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THE WALL STREET JOURNAL.

VOL. XXVIII NO. 116 | EUROPE | Friday - Sunday, July 16 - 18, 2010

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Taking the Orthodox view

Reuters

Dmitry Medvedev, left, and Archbishop Vikenty, second from left, show a cathedral built on the site where Tsar Nicholas II was executed to Angela Merkel. At a joint news conference, Mr. Medvedev defended a bill granting new powers to the KGB's successor, the FSB. **Article on page 6**

Broad overhaul of finance rules passes in U.S.

BY DAMIAN PALETTA
AND AARON LUCCHETTI

WASHINGTON—Congress approved a sweeping rewrite of rules touching every corner of finance, from ATM cards to Wall Street traders, in the biggest expansion of government power over banking and markets since the Great Depression.

The bill, to be signed into law soon by President Barack Obama, marks a potential sea change for the financial-services industry. Mammoth financial firms such as **J.P. Morgan Chase** & Co., **Goldman Sachs Group** Inc. and **Bank of America** Corp. face changes to almost every part of their businesses, from debit cards to derivatives trading and the ability to invest in hedge funds.

The legislation now hands off to 10 regulatory agencies the discretion to write hundreds of new rules governing finance. It will be this process—accompanied by a lobbying blitz from banks—that will determine the precise contours of this new landscape, how strict the new regulations will be and whether they succeed in their purpose. The decisions will be made by officials at new agencies, obscure agencies and, in some cases, agencies tagged with failure in the run-up to the financial crisis.

The Commodity Futures Trading Commission has designated 30 "team leaders" to begin implementing its expansive new authority over derivatives, and the agency wants $45 million for new staff. The Federal Reserve, Federal Deposit Insurance Corp., and Securities and Exchange Commission are also taking steps to begin implementation. J.P. Morgan Chase, one of the U.S.'s biggest banks, has assigned more than 100 teams to examine the legislation.

The Senate passed the bill 60-39 Thursday, following House passage last month. Earlier in the day, three Republicans joined with Democrats to block a filibuster, allowing the bill to squeak through with the narrowest possible margin.

It is the latest sweeping legislation to emerge from the 111th Congress. But the financial revamp, the 2009 stimulus act and this year's health-care overhaul—by any measure significant legislative achievements—haven't translated into support for the White House. In fact, Mr. Obama's approval ratings have sunk to some of their lowest levels in some polls amid a gloomy economic picture and rising doubts that the president's economic policies are working.

Democrats say the bill will mitigate the chance of another financial crisis and help improve the handling of any future crisis. They also say it will restore confidence in U.S. financial markets, protect consumers and spur economic growth. White House officials say it will put an end to taxpayer-funded bailouts of banks, addressing the scars of the financial crisis of 2008.

Among its core features, the legislation creates a coun-

Please turn to page 7

Boeing hedges delivery date of its troubled Dreamliner jet

BY DOUG CAMERON
AND PETER SANDERS

Boeing Co.'s first delivery of its new 787 aircraft could slip a few weeks into next year, though the company is still holding out for a year-end delivery date of the much-delayed Dreamliner.

The cautious new guidance stems from issues with testing rather than the aircraft, according to Scott Fancher, head of the 787 program, who spoke with reporters Thursday. Boeing's first customer for the Dreamliner, **All Nippon Airways** Co., has already waited 2 1/2 years for the plane after five separate technical delays.

"We are talking about flight-test monitoring systems," Mr. Fancher said, adding that Boeing was pleased with a fix to a problem with the plane's horizontal stabilizer that temporarily halted its test program.

The announcement came on the eve of the Farnborough Air Show in the U.K. and a year after Boeing executives stumbled at last year's Paris Air Show by announcing that the plane was ready to make its first flight on June 30. Days later, they announced another six-month delay.

It's the first time Boeing has acknowledged that problems encountered with production and quality issues could hurt the latest schedule laid out after the plane's first flight last December.

An All Nippon executive said in April that the new plane may not start passenger service until next March. Mr. Fancher said Thursday that Boeing remains in "constant contact" with the Japanese carrier.

The company has yet to reveal how much the delays will cost, but analysts estimate that Boeing faces billions of dollars in payments to compensate airlines and to reimburse suppliers.

Mr. Fancher declined to comment on how much of a buffer Boeing had left to meet its existing year-end target.

Boeing will also halt deliveries of 787 components to its

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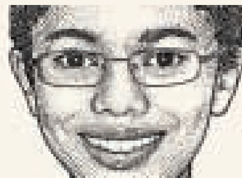
The Quirk



Winning bees spells glory for Indian children on the ethnic circuit. **Page 29**

World Watch

A comprehensive rundown of news from around the world. **Pages 30-31**

Editorial & Opinion

Isaac Getz: To save the NHS, break the bureaucracy. **Page 13**

J.P. Morgan profit sets healthy pace

J.P. Morgan Chase & Co. generated stronger-than-expected quarterly results as the second-largest U.S. bank by assets continued its recovery from sour loans.

The bank improved net income in every line of business except investment banking. A key boost came from a 23% reduction in reserves for loans unlikely to be repaid, as its books of consumer loans, especially credit cards, have generally been improving.

J.P. Morgan reported a profit of $4.8 billion, up from $2.72 billion a year earlier. The recent quarter included a charge for the U.K. bonus tax.

The report from the first major U.S. bank to report second-quarter results may bode well for other big lenders. **Bank of America** Corp. and **Citigroup** Inc. report Friday.

"J.P. Morgan's results indicate from a big picture standpoint that positive trends in the credit cycle are alive and well," Raymond James analyst Anthony Polini said. But he added results also showed that "the economic recovery is still on soft footing."

Chief Executive James Dimon, as he has often done, poured cold water over enthusiasm about the recovery in credit. "We don't consider that earnings," he said about the falling loan-loss reserve.

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PAGE TWO

Truth-or-dare as Europe's bankers and policy makers try to play it cool

[Agenda]

By Terence Roth

Europe's government-debt crisis has assumed a benign tone as the problem borrowers among the euro zone's 16 countries this week all tapped capital markets for funds untested.

Only the hefty premiums betrayed that Greece was on the lip of bankruptcy in March, with Portugal and Spain deemed to be close behind.

Even Europe's banks, two years ago gripped by liquidity crisis, this month are enjoying a widening access to willing buyers of their bonds in global capital markets. It was only in late 2008 that leaders such as the U.K.'s then-finance minister Alistair Darling described how the banking system was only hours away from apocalyptic collapse.

What's clear is that two years of massive infusions of central bank cash, state-funded bank bailouts, new emergency funding facility for governments and other new buttressing have soothed many nerves.

Policy makers can be forgiven for counting their blessings, even forgiven for postponing restructuring a failed regulatory system until the autumn. But there is a high measure of truth-or-dare behind that curtain.

A second glance at bank borrowing this summer shows that only the top tier of European banks issued new debt into the market, with the majority still greeted with skepticism or forced to pay exorbitant premiums.

That doesn't bode well for a European banking system seeking to roll over €1.5 trillion ($1.9 trillion) in debt redemptions through 2012, all the while competing with voracious government borrowers for funds.

Reuters

German's Wolfgang Schäuble laid out the possibilities for struggling banks.

The European Central Bank still has Spain's banking system on life support, last month providing it with a 48% jump in funding from May. Among sovereign borrowers, future funding gaps in the Greek treasury already are readily apparent, making it almost certain that Greece very likely will need its €110 billion multilateral support package to be renewed when it expires in 2012.

With warning lights still flickering red, doubts put the market's full focus on euro-zone stress tests.

With warning lights still flickering red, doubts put the market's full focus on next Friday's stress test results of euro-zone banks.

The moment is so seminal in the region's post-crisis management that it overshadowed the two-day meeting of European finance ministers in Brussels this week, explaining why little else was accomplished.

Euro-zone governments have almost universally expressed confidence that their banks are financially solid and will pass easily in scenario tests. This is worrying, raising suspicion that the fix is in and that the well-shrouded criteria were calibrated to ensure success.

Another scenario could be a decision not to publish results of banks that didn't make the grade, which wouldn't fool anyone.

For credibility's sake, there will have to be a few sacrificial lambs for markets to take the testing seriously, with some independent estimates looking at a capital shortfall of €90 billion systemwide.

This week did bring more clarity on who pays to top up banks with riddled balance sheets. A bank publicly identified as having deficient financing could hardly be expected to successfully refinance itself.

In that case, German Finance Minister Wolfgang Schäuble laid out this week, the national government would have to step in—following the script that bailed out a number of European banks in the 2008 crisis. If the government can't raise the money, he continued, there could be recourse to the European Financial Stability Facility, the €440 billion contingency package aimed at reassuring investors in euro-zone government debt.

In an interview with The Wall Street Journal, EFSF Chief Executive Klaus Regling put it this way: "What a government does with the money is, in a way, up to the country."

It deftly defines the EFSF as a bailout fund for governments, as well as for banks, laundered through their governments. Investors and policy makers are right to hope that the tenuous recovery in Europe's debt market doesn't sail into new squalls.

Carpathian Standoff

Germany's lonely fight to limit potential liabilities of the EFSF emergency funding facility by allowing governments to default and then restructure their debt just got a new ally.

Well, a small one. Slovakia's government has declared that it will withhold its contribution to the fund unless there is a new EU provision for managed national bankruptcies. Bratislava also nixed its contribution to the Greek bailout package.

Slovakia, which accounts for 1% of the EFSF money , isn't going to sink the deal. But it does add an independent voice emerging from among the EU's newer members in the former East Bloc. The Slovak cabinet issued the view despite efforts by EU heavyweights to strong-arm Slovakia's new prime minister, Iveta Radicova, into compliance in Brussels this week.

Pundits can't be blamed for doubting that Slovakia's stance is unlikely to tip the scales in Germany's favor. Even the ECB opposed a bankruptcy provision, fearing the national bankruptcies could do more harm than good to the euro franchise.

What's News

■ **ECB official Yves Mersch** applauded Greece's recent sale of short-term debt to investors, suggesting officials increasingly see a return to normalcy in financial markets that could lead to an end of the bank's controversial debt-buying program. 4

■ **Spain and France received** a strong market reception for government-bond sales Thursday totaling $16.77 billion, as Spain passed a second successful funding test in two weeks. 4

■ **The Slovak government** ended its holdout against a euro-zone emergency bailout fund. But it called for tighter rules before the fund begins granting any aid. 4

■ **GlaxoSmithKline will** record a $2.4 billion charge in its second quarter to cover the cost of settling legal disputes. 17

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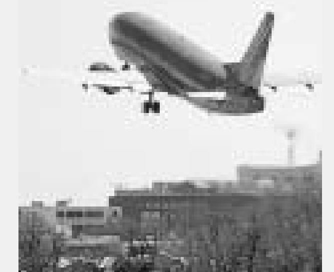

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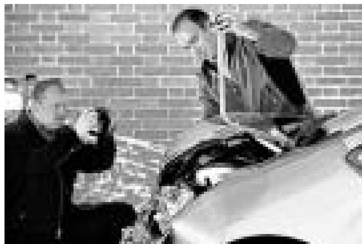

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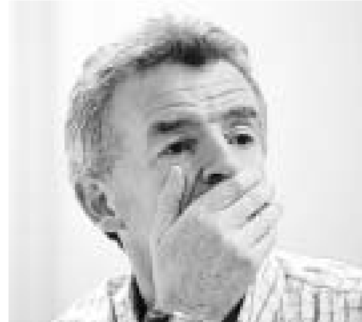
'It's not often that someone as arrogant and as powerful as O'Leary is forced to apologize in public.'

EasyJet founder **Stelios Haji-Ioannou** on a printed apology by Ryanair's CEO



Continuing coverage

Follow the latest on the British Open all weekend at **blogs.wsj.com/dailyfix**

Question of the day

Vote and discuss: Do you think Apple should recall the iPhone 4 in light of mounting criticism over its reception problems ?

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

Previous results

Q: Do you think Spain will be able to avoid falling into a Greek-like crisis?

Yes	50%
No	50%

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

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ADVERTISING SALES worldwide through Dow Jones International. Frankfurt: 49 69 9714280; 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.
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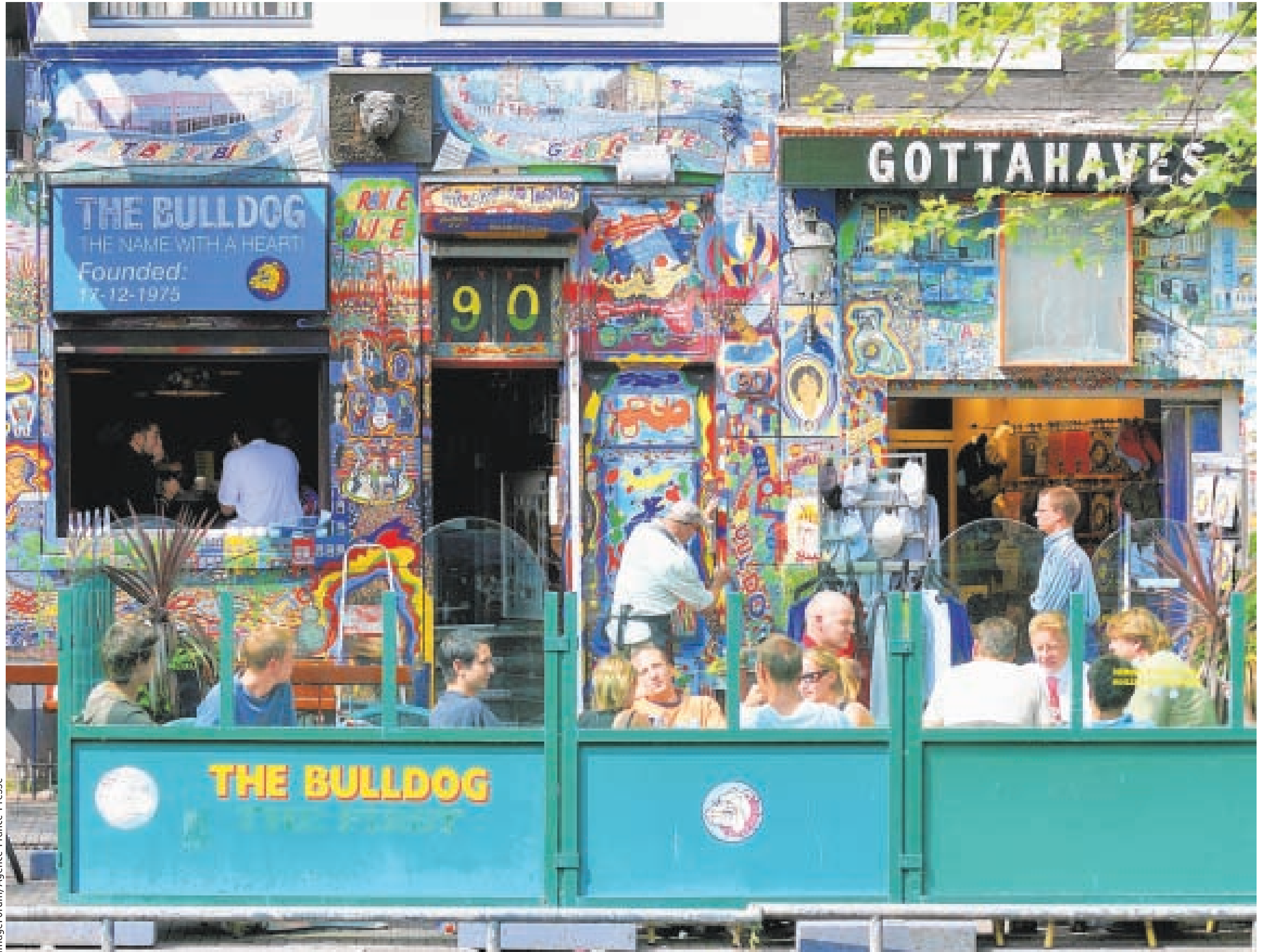
NEWS

Top EU court backs Dutch drug ban

By Mike Gordon



ImageForum/Agence France-Presse

The Netherlands is trying to ban the sale of marijuana and hashish to non-Dutch at coffee shops like the Bulldog in Amsterdam, above.

LUXEMBOURG—A Dutch city was within its rights to bar so-called coffee shops from selling marijuana and hashish to foreigners in an effort to clamp down on drug tourism, an adviser to the European Union's top court said Thursday.

The nonbinding legal opinion from the European Court of Justice's advocate general, Yves Bot, said the city of Maastricht could prohibit drug sales to foreigners even while sales to Dutch citizens were tolerated.

The advocate general said drugs "are not goods like others and their sale does not benefit from the freedoms of movement guaranteed by European Union law" because they are illegal outside the Netherlands, the court said.

Many thousands of young tourists flock to the Netherlands each year to sample marijuana and hashish that are openly sold in cafés and bars known as coffee shops across the country.

The country hasn't formally legalized drugs, but, under government guidelines, possession of small amounts of certain "soft" drugs isn't prosecuted.

Cities are also allowed to license shops to sell a maximum of five grams per customer per day. They can't sell to customers under the age of 18 or permit drugs other than marijuana or hashish on their premises.

Maastricht's "measure is necessary to maintain public order in the face of troubles caused by drug tourism and contributes to combating the illicit trade in narcotics," the court said.

The court was providing its opinion on an effort by the mayor of Maastricht, a midsize university town sitting in a finger of Dutch territory almost surrounded by Belgium and Germany, to clamp down on drug tourism. As many as 70% of the two million customers who visit Maastricht's coffee shops every year have to cross the border.

In 2005, Gerd Leers, Maastricht's then-mayor, prohibited coffee shops in his city from selling drugs to people who aren't from the Netherlands. The ban, at the request of the Dutch Minister of Justice, was meant to create a test case over whether Dutch cities could limit access to Dutch nationals.

Police started strictly enforcing the rules. Shops found in violation are closed for a minimum of three months for a single offense, six months for a second violation, and permanently for a third offense. The restrictions led to the closure of 11 of Maastricht's 26 licensed shops.

Subsequent developments have led to a plan to fingerprint customers and electronically record their identity cards. The rules are supposed to help stores show they aren't selling to underage customers and that they don't sell more than five grams per customer per day.

Marc Josemans, owner of a coffee shop called "The Easy Going" and chairman of the Society for Official Coffeeshops in Maastricht, was one of those who broke the rules.

He says he sells about €10 million ($12.7 million) in drugs per year and risks losing about 30% of that if the ban on sales to non-Dutch stands. He was forced to close for three months after the city found that, in 2006, he had twice sold drugs to Europeans not from the Netherlands.

Mr. Josemans took the mayor to the Dutch court called "the Council of State."

He explained in an interview with Australian television that he wasn't concerned only about his own economic rights, but also his clients' rights and health.

"If they are not allowed to go to the safe haven to buy their cannabis, separated from the hard drugs," he said, "they are obliged to go in their own country in the illegal circuit where everything is in the same room on the same table, and that is a dangerous situation."

The Dutch court decided that some of the issues in the case might contravene the European treaty rights of free movement of goods and services across borders, or even discriminate against people from other EU nations. It therefore referred questions on how the Maastricht law should be interpreted to the European Court of Justice.

Mr. Josemans's lawyer, Andre Beckers, has argued that cannabis should be treated like any other product and that the nationality of the customer shouldn't matter in what is essentially an economic matter.

On Mr. Josemans's side is the European Commission, the EU's executive arm. Hubert Van Vliet of the commission's legal service argued that excluding the coffee shops from the EU single market would undermine fundamental European treaty rights.

He said simpler, less-sweeping measures could deal with any public-order problems. He proposed an ID system, compulsory use on the premises and lower amounts of pot for each buyer.

Defending the law, the Maastricht city council and the Dutch state questioned how goods that are formally illegal can be discussed in terms of free trade. They also argued that the law existed to protect other EU countries from having to deal with tourists disturbing public order upon their return.

The case will now go back to the Dutch court for final resolution.

Boeing hedges delivery date of Dreamliner jet

Continued from first page

final assembly plant in Everett, Wash., for about six weeks later this year to give its network of global suppliers a chance to catch up on work and address continuing quality issues.

It's the second time this year that Boeing has halted deliveries along its supply chain as it struggles to smooth out a system that sees much of the work on the high-tech new jet completed by suppliers in Italy and Japan, as well as elsewhere in the U.S.

The outsourcing model has bedeviled the 787 program for years. Parts shortages and shoddy manufacturing work at various suppliers has forced Boeing to slow the production process at various points and required the company to fix mistakes after some jets have been fully completed.

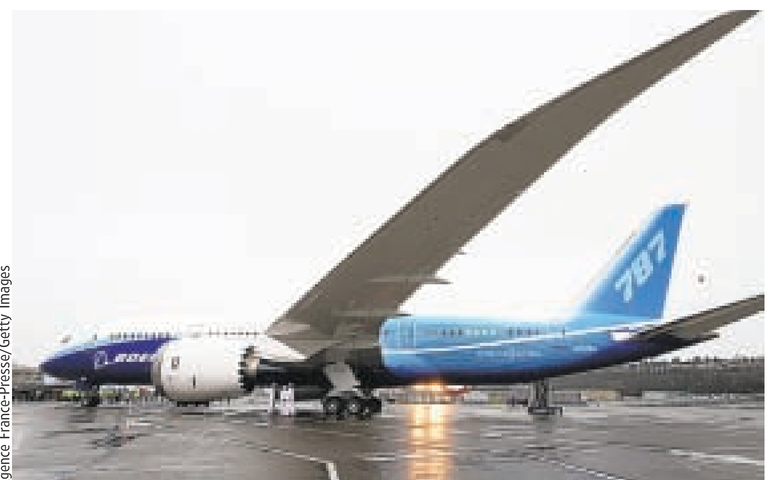
Details of 787 compensation remain undisclosed. Potential profit from the program will play a role in when Boeing decides whether to revamp or replace its other models.

Boeing has also spent more than $1 billion purchasing the operations of struggling vendors in South Carolina and has sent hundreds of its own employees abroad to closely monitor its suppliers' work.

Company executives in the past have said they overreached on the new manufacturing method used with the 787, but they remain committed to the outsourcing model.

While details of 787 compensation remain undisclosed, the potential profit from the program will play a role in when and how it decides whether to revamp or replace its 737 and 777 models.

"A decision will be made by the end of the year," said Randy Tinseth, vice president marketing for Boeing's commercial aircraft division, on an earlier press call on Thursday.



Agence France-Presse/Getty Images

A Boeing 787 Dreamliner sits on the tarmac after a test flight late last year.

ECB's Mersch airs optimism

By Brian Blackstone

LUXEMBOURG—A top ECB member applauded Greece's recent sale of short-term debt to investors, suggesting officials increasingly see a return to normalcy in financial markets that could lead to an end of their controversial debt-buying program.

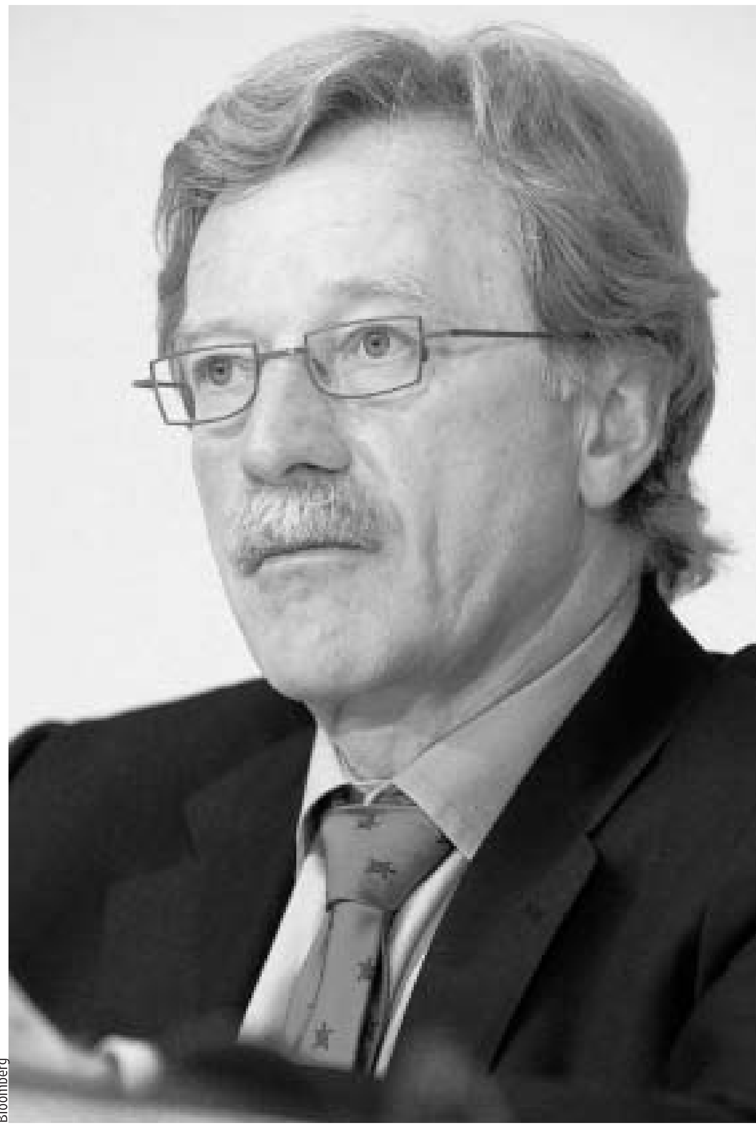
"All in all, these are signals that we will monitor and take into account when we discuss this temporary, nonstandard measure in the future," Luxembourg's central bank governor Yves Mersch said in an interview.

On Tuesday, Athens sold €1.625 billion ($2.07 billion) in six-month Treasury bills at an average yield of 4.65%. It was Greece's first debt sale since it agreed to a €110 billion EU-IMF bailout in May. "What some people considered was not possible is possible," Mr. Mersch said, referring to the debt auction. "They were able to borrow at rates which are encouraging."

The ECB created its debt-buying program two months ago to jump-start what it deemed dysfunctional segments of the financial markets, including government bonds in Greece and other peripheral countries like Portugal and Spain. The ECB has so far spent €60 billion on those bonds.

But officials have signaled in recent days that they are ready for the program, established over the vocal dissent of Germany's central bank head, Axel Weber, to end soon. After buying €16.5 billion in bonds the first week, purchases have tapered off markedly since, and totaled just €1 billion last week.

"If the situation [in financial markets] improves further, there is not a reason anymore to continue with this program," ECB executive board member Jürgen Stark said last week.



Bloomberg

Yves Mersch, Luxembourg's central bank governor, is hopeful about economy.

Messrs. Mersch and Stark are both on the ECB's governing council, which decides on interest rates and other monetary-policy tools like debt purchases.

Mr. Mersch suggested that buying government debt will remain an option for policy makers even after the current facility aimed at Greece and other vulnerable economies ends. But he warned that the program—which stirs concerns about inflation and a loss of central bank independence in parts of Europe, especially Germany—be treated like a powerful but dangerous drug. "I look at it more like in a pharmacy. You have one small cupboard where you know it exists and which is closed with a double key and there is a skull on it; but it exists," Mr. Mersch said.

Speaking in his central bank's offices in Luxembourg, Mr. Mersch defended the ECB against charges that buying government bonds has compromised its independence.

"If we did some measures it was because we felt that as a well-functioning institution working on a near-federal model we had the responsibility to avert the worst," Mr. Mersch said. "This is not putting into question our independence."

"Our monetary-policy stance was in no way affected," Mr. Mersch added, because the ECB has drained, or "sterilized" the purchases by accepting equivalent amounts in interest-bearing deposits from banks.

Still, he concedes buying government debt is a tough sell in Europe and beyond.

"Using the balance sheet and other exceptional measures are not familiar to many people, and it's difficult to explain," Mr. Mersch said. "I'm more concerned that people outside of Europe might be even more confused. When I talk to people in Asia, they think we finance government debt ... which is certainly not the case," he said.

Mr. Mersch was upbeat about the currency bloc's economic outlook, saying he "totally" ruled out any chance of a double-dip recession. Mr. Mersch conceded that the recovery will be "uneven" after a robust second quarter, but said a return of confidence will propel consumer and household spending, leading to "somewhat stronger" growth in 2011.

Slovaks end holdout on bailout

By Gordon Fairclough
And Leos Rousek

PRAGUE—The Slovak government, the last holdout against setting up a euro-zone emergency bailout fund, gave its approval to the plan Thursday, but it said borrowing rules must be tightened before it would clear any country's request for money.

Slovakia is the newest and poorest of the 16-nation group that uses the euro as its common currency. The new center-right coalition government in Bratislava, which is about to embark on budget cuts at home, says it opposes helping richer, more spendthrift states.

Iveta Radicova, the Slovak prime minister, also said the country wouldn't be part of a separate €110 billion ($140 billion) bailout for Greece, put together by euro-zone countries and the International Monetary Fund.

"The Greek loan is about irresponsible government policies, irresponsible behavior of the banking sector," Ms. Radicova told reporters after a cabinet meeting in Bratislava on Thursday. She said Slovakia wants to "strictly differentiate" between profligate nations and prudent ones.

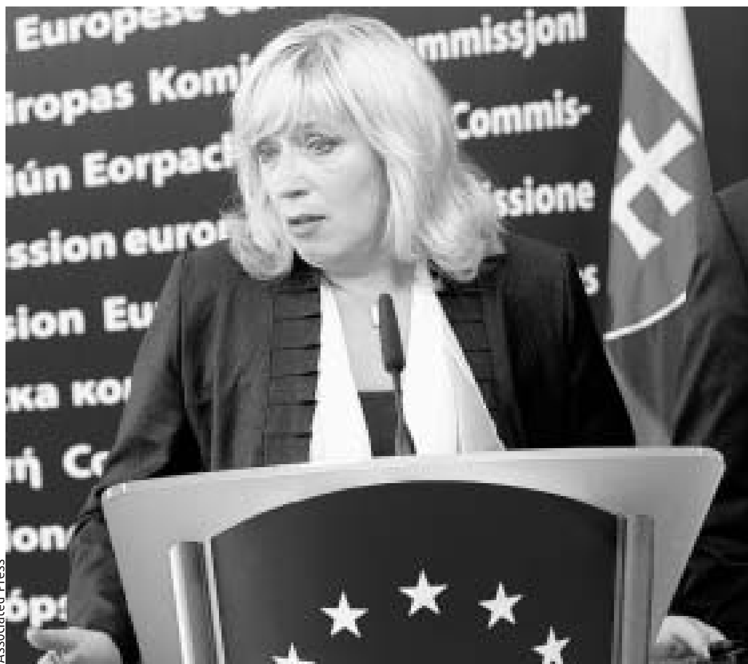
Slovakia's previous, left-leaning government had agreed to an €800 million contribution to the Greek rescue. Amelia Torres, a European Commission spokeswoman, said the group would "continue discussions" in hopes of persuading Slovakia's new leaders to uphold that pledge.

Pressure had mounted on Bratislava to approve the so-called European Financial Stability Facility, or EFSF, a €750 billion package of loan guarantees and money from euro-zone members, the European Union and the IMF.

The facility, which was to have been launched July 1, is an important part of the euro zone's efforts to restore market confidence in the group's shared currency and its members' financial soundness. The European Union is also conducting stress tests to measure the health of European banks.

Slovakia's objection to the bailout plan, and its call for additional conditions before it will agree to any use of the funds, is a sign of the continuing unease among some politicians and anger among citizens in some countries about bailing out governments that overspend.

With Slovakia's approval, the EFSF can now begin operations. But any loan to be provided by the facility would also need to be agreed to by all 16 euro-zone countries, which would also have to sign off on terms and conditions of any assistance, according to the European Commission, the EU's executive arm.



Associated Press

Prime Minister Radicova speaking Tuesday at the European Commission.

Still, in a crisis, Slovakia or any other state objecting to a rescue effort would face serious pressure from the currency bloc's larger members not to stand in the way.

Bratislava said EU rules need to be changed to set up a mechanism for forcing euro-zone countries that have "consistently carried out irresponsible fiscal policy" into insolvency in an orderly manner.

Slovakia also said any country seeking to borrow bailout funds should have to prove it has exhausted every alternative means of raising money.

Bond sale from Spain gets strong reception

By Emese Bartha

Well-received Spanish and French government bond sales Thursday, totaling €13.165 billion ($16.77 billion), rounded off a week of heavy issuance in the euro zone, cheering the market ahead of key bank stress-test results next week.

They came after the Greek Public Debt Management Agency sold €375 million of 26-week Treasury bills in the second noncompetitive round of an auction on Tuesday, bringing the total raised to €2 billion, in its first auction since Greece accepted a €110 billion bailout from the International Monetary Fund and the European Union in May.

Tuesday's successful Greek T-bill auction set the pace for around €28 billion in Dutch, German, Italian, Portuguese, Spanish and French bond sales during the week.

The Spanish Treasury on Thursday passed a second successful funding test in two weeks. Its €3 billion 15-year government bond found strong demand and was fully taken up at an auction. While the Treasury had to pay a yield that is 15% higher than at the previous auction of the same bond in April, the tender left no doubt that Spain can raise the cash it needs through markets, despite pressure on the Spanish banking sector.

"For Spain, this is again a good signal to the market after the recent launch of its 10-year [bond] and also a reassurance for the market that Spain can raise money with the heavy redemption and coupon payments due within the coming weeks," said Wilson Chin, strategist at ING Commercial Banking.

Chiara Cremonesi, strategist at Unicredit Bank in London, said the result "confirms that appetite for Spanish paper is alive and also reassures investors ahead of the €16 billion redemption of Spain due July 30."

The Treasury offered €2 billion to €3 billion of the 4.65% July 2025 bond. It received bids totaling €7.722 billion and sold the maximum targeted amount at an average yield of 5.116%, compared with 4.434% at the previous auction. The target range enables the Spanish Treasury, and other debt agencies also applying a target range, to achieve the best possible combination of the allotment amount and pricing.

In a sign of healthy bidding, the average yield, was below the 5.2% secondary market level ahead of the auction, analysts said.

The Spanish banking sector's record use of European Central Bank liquidity, according to data from the country's central bank, is a source of concern. It shows that Spanish banks have been squeezed out of international markets amid counterparty fears. The results of European banking stress tests due next week, including for Spanish banks, will be a key driver of sentiment.

Meanwhile, in two tenders, the French Treasury Agency sold €8.395 billion of short-term paper maturing in 2012, 2013 and 2015, just below the maximum intended €8.5 billion.

It also sold €1.77 billion of inflation-linked paper, maturing in 2019 and 2022.

Vatican sets rules on reporting abuse

By Stacy Meichtry

VATICAN CITY—The Vatican tightened its rules for disciplining sexual-abuse cases on Thursday, but victims criticized the measures for not requiring church officials to report all sexual-abuse allegations to civil authorities.

The toughened rules mark the first time the Vatican has changed church laws to address the sexual-abuse scandal that has opened Pope Benedict XVI to widespread scrutiny over his handling of abuse cases as pontiff and as the former head of the Congregation for the Doctrine of the Faith. But rather than quell accusations that Vatican policies have fostered coverups of sexual abuse by those within church ranks, the new measures appeared to inflame the criticism.

The measures, unveiled at a Vatican conference on Thursday, revise rules—originally decreed by the late Pope John Paul II in 2001—by doubling the statute of limitations for sex-abuse allegations to 20 years from a victim's 18th birthday. The revision also drops requirements that clerics act as judges in church trials, and allows the Congregation for the Doctrine of the Faith, the Vatican's office in charge of disciplining abusive priests, to dispense with costly and time-consuming church trials and defrock abusive priests with the stroke of a pen.

The possession of child pornography and the abuse of mentally impaired adults were also added to a list of crimes covered under the revised rules, which the Vatican said were approved by Pope Benedict on May 21.

Groups representing victims of sex abuse said the revisions fell far short of the deep overhaul needed to address a crisis that has rippled across the globe this year, engulfing Pope Benedict's papacy. The global scale of the crisis has exposed contradictions between dioceses in the U.S.—where bishops overhauled regulations in 2002 to require officials to immediately report abuse to authorities—and the rest of the world, where many priests accused of abuse continue to work in parishes.

The revisions don't require bishops to report sex abuse to civil authorities. Victims say Vatican laws, which call for church officials to comply with civil laws, aren't tough enough to protect children, because many countries don't have laws that require the reporting of sex abuse.

"This is a puny response when measuring it against the vastness and chaos of this scandal," said Kristine Ward, chairwoman of the National Survivor Advocates Coalition, a sex-abuse victims' advocacy group based in Dayton, Ohio.

In a statement Thursday, Cardinal William Levada, head of the Congregation for the Doctrine of the Faith, said the revisions made the Vatican rules "more useful."

The Vatican's top prosecutor for sex-abuse cases, Msgr. Charles Scicluna, said the revisions were a "consolidation" of practices the Vatican adopted in 2003 to discipline abusive priests more quickly. Msgr. Scicluna described the revisions as a "signal" and "a step forward."

The revised rules also apply to other acts the Vatican regards as grave crimes, such as heresy or throwing away the Eucharist, which Catholics believe is the body of Jesus Christ. To this list of crimes deemed punishable by excommunication, the Vatican added the attempt by a cleric to ordain a woman.

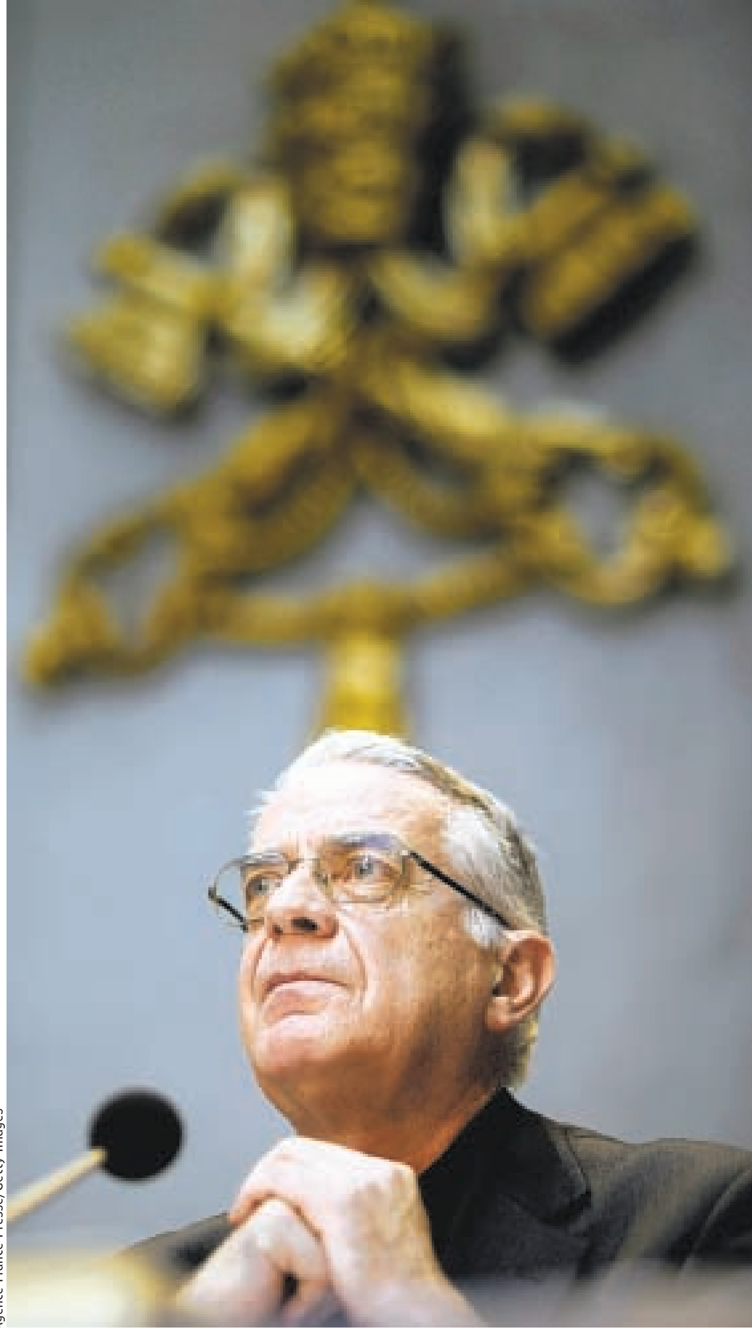
That move drew immediate fire from women's rights groups, which accused the Vatican of equating sexual abuse with the ordination of women. "The Vatican's decision [to] list women's ordination in the same category as pedophiles and rapists is appalling, offensive, and a wake-up call for all Catholics around the world," said Erin Saiz Hanna, executive director of the Women's Ordination Conference in Washington.

American church officials scrambled to address the anger. "The church's gratitude to women cannot be stated strongly enough," said Archbishop Donald Wuerl of Washington. The archbishop backed the Vatican's opposition to the ordination of women, but added that "women have had an essential role in the life of the church."

The Vatican prefaced the revisions with a "historical introduction" to sexual-abuse policies. The overview didn't clarify how the Vatican handled specific cases or how many. Thousands of priests have been disciplined under Pope John Paul II's 2001 decree. Little is known about how cases were handled before then.

For the first time, the Vatican traced the history of internal sexual-abuse policies, which it said dated back to 1917, when the Congregation for the Doctrine of the Faith, then known as the Holy Office, was first assigned to discipline priests who committed "a certain number of crimes."

In 1922, the Holy Office issued *Crimen Sollicitationis*, Latin for "the crime of solicitation," a document that instructed bishops to set up local church tribunals to prosecute priests who use confession to solicit sex, according to the Vatican overview. The document also instructed bishops to maintain "a strict code of confidentiality to protect all persons concerned from undue publicity" until the tribunal reached a "definitive decision," the Vatican said.



Agence France-Presse/Getty Images

Vatican spokesman Rev. Federico Lombardi at the news conference Thursday.

Crimen has been a lightning rod for debate since the Vatican disclosed its existence in the wake of an abuse scandal in Boston in 2002. Victims of abuse cited Crimen as evidence that the Congregation for the Doctrine of the Faith failed to exercise its authority to stop pedophile priests.

Crimen also stipulated that sex-abuse cases are covered by the "secret of the Holy Office"—a level of secrecy under church law that calls for excommunication for anyone who violates it. Msgr. Scicluna said the secrecy requirement, which remains in force, aimed to protect the "dignity of all people involved" in the cases and wasn't intended to stop church officials from reporting sexual abuse to civil authorities.

Alleged victims of sexual abuse who have brought lawsuits against the Vatican have cited Crimen as evidence in civil trials that the Holy See obstructed investigations by civil authorities. "Hundreds of thousands of children across the world have been molested because bishops usually won't tell the truth, call police," said David Clohessy, director of the Survivors Network of those Abused by Priests.

"Crimen Sollicitationis was ... never intended to represent the entirety of the policy of the Catholic Church regarding sexual improprieties on the part of the clergy," the Vatican said in the overview.

The Vatican sought to distance the Congregation for the Doctrine of the Faith from criticism of the Vatican's handling of abuse cases before 2001, noting that "a small number of cases" were reported to the office. It wasn't until 2001, with John Paul II's decree, that the Congregation for the Doctrine of the Faith was given clear jurisdiction over sex-abuse cases, the Vatican said. From 2001 forward, bishops were required to report all credible sex-abuse allegations to the Congregation for the Doctrine of the Faith.

—Margherita Stancati contributed to this article.

Slow change

The church's policies on abuse

- **1917:** Pope Benedict XV updates canon law, assigning the Holy Office—the future Congregation for the Doctrine of the Faith—to discipline priests who commit serious crimes.
- **1922:** The Holy Office issues Crimen Sollicitationis, Latin for 'the crime of solicitation,' which instructs bishops to set up tribunals to prosecute priests who use confession to solicit sex. Crimen, as it is known, requires church officials to maintain a code of confidentiality under threat of excommunication.
- **1962:** Vatican reprints Crimen, but doesn't distribute it widely.
- **1983:** Pope John Paul II makes the Roman Rota, a Vatican tribunal, an appeals court for sex-abuse cases. Under the updated law, abuse is defined as sexual acts with a minor under 16.
- **April 30, 2001:** John Paul II issues a decree overhauling the Vatican's sex-abuse rules. The decree requires bishops to swiftly report sex abuse by priests to the Congregation for the Doctrine of the Faith, a Vatican office then headed by Cardinal Joseph Ratzinger, who is now Pope Benedict XVI. The decree raises the age of majority to 18 years and establishes a 10-year statute of limitations.
- **July 15, 2010:** Vatican announces revisions to rules for disciplining sex abuse, and doubles the statute of limitations on priests accused of abuse to 20 years after their alleged victim's 18th birthday.

The Vatican; WSJ research

Osborne makes tweak to OBR

By Laurence Norman

LONDON—U.K. Chancellor of the Exchequer George Osborne said Thursday he will give lawmakers on Parliament's Treasury Select Committee the right to veto the new head of the Office for Budget Responsibility in a bid to quash concerns about the fiscal council's independence.

Mr. Osborne said the panel will advertise Friday for the new head of the OBR to succeed Alan Budd, who is leaving in mid-August. "I want there to be absolutely no doubt that this is an independent body, that this person has the support and approval of the Treasury Select Committee," Mr. Osborne said.

Mr. Budd's successor will take charge of the new, permanent OBR, which is expected to be established later this year, once Parliament has approved the legislation.

Applications for the new post are due mid-August, so the post will likely be vacant for a period. In further efforts to boost the OBR's independence, Mr. Osborne said he wanted the council to move out of the Treasury building and to have its own "core secretariat" of staff.

Mr. Osborne said he wants the new OBR head to serve a five-year term with the possibility of being reappointed. Mr. Osborne indicated his intention is that the OBR chief can't be fired by the chancellor, as with the Bank of England governor.

Mr. Osborne gave the OBR the power to draw up the growth and borrowing forecasts—a power previously held by the chancellor. The move was intended to prevent chancellors from making overoptimistic growth forecasts, allowing them to borrow more than was wise.

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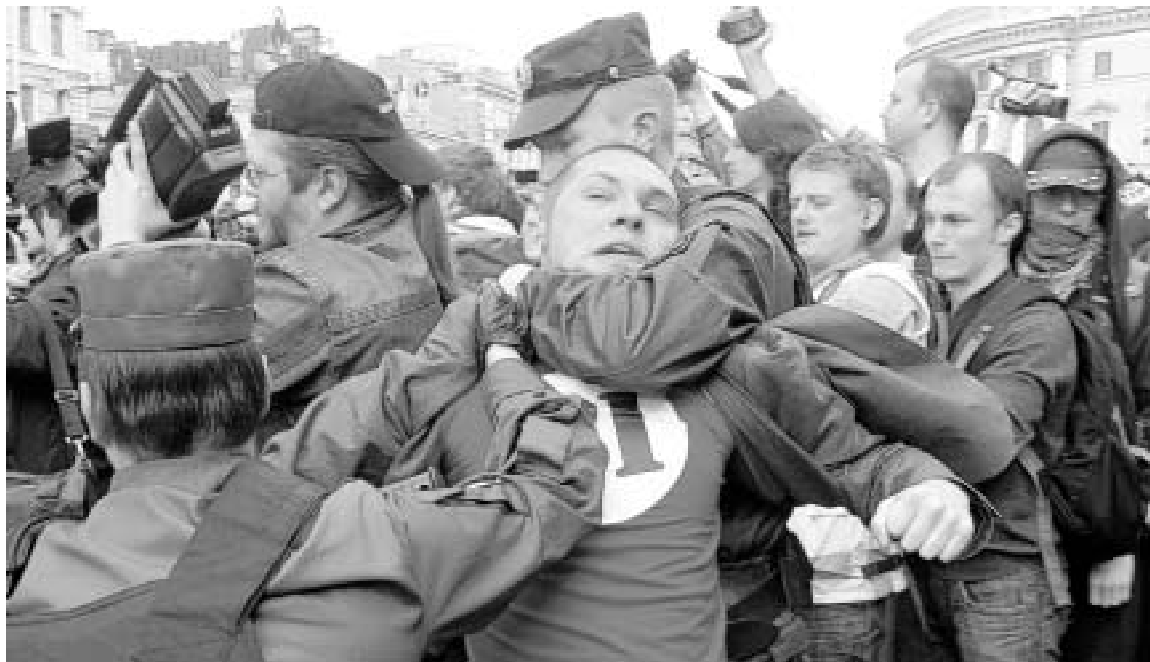

Agence France-Presse/Getty Images

Russian police arrest a political activist at an opposition rally in St. Petersburg on May 31.

Medvedev backs FSB law

Russian president defends plan to expand security service's powers

By Gregory L. White

MOSCOW—Russian President Dmitry Medvedev on Thursday endorsed a controversial draft law that would expand the powers of the Federal Security Service, the KGB's main successor. The plan has triggered fierce opposition from human-rights groups.

In his first public comments on the draft, which comes up for final approval in the lower house of Parliament Friday, Mr. Medvedev told a joint news conference with German Chancellor Angela Merkel that he had ordered the proposed changes, which he defended as a routine domestic matter.

Ms. Merkel said the issue had come up in talks between the two presidents in Yekaterinburg on Wednesday. She cited "different assessments" of human-rights and civil-society issues between Germany and Russia but stopped short of criticizing the draft law.

Domestic critics said Mr. Medvedev's support for the plan is at odds with his pledges to increase political openness and shore up the rule of law. Kremlin opponents say the proposal is the latest in a series of measures that amount to a tightening of state control.

"The president has said publicly today that there's no hope for liberalization of the regime," said Lev Ponomaryov, head of the nongovernmental group For Human Rights and a member of a Kremlin advisory panel that recommended against passage of the plan last month. "It's an absolutely totalitarian law," he added.

Supporters of the law—which is virtually assured of passage thanks to the commanding majorities held by the pro-Kremlin United Russia party in both houses of Parliament—deny the plan represents an effort to tighten the screws on critics. They argue that it gives the Security Service, known by its Russian initials FSB, necessary powers to fight terrorism and extremism.

"The draft law today corresponds to the most human, the highest standards of a law-based state," Vladimir Vasiliev, chairman of the parliamentary committee responsible for the draft, told reporters Wednesday.

The latest draft law would allow FSB agents to issue binding warnings to people they suspected were preparing to commit crimes, imposing stiff penalties for those who ignored them.

Supporters say amendments to the original draft removed elements that had raised concerns among human-rights advocates, but critics say those changes do little to soften the plan.

"The FSB's powers in our country have long since gone beyond all reasonable limits," Memorial, one of Russia's oldest human-rights groups, said in a public appeal Thursday. The new law will be a "tool of political intimidation" reminiscent of Soviet-era curbs on dissidents, the group said.

Although it reveres Soviet dictator Josef Stalin, the Communist Party also opposes the law, saying it unnecessarily strengthens the FSB's powers.

That view is shared by Just Russia, a party that usually supports Kremlin initiatives.

Critics said the new plan was the latest of several Kremlin steps to limit dissent. Last week, Parliament gave initial approval to a government plan to increase penalties for protests that block roads and railways—areas where popular demonstrations last year often led to officials giving in to protesters' demands. Earlier in the year, parliament approved new restrictions on trade unions.

Former Soviet President Mikhail Gorbachev, meanwhile, called for broader democracy to combat rising social tension. "To prevent society from exploding, a new policy is needed," he said in a newspaper interview published Wednesday.

Opinion polls show approval ratings for Mr. Medvedev and his patron and predecessor, Prime Minister Vladimir Putin, remain high. But dissent remains tightly controlled.

Opposition groups say they plan another demonstration on July 31 to draw attention to limits on freedom of assembly, which is protected by article 31 of Russia's constitution.

The last such protest, on May 31, led to more than 100 arrests. That spurred rare criticism from the Kremlin's human-rights ombudsman, Vladimir Lukin, who denounced the authorities' refusal to allow the demonstration as illegal and police manhandling of demonstrators as overly harsh.

In the weeks following, Mr. Lukin has been subject to a wave of criticism himself from pro-Kremlin officials, as well as reports that he will soon be ousted.

—Olga Padorina contributed to this article.

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Cephalopod diplomacy

By Richard Boudreaux

MOSCOW—Paul, the octopus who predicted Germany's defeat in the World Cup semifinals, was on the agenda when Russian President Dmitry Medvedev welcomed German Chancellor Angela Merkel to a summit in the Urals. A less fortunate octopus was on the menu.

"I rooted for the German team and I saw how you rooted for your team," Deputy Prime Minister Viktor Zubkov told Ms. Merkel during a meeting Thursday, according to Interfax news agency. "Of course, if it had not been for Paul—you know who I'm talking about, Paul the octopus—then everything would have been fine."

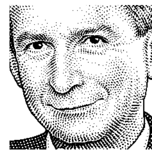
Mr. Medvedev interjected: "We ate his colleague last night at the restaurant."

Paul achieved celebrity by correctly predicting the outcome of eight out of eight World Cup matches. The eight-legged oracle selected a mussel from one of two containers draped in the flags of the opposing teams.

Navigating the EU's plans on financial regulation

[Brussels Beat]

By Stephen Fidler



The European Union's agenda to boost financial regulation has many moving parts, some of which—for example, the plan to regulate hedge funds—are moving more slowly than its supporters hoped. But here, as Brussels gets ready to embark on its summer recess, is a quick checklist, based on conversations with officials, on where the main proposals stand.

Alternative Investment Funds Directive: This effort to regulate hedge funds, private-equity and venture-capital funds has stagnated as negotiators try to find a way to resolve differences between the 27 member states—which together form the European Council—and the European Parliament.

The main issue of contention relates to the treatment of managers and funds from third countries. The Council, or at least a majority of it, supports a system that looks much like the existing one: 27 national regulators allowing access to national markets, with all facing higher transparency and disclosure requirements than in the past. The Parliament is still backing the idea of a European passport that would allow a fund manager satisfying certain criteria to market throughout the whole EU.

Here, the Parliament is the champion of the single market—supported by the European Commission, the EU's executive arm—but the opposition from France and others has been pretty implacable.

There are differences on other issues, for example on how to treat private-equity funds. Here, the governments appear to take a more relaxed view than the Parliament, which appears to view them as a bunch of asset strippers. But treating private equity too harshly raises questions about why it should be treated differently from other ownership structures, such as those for sovereign wealth funds and Russian oligarchs. Still, it could be ironed out in September or October.

Financial Supervision: This sets up an overarching European Systemic Risk Board, based in Frankfurt, and three European supervisors—one each for banking, insurance and financial markets. Again, the expected date for resolution is September.

The Council wants the agencies to be based in London, Paris and Brussels, respectively. Parliament had voted for all three agencies to be located in Frankfurt, but the all-Frankfurt option was quickly negotiated away, as expected.

The remaining divisions here concern how much responsibility the European supervisors will have and how much will remain with the national authorities.

So far only one set of organizations is guaranteed to be regulated on a European level: rating agencies. The Parliament wants to include the big banks, but the governments are set against and it won't happen.

European authorities will, however, be able to assume extra powers in financial emergencies. The question about who would declare emergencies seems to have been answered: the member states will together make the declaration. There are still questions, however, over what interventions the European agencies could make. The U.K., which takes the toughest position in the Council, wants to restrict interventions to cases where there is a clear breach of European law.

Derivatives and short-selling: The Commission launched a consultation in June. Proposals for derivatives legislation are likely to emerge from the Commission by mid-September, and Commission officials say they will probably follow the broad pattern laid down in the consultation document. That will preserve the exemption from most requirements for nonfinancial companies hedging as part of their business—though they will still face transparency requirements so that supervisors can be sure of what's going on.

Officials say, however, that the shape of proposed legislation related to short-selling and credit-default swaps is less certain, meaning a possible delay beyond September in its introduction.

Mifid: Consultations have started on the review of the Markets in Financial Instruments Directive, which was agreed on in 2004 and went into force in 2007. The objective is to improve information to investors as well as incorporate new markets in the scope of the directive. Not much space for the discussion here, but a lot of debate ahead before proposals are introduced, possibly early in the new year.

Bank capital requirements: This is the hottest topic for banks. The outcome is linked to what happens in talks under way among the Group of 20 governments in Basel. This will be translated in Europe into a fourth revision of the Capital Requirements Directive. Proposals will probably come out before the year end.

There are divisions between Europe and the U.S. on the approach and even within Europe. In very broad terms, U.S. and U.K. governments lay more emphasis on bolstering capital, while those in continental Europe argue that improved supervision would reduce the need for extra capital.

Americans see European banks as undercapitalized. On the other hand, I've often heard Europeans seriously argue that this is a U.S. plan to put European banks at a disadvantage by introducing rules the U.S. won't implement—just as it didn't implement the Basel II directive on bank capital.

Banks play a much more important role in continental Europe in channeling funds to companies than they do in the U.S., where financial markets are much more important. Hence the sensitivity to overloading them with capital requirements, particularly if they would curb lending and hamper recovery.

U.S. NEWS

Optimism about the economy grows

By Phil Izzo

Economists surveyed by The Wall Street Journal are more optimistic about the direction of the economy than the general public, though they are revising down forecasts for growth and jobs for the next 12 months.

The majority (64%) of the 55 economists polled—not all of whom answered every question—said that the economy would get better over the next 12 months and 9% said it would get worse; the rest said it would stay about the same.

In contrast, 33% of the general public expected the economy to improve and 23% think it will get worse.

The difference may depend on the definition of "better." The economy is "doing better, but not yet doing well," said Neal Soss of Credit Suisse. Economists, on average, now see the odds of double-dip recession at 20%. On average they expect the economy to grow at a pace below 3% through the second quarter of 2011, so slow that they anticipate the unemployment rate, now at 9.5%, will drop to just 8.6% by the end of 2011.

Half don't see the jobless rate returning to 5.5%, roughly full employment, before 2015. "We see gradual improvement, with an emphasis on gradual," said Bruce Kasman of J.P. Morgan Chase.

The forecasters see the economic effects of the **BP** PLC oil spill sharply different from the public. While 41% of respondents to the WSJ/NBC poll said the spill would affect the economy "a great deal," not a single economist agreed. Thirty-seven economists, or 70%, said the effect would be "very little," compared to just 6% in the public-opinion poll. "It's an environmental nightmare, but the national economic impact is minimal," said Paul Ballew of Nationwide.

The economists and public were in line on their views of President Barack Obama's handling of the economy. Half the respondents to the WSJ/NBC poll disapprove of it; 46% approve.

Among the economists, 29 or 64% of those who answered the question disapprove.And similar majorities of the public (63%) and the economists (70%) agree that Congress should focus on reducing the budget deficit even if it means it will take longer for the economy to recover.

"The administration has created immense uncertainty and arbitrarily attacked various industries," said Stephen Stanley of Pierpont Securities. "Stimulus efforts were a bust. Let's try some fiscal responsibility."

But some economists, while worried about the long-run deficit, think economic growth should take precedence. "Stimulate now but pass credible laws that will reduce deficit several years out," said Nicholas Perna of Perna Associates.

Most—27 or 59% of those who responded to the question—of the economists said if they were in Congress they would vote to renew the extension of unemployment compensation for up to 99 weeks, a proposal that is stalled in the Senate.

"An abrupt end to unemployment benefits could do more to damage the deficit than repair it by weakening the recovery and forcing the long-term unemployed to apply for more costly long-term benefits, such as Social Security," said Diane Swonk of Mesirow Financial.

Poles apart

Economists are more optimistic about the U.S. economy and much less worried about the Gulf oil spill than the general public.

How much do you think the Gulf Coast oil spill will affect the U.S.'s economy?

	Percent of respondents*:	
	WSJ/NBC (1,000 polled)	WSJ survey of economists (55 polled)
Affect the nation's economy a great deal	41%	0%
Affect the nation's economy quite a bit	28	6
Affect the nation's economy some	22	22
Affect the nation's economy very little	6	70
Will not affect the nation's economy at all	2	2
Not sure	1	n/a

During the next 12 months, do you think that the U.S.'s economy will get better, get worse, or stay about the same?

	Percent of respondents*:	
	WSJ/NBC (1,000 polled)	WSJ survey of economists (55 polled)
Economy will get better	33%	64%
Economy will get worse	23	9
Economy will stay about the same	43	26

*Numbers don't add up to 100 because of rounding
Sources: WSJ/NBC poll; WSJ survey of economists

Congress approves finance overhaul

Continued from first page

cil of regulators to monitor economic risks, establishes a new agency to police consumers' financial products and sets new standards for the way derivatives are traded.

Republicans said the bill could jeopardize the economic recovery by constraining credit and crimping the banking industry, and chided the expansion of government power it envisions.

The bill "is a 2,300-page legislative monster...that expands the scope and the powers of ineffective bureaucracies," said Sen. Richard Shelby (R., Ala.).

Lawmakers and the Obama administration are expected to soon pivot to a potentially more contentious issue: the future of Fannie Mae and Freddie Mac.

Once this bill is signed into law, lawmakers and the Obama administration are expected to pivot to a potentially more contentious issue: the future of government-run mortgage-finance giants Fannie Mae and Freddie Mac. Many Republicans complain that not tackling these companies in the finance bill was a glaring omission. The administration has begun work on a proposal to redesign the mortgage-finance system, and Congress could take up the issue in 2011.

The law will be implemented in a volatile environment. Profits on Wall Street are soaring, with J.P. Morgan reporting $4.8 billion in net profit in the second quarter. But the banking sector is contracting, with close to 300 banks failing since January 2008. Many businesses and borrowers are struggling to obtain loans.

Supporters and critics agree the impact of the bill will be determined over several years, depending in large part on decisions made by regulators. The law's passage "is the beginning of the process and not the end," says Satish Kini, co-chair of the banking group at law firm Debevoise & Plimpton LLP. "The shape of the reform won't be known until the regulators have spoken."

Treasury Department officials have taken initial steps to lay the groundwork for the new consumer agency and are also creating a structure so that large, complex and failing financial companies can be taken apart and liquidated without disrupting markets.

The bill gives discretion to regulators, including the Federal Reserve and SEC, to apply the bill's mandates. Aside from creating the new consumer regulator, it leaves the U.S.'s patchwork regulatory framework largely intact, and most of the players will be familiar. That has irked critics on the left and right who say one of the bill's key flaws is that it relies on the judgment of officials rather than hard rules. Conservatives worry regulators will throttle the industry. Liberals worry they will be co-opted by lobbyists.

"The same regulators who ignored consumer advocates' warnings about predatory lending have veto power over the consumer agency," said John Taylor, chief executive of the National Community Reinvestment Coalition. "That club of regulators is very insular, and usually in agreement."

In a sign of the challenge, at a congressional hearing Thursday to approve her nomination as Fed vice chairman, Janet Yellen said the Fed's regulatory approach was insufficient for years.

"We failed completely to understand the complexity of what the impact of the national decline in housing prices would be in the financial system," said Ms. Yellen, currently president of the Federal Reserve Bank of San Francisco. "We saw a number of different things and we failed to connect the dots."

Senate Banking Committee Chairman Christopher Dodd (D., Conn.), a chief architect of the bill, said such problems could be remedied by hiring the right people. But he also acknowledged the limits of the law to ensure success. "I can't legislate wisdom," he said.

European Pressphoto Agency

Sen. Harry Reid (D., Nev.), left, and Sen. Jon Tester (D., Mont.), center, Thursday.

Regulators will have multiple questions to answer. What kind of trades can banks conduct and which will be illegal? At what level should regulators cap the fees that retailers pay to banks to process debit-card transactions? On which companies will the Fed apply stricter regulations? What will be the new standards for mortgages, credit cards and ATM fees?

By next summer, regulators could have answered many of these questions. The new consumer agency should be established, with its own staff and director. A new council of regulators will be monitoring emerging risks to the economy. There will be new rules on golden parachutes for employees at public companies, policies for ATM cards, the abolishment of the Office of Thrift Supervision, new derivatives rules and hedge-fund registration.

Banks' outreach to regulators began in earnest months ago. French bank **BNP Paribas** hosted a dinner at Manhattan's Le Bernardin at which investors grilled a Federal Reserve Bank of New York official about how the derivatives rules would be applied.

Over striped-bass tartare, some participants told Patricia Mosser, the Fed official attending, that they didn't want much to change the current model of derivatives trading.

Ms. Mosser said pushing more derivatives onto exchanges, as the law demands, would make the market more transparent and safer, people familiar with the matter said. Still, it was clear the rules wouldn't be put in place overnight. The law would take months, maybe years, to implement, she told the group.

Economists surveyed split on merits of overhaul bill

By Phil Izzo

Economists surveyed by The Wall Street Journal this week were evenly split on whether they would have voted for the financial regulatory bill that passed the Senate Thursday.

Of those surveyed, 21 said they would vote yes; 22, no.

Asked how much the legislation would do to prevent a repeat of the global financial crisis, a majority (58%) said the overhaul would reduce the risks "just slightly," and only 6% thought it would have a "significant" impact.

Among those who said they would vote against the bill, Diane Swonk of Mesirow Financial raised concerns about moving too fast. "The legislation is outpacing our understanding of the crisis, and I would like to make sure that we learn something from what went wrong before we legislate a new problem," she said.

Others echoed concerns about unforeseen risks resulting from the overhaul. "Minor reduction in financial risk is not worth a major overhaul," said Brian Wesbury of First Trust Advisors.

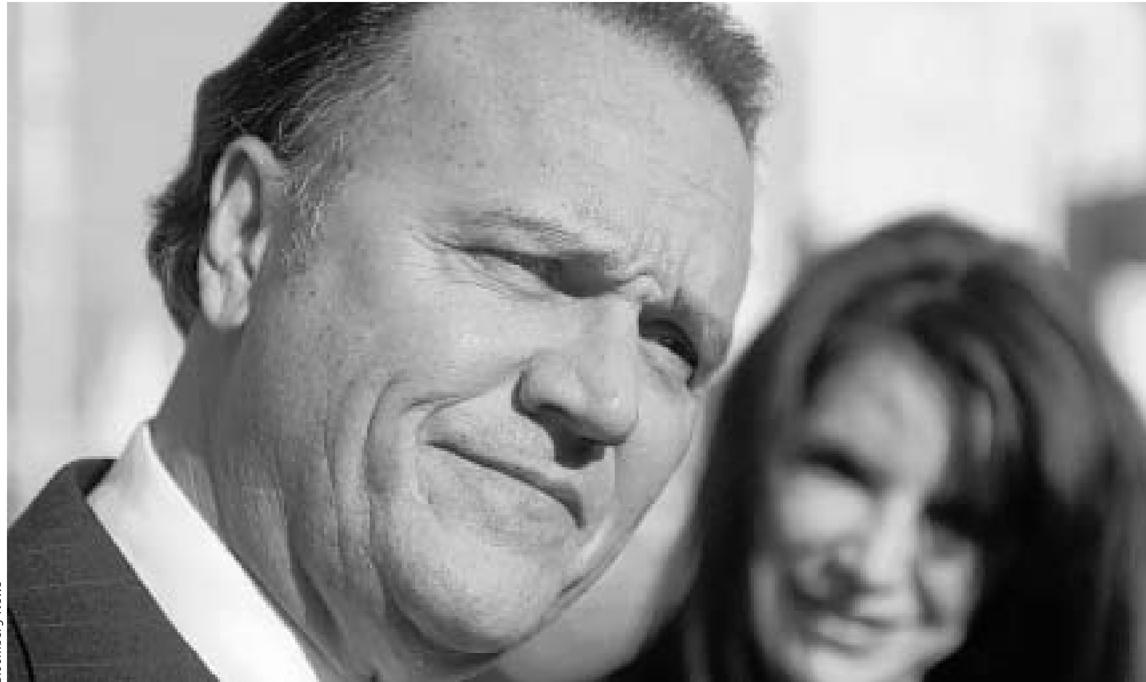
Many of those who said they would vote to pass the legislation weren't enthusiastic. "Better it than nothing," said Allen Sinai of Decision Economics, "though [the measure] is very imperfect."

"Human nature makes more financial crises inevitable. Hopefully the legislation will make them milder," said Dana Johnson of Comerica Bank, who backed passage.

On the impact of the bill, some, such as Mark Nielson of MacroEcon LLC, were skeptical that any regulation could help. "Anything Congress puts in place will in the short run be undone at the trading level and in the long run will become captive of the cozy high-finance industry," he said.

Scrushy seeks early out amid appeal

By Mike Esterl



Bloomberg News

A U.S. appeals court will review the conviction of former HealthSouth CEO Richard Scrushy, seen with his wife in 2006.

Richard Scrushy is seeking early release from prison, but a huge civil judgment means the former **HealthSouth** Corp. chairman won't resume his lavish lifestyle any time soon.

Lawyers for Mr. Scrushy filed a motion for release Wednesday with the 11th U.S. Circuit Court of Appeals, asking that he be freed while his 2006 bribery conviction is being reviewed. The U.S. Supreme Court ordered the Atlanta court to revisit the conviction last month after it curbed an "honest services" law used to prosecute executives.

"He's served sufficient time to reduce any risk of flight, and we're hopeful now's the time he should be released," said Art Leach, an attorney for Mr. Scrushy, after filing the motion.

While a ruling on the conviction may take several months, the decision about whether Mr. Scrushy will stay behind bars in the interim could be handed down sooner. The 57-year-old former chief executive has served roughly half his 82-month sentence at a minimum-security jail in Texas. He was convicted of six charges—including bribery, conspiracy and mail fraud—for contributing $500,000 to a campaign for a state lottery favored by former Alabama Gov. Don Siegelman in exchange for a seat on a state regulatory panel.

The one-time symbol of the mega-rich CEO faces one other legal hurdle: a $2.88 billion civil judgment on behalf of HealthSouth shareholders after an Alabama judge ruled last year that Mr. Scrushy falsely inflated the rehabilitation chain's earnings.

Mr. Scrushy, whose net worth was estimated to be as high as $300 million prior to his legal woes, is also appealing the civil judgment. Alabama's highest court is weighing the appeal, but oral arguments have yet to begin and people familiar with that case don't expect a swift ruling.

In the meantime, civil plaintiffs have seized Mr. Scrushy's roughly 17,000-square-foot mansion in Birmingham, Ala., and they are offering it to prospective buyers for $4.7 million. A similarly sized retreat on Alabama's Lake Martin, featuring 10 bedrooms, nine bathrooms and a fireplace big enough to walk through, has a $5 million sale price after being seized from Mr. Scrushy.

Mr. Scrushy also owned a flashy stable of cars, including a Rolls-Royce, Lamborghini and several Porsches and BMWs. Nineteen of the cars, including a 1929 Cadillac, were auctioned last autumn, netting about $850,000 for plaintiffs.

Leslie Scrushy, Mr. Scrushy's wife, moved into a smaller house in a Houston suburb last year along with four children. But plaintiffs are targeting that home, too. Ms. Scrushy drives a Toyota Sienna, and the children attend public school.

"I buy a whole lot more at Wal-Mart and Target than before," Ms. Scrushy, 41, said in a telephone interview, adding that she recently started a new job to secure health insurance.

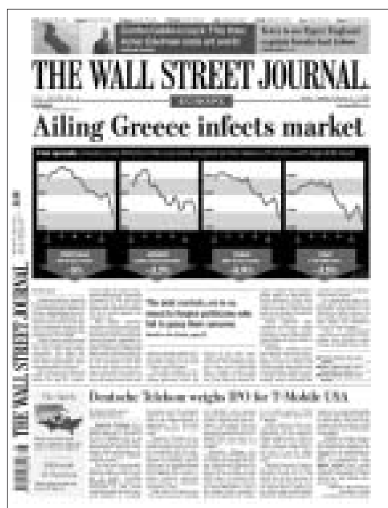
Lawyers for plaintiffs in the civil case estimate that Mr. Scrushy's remaining assets most likely total tens of millions of dollars, not hundreds of millions of dollars. Still, they hope to have an easier time tracking down the assets if he leaves prison early. "It might be a little bit more expensive for him to live" outside of jail, said John Haley, an attorney for the civil plaintiffs. "Maybe he'll start moving some money, and we can find out where it is."

A Birmingham judge ruled that Mr. Scrushy was in contempt of court last year for failing to provide information about his assets. Mr. Scrushy's attorneys say their client's ability to cooperate while he is in prison is severely limited because he has limited contact with the outside world.

Mr. Scrushy's attorneys deny that their client is hiding any assets following his earlier payment of about $70 million in civil claims. They say Mr. Scrushy has spent tens of millions of dollars in lawyer fees and suffered investment losses over the last several years.

Lawyers for shareholders are also trying to trace $6.5 million that they claim was fraudulently funneled to third parties from Mr. Scrushy's charitable foundation.

Make sure you have your breakfast briefing every day.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NEWS FOR NEWS MAKERS

Confusion abounds as tax debate looms

By John McKinnon

WASHINGTON—President Barack Obama wants to extend the Bush-era tax cuts for the middle class only. Many House Democrats want to extend them for that group, too, but perhaps only for a year or two. Republicans, and a handful of centrist Democrats, are talking about extending all the tax cuts.

Such is the confused state of play heading into one of the biggest tax debates in a decade.

The crunch will come later this year when Congress tackles the roster of tax cuts that expire Jan. 1. On the list are taxes on income, dividends and capital gains. Lawmakers also have to deal with the estate tax, which went to zero this year and is set to leap to 55% next year unless Congress acts.

The uncertainty has many businesspeople sitting on their hands, because they don't know what tax rates will be next year, business groups and economists say.

Lawmakers are negotiating a tax bill but appear likely to wait until after the November election to take any final action that could anger voters. Congress ultimately could decide to extend current tax levels for just a few months, leaving the issue for the next Congress to settle. Another option is a short-term extension of a year or two, avoiding for now the huge cost to the Treasury of a permanent extension. It's even possible Congress might fail to take any action this year.

"Raising income taxes even on people making $250,000 runs the risk of dampening consumer demand at a time when that is critical to recovery," Sen. Evan Bayh (D., Ind.) said. It might be appropriate to raise some taxes once the economy is back on its feet, he said, "but the economy is too weak right now."

The George W. Bush-era provisions established the current relatively low tax rates on personal income and on capital gains and stock dividends, and also provided for the current lapse in the estate tax. President Obama has been pushing to keep the current rates for the middle class only, and to allow rates for higher earners, defined as families making more than $250,000, to rise. That would include a new 39.6% top income-tax rate, up from 35% now, as well as a 20% top tax rate for dividends and capital gains, up from 15%. Many congressional Democrats want to go further, and allow dividend rates for high earners to rise to 39.6%.

Mr. Obama and his advisers have been busy this week seeking support among businesspeople, but business groups warn that higher income-tax rates for higher earners could affect hundreds of thousands of small businesses, whose owners often file their proceeds as personal income.

White House spokesman Robert Gibbs acknowledged concerns about investment but noted that company profits had rebounded over the last two years. "I don't think what they're saying squares with what's going on in the business world in this country right now," he said.

Bloomberg News

Fed board nominees—from left, Janet Yellen, Peter Diamond and Sarah Bloom Raskin—at a Senate hearing Thursday.

Fed nominees vow to keep closer watch on industry

By Sudeep Reddy

WASHINGTON—The Obama administration's nominees to the Federal Reserve Board said the central bank fell short of its responsibilities before the financial crisis and vowed to monitor the financial system more aggressively using new powers the Fed is gaining in a financial-rules overhaul.

"One thing we've learned from this crisis is there is a need for all of us in regulation to act in a timely way to take away the punch bowl" and put more stringent requirements on financial institutions, said Janet Yellen, the nominee for Fed vice chairman who has served as president of the Federal Reserve Bank of San Francisco since 2004.

Ms. Yellen appeared Thursday at a confirmation hearing before the Senate Banking Committee alongside two other nominees to become Fed governors, Massachusetts Institute of Technology economist Peter Diamond and Maryland financial regulator Sarah Bloom Raskin. The trio reflected the Obama administration's impetus to take a tougher stand against emerging risks across the economy.

Ms. Raskin said the Fed "has been subject to substantial and I believe justified criticism" for failures in regulation and monetary policy ahead of the crisis. The central bank didn't put enough focus on banks building up capital in good times. And as lax mortgage practices fueled the housing sector, she said, "I think the extent of the housing bubble that was developing was not appropriately monitored or taken seriously."

The vast number of new financial instruments created in recent decades "has done a great deal of good but in crisis has done a great deal of harm," Mr. Diamond said. "A big part of that problem was not just the regulators, but also the financial institutions themselves didn't understand the risks they were taking on and the risks associated with the interconnections of the different financial institutions."

If confirmed to the seven-member Fed board, the incoming Fed officials would likely shift the balance of power at the Fed toward policymakers who worry more that the economy isn't expanding quickly enough—a growing concern in Washington—rather than the risk of emerging inflation.

Senate Banking Committee Chairman Christopher Dodd (D., Conn.), noted that recent weak economic data "suggest that we are moving toward price deflation.... It is evident that the economy is going to need all the help the Fed can provide over the coming year," he said.

Ms. Yellen and Ms. Raskin both acknowledged the importance of stable prices—half the Fed's mandate—but they stressed the importance of boosting the economy.

"Over the next few years, the Fed must craft policies that ensure that our economy accelerates its progress along the recovery path it has begun to trace," Ms. Yellen said. "With unemployment still painfully high, job creation must be a high priority of monetary policy."

While the Fed achieved price stability for a generation, Ms. Raskin said, "it is only a partial victory when many American households continue to face the perils of unemployment and many small businesses struggle with weakened consumer demand and reduced access to credit."

In a hearing that came just before a key vote on a financial-regulation bill that strengthens the Fed's powers, lawmakers sought—and repeatedly received—acknowledgments of the Fed's failures ahead of the crisis.

Ms. Yellen admitted that the Fed's regulatory approach was insufficient for years. She described regulators' guidance about real-estate risks as "weak." And even though she warned publicly about some risk of a housing bubble as early as 2005, Ms. Yellen said, she and other officials should have focused more on faulty mortgage practices and the broader risks they created for the financial system.

"We failed completely to understand the complexity of what the impact of the national decline in housing prices would be in the financial system," she said. "We saw a number of different things and we failed to connect the dots."

Jobless claims fall; output weakens

By Conor Dougherty

The number of people filing for unemployment insurance fell last week, but weak industrial output and a drop in wholesale prices point to a slowing in economic recovery.

Initial claims for jobless benefits fell a seasonally adjusted 29,000 to 429,000 in the week ended July 10, the Labor Department said Thursday. Jobless claims are an early indicator of the labor market's direction, so a drop would be welcome news for an economy on the mend. Several economists downplayed the decline, noting it likely arose in part because some manufacturers chose to skip their normal summer shutdowns as they rebuild inventories.

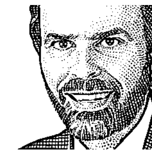
The number of workers applying for continuing claims—those made by people who have been out of work for more than one week—increased 247,000 to 4,681,000 in the week ended July 3.

Separately, the Federal Reserve said industrial production inched up 0.1% in June. The gain reflected a 2.7% increase in utility output brought on by hot weather, which offset a 0.4% decrease in manufacturing. The report also showed factories, mines and utilities used just over 74% of their capacity in June, a low number by historical standards.

For election, parties pursue strikingly simple strategies

[Capital Journal]

By Gerald F. Seib



Campaign tactics can be complex, full of computerized voting analyses, 24/7 communications strategies and elaborate get-out-the vote schemes.

Campaign strategies, by contrast, are often very simple.

And so it is with this year's congressional campaign strategies, which boil down to this: Republicans want November's election to be a referendum, while Democrats want it to be a choice.

More precisely, Republicans want the vote to be a referendum on Democrats and their economic record. Democrats want it to be a choice between them and the still-not-popular Republican Party. Those calculations explain much of the maneuvering seen in the American political world right now.

Both strategies make sense given the jaundiced state of public opinion. For their part, Republicans know that the Democrats' leader, President Barack Obama, hasn't merely declined in popularity. He has faltered most noticeably among groups on which Republicans should be able to capitalize—if the GOP can ensure that the focus remains on Mr. Obama and his Democrats.

A review of the president's job-approval ratings in the Wall Street Journal/NBC News poll illustrates the opening. Mr. Obama's decline since early 2009 has been particularly steep among independent voters (approval down to 37% from 58%), small-town and rural residents (31% from 51%), suburban women (44% from 63%) and baby-boomer men (44% from 66%).

Those are groups with which Republicans had been doing well before losing ground in 2006 and 2008. Logically, the party should be able to do well again—provided those groups are focused on their current disenchantment with Democrats, rather than the disenchantment with the GOP that drove them away from the party a few years ago.

Republicans have seen this movie before, so they know how it can end. In 1982, it was a new GOP president, Ronald Reagan, who was enduring the aftermath of a deep recession, double-digit unemployment and rising deficits, amid charges he had implemented radical economic policies that weren't working.

Mr. Reagan and his party became the focus of the 1982 midterm elections—and lost 26 House seats.

Now, Republicans want to turn the tables. That's why, despite periodic talk of pushing their own policy proposals, Republicans expend far more energy pounding away on high unemployment and deficits under Democratic rule, and doubts about the Democrats' health-care initiative.

It's why the GOP House campaign committee this month sent similar news releases to the home turf of more than 100 vulnerable House Democrats, blasting them for failing to pass a budget to deal with the deficit and asking, "Where are the jobs?" Republicans don't want to distract from Democrats' problems by inserting themselves into the picture.

Democrats, by contrast, want Republicans in the picture. Democrats know that, whatever their party's problems, voters are hardly swooning over Republicans.

In the most recent Journal/NBC News survey, in fact, just 30% of respondents said say they have a positive view of the GOP. That actually puts Republicans below Democrats (35%) and well below Mr. Obama (47%).

It's particularly important for Democrats to remind independent and swing voters that they don't love Republicans very much. Democratic strategists think they are in much better shape if they can cast each House race not as a national referendum on their party, but a choice between a specific, local Democratic candidate—one presumably well-known and better liked than the national party—and an actual Republican opponent.

The strategy worked in a recent special election to fill a vacant U.S. House of Representatives seat in Pennsylvania.

At the same time, Democrats need to remind their own core voters that they don't like the Republican alternative, because many base Democrats are mired in apathy.

For example, voters who cast ballots for GOP presidential contender John McCain in 2008 actually say are they are *more* interested in this year's election than they were in that race. More than seven in 10 McCain backers say they are highly interested in this year's contests, up from 67% two years ago.

Obama backers, by contrast, are far less interested this time around. In 2008, 82% of Obama voters said they were very interested in the election. Now just 44% say that they're interested—a staggering 38-point drop.

That's why you see Democrats trying to remind their own voters the Republicans are out there. At a Democratic rally in Missouri last week, for example, Mr. Obama said of the Republicans: "They spent nearly a decade driving the economy into the ditch, and now they're asking for the car keys back."

Party spokesmen tirelessly remind voters that, if Republicans take over, the House Energy Committee would be run by Rep. Joe Barton, who famously apologized to BP PLC because it was compelled to set up a $20 billion contingency fund to pay claims from the Gulf of Mexico oil spill.

Democrats this year need a foil such as Mr. Barton; Republicans are trying hard to avoid playing that role.

WORLD NEWS

Charge mars India-Pakistan talks

By Amol Sharma
And Tom Wright

NEW DELHI—The foreign ministers of India and Pakistan struck a positive note Thursday after peace talks in Islamabad, but India's new claim that Pakistan's spy agency orchestrated the 2008 terrorist attack on Mumbai underscores that distrust remains between the nuclear-armed rivals.

Indian External Affairs Minister S.M. Krishna said his Pakistani counterpart, Shah Mehmood Qureshi, assured him that Pakistan will try to speed up the prosecution of terrorists on its soil and will use investigative leads provided by India to "unravel the full conspiracy" of the Mumbai attack, in which 10 gunmen killed more than 160 people.

Mr. Qureshi said the countries also discussed the divided Himalayan region of Kashmir, which has seen a rise in violence recently, as well as their longstanding dispute over Sir Creek, a 96-kilometer strip of water on their borders that opens up into the Arabian Sea.

He said the countries also explored confidence-building measures, such as increasing cross-border trade and exchanging fishermen detained after straying into each other's waters. "Pakistan has always wanted friendly, cooperative and good neighborly relations with India. We've started a process to achieve this objective," Mr. Qureshi said in a joint news conference of the two ministers.

India says terrorism is the core issue of the talks, while Pakistan wants to focus on other issues, including disputes over shared water resources and over Kashmir, which is two-thirds controlled by India but claimed in entirety by both countries. India and Pakistan have fought two of their three wars over Kashmir.

Despite the moves to ease tensions, the new spat that played out ahead of the meeting could complicate the nascent rapprochement between the neighbors. India is now accusing elements of the Pakistani government of planning and executing the Mumbai attack. India had previously blamed Pakistan-based militants for carrying out the attack, but hadn't publicly accused Pakistan's government of direct involvement.

This week, Indian Home Secretary G.K. Pillai told the Indian Express newspaper that Pakistan's spy agency, the Inter-Services Intelligence was "literally controlling and coordinating [the attack] from the beginning till the end."

A home ministry official said Thursday that information about the ISI's involvement came from India's interrogation of David Headley, a Pakistani-American in U.S. custody who pled guilty in March in a Chicago federal court to doing reconnaissance on Mumbai targets before the siege of India's financial capital in November 2008.

Pakistani officials have vehemently denied that its intelligence agency played any role in the Mumbai attack. Pakistani Information Minister Qamar Zaman Kaira said Mr. Pillai's comments were "baseless propaganda," according to the Press Trust of India news service. "When two foreign ministers are meeting, such allegations should not be made."

The row was a significant diplomatic setback after both countries had tried to strike a tone of reconciliation in recent months. In February, their foreign secretaries met to lay the groundwork for a peace push, and since then the prime ministers and home ministers of India and Pakistan have met on the sidelines of regional summits to advance the talks.

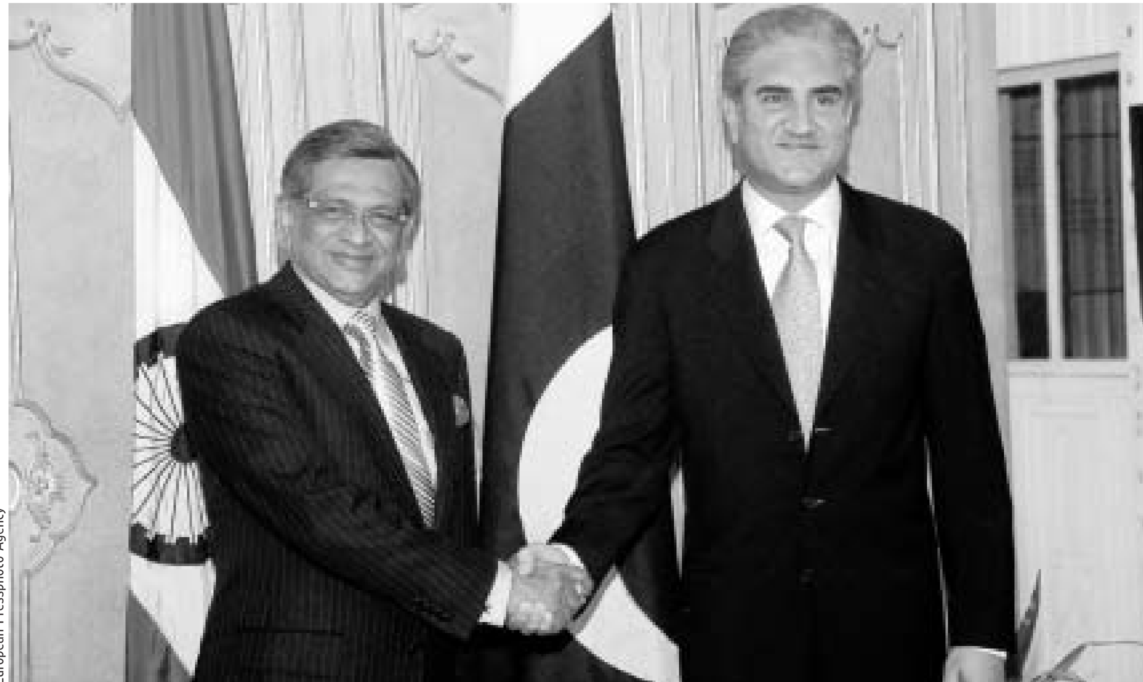
Mr. Krishna said he raised with Mr. Qureshi the new information India has gleaned from Mr. Headley, but he didn't specifically mention the ISI controversy.

In addition to the ISI dispute, there are other hurdles to peace. India has said Pakistan isn't moving fast enough to prosecute militants based there, including those tied to the group Lashkar-e-Taiba. Pakistani authorities have arrested five Pakistanis and have warrants out on two others for their roles in the Mumbai attack. But the trials of the five men have yet to begin, according to Pakistani government officials. Mr. Qureshi said the two foreign ministers discussed how to "hasten the trial process."

In Kashmir, violent demonstrations by separatists have erupted in recent weeks in the portion of the region India administers. At least 15 Kashmiri protesters have died in fighting with Indian security forces since mid-June. India deployed its army to quell the protests, but it is still largely relying on police. Some Indian officials have said Pakistan-based militants are fueling the separatist unrest in Kashmir. Pakistan denies that and has said it is concerned about human-rights abuses by Indian forces.

Pakistan's ISI has faced accusations for years of interfering in regional security and having links to terrorist outfits. India blamed the spy agency for the suicide car-bombing of the Indian Embassy in Kabul in 2008, while the same year, Afghan officials said the ISI plotted a failed assassination attempt on President Hamid Karzai at a parade. Pakistan has denied those allegations.

The ISI helped fund and train Lashkar-e-Taiba in the 1990s as a militia force to fight Indian troops in Kashmir. The group was banned in 2002 by then-President Pervez Musharraf, but militants from the organization continued to operate under an Islamic charity, according to the United Nations. The ISI says it is no longer involved with the group.


European Pressphoto Agency

Foreign ministers S.M. Krishna of India, left, and Shah Mehmood Qureshi of Pakistan in Islamabad on Thursday.

U.S., China avoid tiff over naval drills

By Brian Spegele

BEIJING—China's government responded indignantly Thursday to U.S. plans for naval exercises in waters around South Korea, but analysts said an apparent compromise by the U.S. on the drills will likely prevent escalation of the issue.

The exercises, originally scheduled for June but delayed, are designed to reinforce joint naval work between the U.S. and South Korea after the sinking of a South Korean warship that both countries blame on North Korea, a Chinese ally.

Separately, North Korea used a meeting of military officials at the inter-Korean border Thursday to renew its wish to send its own military officers to inspect the recovered wreckage of the sunken ship and to go to the sinking site near a South Korea-controlled island. North Korea has made similar requests since late May, when an international team of investigators concluded it was responsible for the sinking, which killed 46 sailors. Seoul has denied the request.

In colonel-level talks between North Korea and the United Nations Command Military Armistice Commission, North Korea said its inspection of the wreckage should occur before generals from the two sides meet, according to the North's state media. The U.N. command said after the Thursday meeting that said both sides offered proposals for the generals' talks, but would decide later whether to hold them.

The accusations against North Korea created another rift between China, Pyongyang's main ally, and the U.S. Most visibly, China for several weeks has objected to the planned joint naval exercise by South Korea and the U.S.

After U.S. officials on Wednesday described tentative plans for the exercises, China foreign-ministry spokesman Qin Gang on Thursday said, "We firmly oppose any foreign warships or airplanes to conduct activities undermining China's security in the Yellow Sea and China's coastal waters."

The exercises were expected to take place in the Yellow Sea, between China's east coast and the Korean Peninsula, though Washington never publicly confirmed that. At a briefing on Wednesday, Pentagon Press Secretary Geoff Morrell said part of the operations will be conducted in the Yellow Sea, and part in the Sea of Japan, or East Sea, east of the Korean peninsula.

"All of these exercises are defensive in nature, but will send a clear message of deterrence to North Korea and demonstrate our steadfast commitment to the defense of South Korea," Mr. Morrell said.

He declined to specify which types of operations would occur where. But several analysts and Chinese media outlets speculated Thursday that the U.S. might put the aircraft carrier USS George Washington in the Sea of Japan. That could ease China's concerns, because the presence of the carrier in the Yellow Sea was one of its biggest objections.

U.S. Secretary of State Hillary Clinton and Defense Secretary Robert Gates are likely to officially announce plans for the exercises when they travel to Seoul next week.

Shi Yinhong, a foreign-affairs expert at Renmin University in Beijing, interpreted the Pentagon statement as a decision to scale back operations in the Yellow Sea, which he said was positive for both countries. "I think this means the U.S. government understands the message that they don't want to make this quarrel more serious," he said.

Some U.S. analysts warn that if Washington doesn't put the carrier in the Yellow Sea this time, it could signal weakness to China.

Mr. Morrell on Wednesday said the U.S. wouldn't allow China to influence its activities in international waters. "This is a matter of our ability to exercise in the open seas, in international waters," he said. "Those determinations are made by us, and us alone."

—Aaron Back in Beijing and Evan Ramstad in Seoul contributed to this article.

Citizens panel in Japan calls for indictment of party official

By Yuka Hayashi

TOKYO—Ichiro Ozawa, the beleaguered former leader of Japan's ruling party, came under fresh attack Thursday after a judicial panel composed of ordinary citizens looking into his fund-raising activities recommended that he be indicted by prosecutors.

The latest ruling is unlikely to have an immediate impact on Mr. Ozawa, due to the complex and convoluted nature of the citizen panels and their rulings. Two separate citizen panels are debating similar but separate allegations that Mr. Ozawa was aware of false statements made at his fund-raising organization. The first citizen panel already delivered a similar verdict.

A representative for Mr. Ozawa's office declined to comment.

The twists and turns of Mr. Ozawa's campaign-fund scandal have been followed closely in Japan, as they have affected the influence of the lawmaker once seen as the single most powerful politician within the ruling party. Mr. Ozawa was forced to step down as the party's secretary-general last month, along with then-Prime Minister Yukio Hatoyama. The latter had been criticized for his own campaign-funding scandal, as well as for his policy errors.

Ichiro Ozawa was forced to step down as the ruling party's secretary-general last month.

All eyes are now on the second round of deliberations by the first panel. The 11-person group, appointed by the court after complaints from a group of citizens, concluded unanimously in April that the prosecutors were wrong to clear Mr. Ozawa of allegations he had violated a political-funds law related to the purchase of a $4 million property in Tokyo in 2004.

That decision forced prosecutors to reopen their probe, but they again decided in May not to indict him. Since then, the first citizens panel has been engaged in the critical second round of debate. This time, the panel has the authority to order an indictment against Mr. Ozawa. Japanese media reported this week the panel probably won't make its decision until August or later.

Despite his resignation from the top party post, Mr. Ozawa remains a central figure in directing the future of Japanese politics. Even after Prime Minister Naoto Kan asked him in June to "keep quiet for awhile" and he himself made a pledge to go back to being a "foot soldier," Mr. Ozawa has been grabbing headlines. The senior politician attacked Mr. Kan and his policy stance publicly, even as his party fought a doomed battle to defend its presence in national elections Sunday.

Now that the party's defeat has made Mr. Kan vulnerable, some political experts predict Mr. Ozawa might use his influence to try to unseat him. But if Mr. Ozawa is indicted, his clout would be curtailed sharply.