger GDP report.

"The economy clearly isn't going to be as strong going forward," says Douglas McWilliams, chief executive of the Centre for Economics and Business Research, a London-based economics consultancy. While Tuesday's figures will likely be revised higher, he says, "2010 will continue to be a tough year," with only muted growth this quarter.

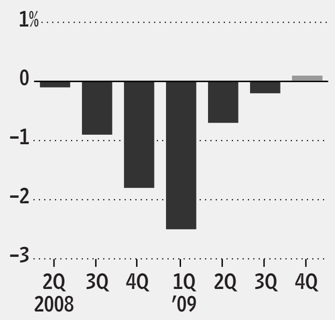
The Office for National Statistics said the U.K. economy shrank 6% from April 2008 through September 2009, the deepest slump since the government began maintaining records in 1955.

Before the recession, the U.K. had 63 consecutive quarters of growth stretching back to late 1992, according to the Organization for Economic Cooperation and Development. Britain's return to growth is good news for Prime Minister Gordon Brown's governing Labour Party, which must hold elections by June 3. The U.K. government had forecast growth would return early this year.

But the feeble figure also underscores the persistent weaknesses of the U.K. economy and could pose a challenge for British politicians vying for voters in the coming months.

Out of recession

U.K. GDP growth, change from previous quarter



Source: Office for National Statistics

Economists worry that the U.K. consumer-debt binge during the boom will hamper Britain's recovery this year. At the end of 2008, the average British household had a debt-to-income ratio of 181.4% compared with 131.6% for the average U.S. family, according to the OECD.

Meanwhile, personal savings rates in Britain are rising, suggesting consumers are cutting back and reducing debt rather than splurging. While that should help the U.K. economy in the longer term, it poses near-term problems by putting a cap on consumer spending, which fuels some 65% of U.K. economic output.

British companies aren't faring much better. Lending by banks to businesses remains weak, though it edged up in November, according to a recent Bank of England survey. Small businesses continue to have trouble getting credit, while most firms are paying off debts rather than investing in the future.

Meanwhile, the pressure on Britain's economy may actually increase this year. For starters, a temporary reduction in sales tax from 17.5% to 15% expired on Jan. 1 of this year, while a car-scrappage program that has buoyed car sales is also winding down. The recession has fueled a worrisome jump in Britain's national debt, which the government expects will hit 77% of GDP in 2014. Rising taxes and reduced public spending are also likely in the coming years and will further hurt U.K. consumers.

A bumpy road to recovery might also complicate matters for Britain's leading political parties. While Tuesday's figures shouldn't significantly boost Mr. Brown's prospects, they aren't a gift for the Conservatives, either. The Tories are proposing to move faster and more dramatically to cut Britain's yawning budget deficit, but those plans could now come under closer scrutiny.

The U.K.'s Bank of England will also be poring through the latest figures. Observers said the central bank may now wait a little longer before starting to raise interest rates again, though many continue to expect officials to pause their controversial bond-buying program, known as "quantitative-easing," next month.

Former U.K. law adviser says invasion of Iraq illegal

By William Lyons

LONDON—A former adviser to the British government has told the country's Iraq Inquiry that the U.K.'s invasion of Iraq was illegal.

Michael Wood, the most senior legal adviser at Britain's Foreign Office in the run-up to the invasion, told the Chilcot Inquiry that the use of force against Iraq in March 2003 was contrary to international law," as it had not been authorized by the U.N. Security Council.

Britain is holding its third and widest-ranging inquiry into the conflict, which triggered huge protests and left 179 British dead before the country's troops withdrew from Iraq last year.

Sir Michael was giving evidence with former deputy, Elizabeth Wilmshurst, who became the only British civil servant to quit over the war when she resigned days before the first attacks on Iraq. She told her superiors that an invasion without U.N. sanction would be a "crime of aggression."

Both lawyers submitted written statements to the inquiry stating that they thought the invasion had no basis in international law, to have lacked Security Council authorization and to have been illegal.

"I considered that the use of force against Iraq in March 2003 was contrary to international law," Sir Michael said in a written statement to the inquiry.

"In my opinion, that use of force had not been authorized by the Security Council, and had no other legal basis in war."

Declassified letters also released by the inquiry show that Sir Michael warned ministers three months before the invasion that it wasn't certain that military action would be legal.

On Jan. 24, 2003, he wrote to then-Foreign Secretary Jack Straw telling him the "U.K. cannot lawfully use force in Iraq in ensuring compliance" on the basis of existing U.N. resolutions, including resolution 1441, which gave Saddam Hussein a "final opportunity" to comply in November 2002.

"To use force without Security Council authority would amount to the crime of aggression," Sir Michael wrote.

But when he presented his view to Mr. Straw in January 2003, he said it was dismissed out of hand.

"He took the view that I was being very dogmatic and that international law was pretty vague and that he wasn't used to people taking such a firm position," Sir Michael told the inquiry.

Mr. Straw told the inquiry last week that he had "only very reluctantly" supported the conflict and described his moral and political anguish in the run-up to the invasion.

Former Prime Minister Tony Blair is due to give evidence to the Iraq inquiry on Friday.

Mr. Blair is expected to face questions about the legitimacy—and legality—of the U.K.'s involvement in Iraq. He will be confronted about whether he committed to overthrow Iraqi leader Saddam Hussein long before the immediate run-up to the war, and also face questions about criticisms of the U.K.'s preparedness for the invasion and its minimal influence over U.S. allies.

Greece to sell bonds to Asia investors

By Alkman Granitsas
And Costas Paris

ATHENS—Greek Finance Minister George Papaconstantinou detailed a diversified borrowing plan to plug holes in the budget deficit, including hopes to raise up to $10 billion from Chinese and other Asian investors.

In an interview, he also said he is confident that the European Union council of finance ministers will approve the country's three-year deficit-reduction plan next month.

Greece is under pressure from the European Union and ratings agencies to fix a 2009 budget deficit of 12.7% of gross domestic product—four times the EU's 3% ceiling.

The government this year must raise some €54 billion ($75 billion) to cover its financing needs, including more than €20 billion of maturing bonds due in April and May.

Concerns that Greece might slip into default have spilled over in recent weeks to other European markets, depressing other government bond prices and even dragging on the euro in currency markets.

On Monday, Greece issued its first five-year bond of 2010 as a major test of investor confidence. The issue was heavily oversubscribed, but the Greek government paid a high premium to ensure success.

As a next step, Greek officials said Tuesday that they now intend to issue a 10-year bond sometime next month that could raise a minimum of €5 billion.