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After high drama, U.S. goes through

Reuters

An injury-time goal from Landon Donovan against Algeria ensured that the U.S. went on to the next round, while England ended its run of draws to defeat Slovenia 1-0. Article on page 28

Obama sacks top general in Afghan war

By Jonathan Weisman and Peter Spiegel

WASHINGTON—U.S. President Barack Obama accepted the resignation of Gen. Stanley McChrystal, the top U.S. commander and strategist of the Afghan war, following comments by the general and his aides disparaging the president and other senior officials.

Mr. Obama nominated Gen. David Petraeus, the head of the military's Central Command and the architect of the surge of forces into Iraq in 2007, to take over as the commanding general in Afghanistan.

The nomination of Gen. Petraeus, who still requires Senate confirmation, sends a signal that the president stands behind the counterinsurgency tactics pushed hard by Gen. McChrystal and championed by Gen. Petraeus.

Mr. Obama said his acceptance of Gen. McChrystal's resignation didn't reflect a disagreement about strategy or any sense of personal insult. "We are in full agreement about our strategy," he said Wednesday, expressing "great admiration" for the general.

"But war is bigger than any one man," Mr. Obama said. "As difficult as it is to lose Gen. McChrystal, I believe it is the right decision for our national security."

He said the change was necessary to maintain a "unity of effort" in Afghanistan. "I welcome debate among my team, but I won't tolerate division."

The switch comes at a crucial time in the war, as thousands of troops are pouring into Afghanistan ahead of a planned operation in Kandahar that is seen as central to the campaign. The balance of surge forces are to arrive by August.

Gen. Petraeus, as combatant commander in the military region that includes Afghanistan and the Middle East, was Gen. McChrystal's commanding officer.

By agreeing to take command, Gen. Petraeus himself was showing resolve to see the counterinsurgency effort through in Afghanistan.

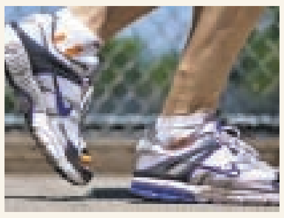
Gen. McChrystal, 55 years old, faced a barrage of criticism from top U.S. officials for mocking his civilian bosses and administration colleagues in a magazine article.

Some of his strongest advocates failed to jump to his defense after copies of the profile in Rolling Stone, titled "The Runaway General," circulated ahead of its publication Friday.

The article portrays Gen. McChrystal and his staff as rogues with little regard for the Washington chain of command.

Please turn to page 7

The Quirk



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World Watch

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Editorial & Opinion

Jean-Claude Trichet's ill-advised foray into budgetary politics. Page 11

Merkel defiant as G-20 raises pressure to spend

Chancellor Angela Merkel rejected calls on Germany to rethink its role in the global economy as an export powerhouse, rebuffing calls from the U.S. for exporters to boost spending at home.

In an interview with The Wall Street Journal, she said the Group of 20 industrial and developing nations meeting in Toronto this weekend should focus on financial regulations.

China's announcement of a more-flexible exchange-rate policy has increased pressure on Germany to similarly take steps to redress trade imbalances. She rejected the idea that Germany depends on unsustainable spending around the world to maintain its economy. "German export successes reflect the high competitiveness and innovation strength of our companies," she said. "Artificially reducing Germany's competitiveness would be of no use to anyone." She has also said Germany won't prolong stimulus measures short term.

Maurice Weiss/Ostkreuz for The Wall Street Journal

Angela Merkel

Berlin's emphasis on fiscal discipline received support from top European Union officials Wednesday in a letter to the G-20 that said "global recovery is progressing better than anticipated." Leading economies should agree to consolidate budgets "starting at the latest in 2011," EU President Herman Van Rompuy and European Commission President José Manuel Barroso wrote.

—Full article on page 5

PAGE TWO

Keep those exodus plans locked away

[Agenda]

By Patience Wheatcroft

Since 2008, Ireland has been the home of the world's largest advertising and marketing company. The country has much to recommend it: delightful scenery, good food and some handsome architecture. Martin Sorrell, however, was attracted by its low corporate taxes.

The WPP chief executive followed several other British companies across the Irish Sea because of a corporate tax rate of 12.5%. Even as Ireland has had to institute a raft of tough austerity measures to try to redress its gaping deficit, that tax rate has stayed firm. Enticing companies to the country, even if they establish only a minor physical presence there, is something that the government judges important to its economy.

When he composed his emergency budget, U.K. Chancellor George Osborne had to take into account the risk that anything judged unduly harsh to business could have encouraged a mass corporate exodus. Virtually every major U.K. company has in its safe the blueprint for moving headquarters to a more friendly regime. The possible destinations vary. A major consumer goods company, for instance, reckons that a split between Switzerland and Singapore would be the optimum solution should the time come for it to quit Britain.

In the interregnum between the U.K.'s recent general election and the emergence of the current coalition government, there was frightened chatter among some chief executives about the prospect of the Liberal Democrats' then-Treasury spokesman, Vince Cable, taking charge of the economy. Fearing, rightly or wrongly, that his tough stance on banking would be echoed by other perceived anti-business measures, they were already re-examining those reports on how they might stage a corporate escape.

Agence France-Presse/Getty Images

Ireland's scenery is a great draw—and so is its corporate tax structure.

In the event, Cable has been given a less powerful role as business secretary. Responsibility for nurturing the country's fragile economy has been handed to Mr. Osborne and, in his first budget on Tuesday, he said and did enough to persuade business that he wanted to encourage its success. Central to his pro-business case was a pledge to cut corporation tax by 4% by 2014/15. That will, he said, be one of the lowest rates in the G-20, and the lowest rate this country has ever known. It will though, leave the headline rate of U.K. corporate tax at almost double the Irish rate.

The coalition cannot afford to be overly generous to flighty corporates but it needs them to stay.

As important as the cut was what Mr. Osborne promised on the overall attitude towards business taxes. The sheer unpredictability and huge complications of the U.K. tax regime have caused companies almost as much disquiet as the charges themselves. Now they are being promised a different approach, with more consultation and an aim of simplification. A discussion document published contemporaneously with the budget papers outlines the U.K. government's "ambition for a more predictable, stable and simple tax system."

That could deal a blow to the income hopes of some accountants who specialize in finding routes through the minutiae of the unwieldy tax code but, for business, it sounds like blissful common sense.

A system that involves effective consultation followed by the publication of draft legislation and a notice period of at least three months before tax changes come into force should make for workable measures for which business can plan.

On Tuesday, Mr. Osborne gleefully announced that he was disbanding the Treasury's Euro Preparation Unit.

Few would have expected that such a unit, albeit only small, would have existed in any form at the moment, since the prospects of the U.K. joining the euro are so distant as to be ignorable. But bureaucracy has a remarkable facility for survival, even after being subjected to repeated attempts to withdraw oxygen supplies. This is something that the new coalition government will have to tackle as it strives to take a massive 25% out of many departments' spending over the next four years.

It is to be hoped that any bureaucratic tendencies can be avoided in Mr. Osborne's new creation, an Office of Tax Simplification. The risk is that this becomes a parody of itself, accumulating staff, producing working papers and generally adding extra layers of complication when the opposite is the intention.

In the short term at least, business should give the government the benefit of the doubt. There are areas of concern—although the levy on banks was lower than forecast, Mr. Osborne's comment that "We are exploring the costs and benefits of a Financial Activities Tax, on profits and remuneration" was guaranteed to send nervous reverberations around the City.

On the other hand, his promise that: "We will agree with business a long-term approach to the taxation of foreign profits," will have had many chief executives clamoring for his ear. With about 90% of its revenues coming from outside the U.K., it was the taxation of its overseas earnings that drove WPP to quit the country.

As it struggles to rebuild the country's finances, the coalition government cannot afford to be overly generous to flighty corporates but it needs them to stay. There are businesses currently headquartered in the U.K. that could actually make an operational case as well as a tax one for being based elsewhere.

HSBC, for instance, already has its chief executive in Hong Kong. Rivals view the arrangement, with the finance director still based in the U.K., as unusual, to say the least. Most banking chief executives like to have their finance director within eye-balling distance, and not via video-conferencing in a different time zone. The bank insists that it has no plans to move but it would surely take only a small push from an unsympathetic government to encourage the former Hong Kong and Shanghai Banking Corporation to pack its bags.

What's News

■ **The Fed offered** a subdued assessment of the U.S. economy and affirmed that short-term interest rates would remain near zero for "an extended period," which most economists now believe could mean well into 2011 and possibly into 2012. 8

■ **Vindi Banga**, once considered a contender to lead Unilever, has been hired as operating partner in the London office of private-equity firm Clayton, Dubilier & Rice. 23

■ **AIG has changed** its compensation plan for its most highly paid employees, potentially making their income more secure. 17

■ **A gas-payment dispute** between Russia and Belarus spilled over into the EU as Lithuania said its Russian gas supplies had fallen 40%. 4

■ **BOE minutes** from June showed one member called for a rate rise, the first time in nearly two years a policy maker voted for tightening. 4

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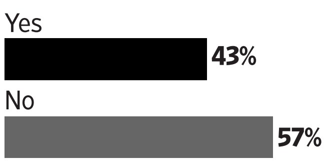

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NEWS

Russia lands Silicon Valley deal

By Don Clark

SAN JOSE, Calif.—Russian President Dmitry Medvedev came here to learn about Silicon Valley, and managed to land at least one deal in the process.

During Mr. Medvedev's visit to the headquarters of **Cisco Systems** Inc., the company pledged to invest $1 billion over ten years in technology projects in Russia. The networking giant, which already has a major presence in the country, said it will undertake a series of initiatives that include a $100 million increase in venture-capital investments in Russia, up from a previous commitment of $30 million.

"Simply put, we are all in," said John Chambers, Cisco's chief executive, addressing Mr. Medvedev at a news conference that featured demonstrations of the company's videoconferencing technology and an appearance by California Gov. Arnold Schwarzenegger.

Mr. Medvedev, who visited microblogging service **Twitter** Inc. earlier in the day, mainly listened during this phase of his visit. After Cisco, his schedule included a trip to **Apple** Inc., where he was expected to meet with Chief Executive Steve Jobs. He also planned to visit the Silicon Valley office of Yandex, a Russian Internet company.

The trip was prompted in large part by Mr. Medvedev's plans to build an innovation hub at Skolkovo, a suburb west of Moscow. Offices, apartments and laboratories are expected to be constructed over the next three years on what is now a collection of fields.

Russia hopes to attract engineers, programmers and venture capitalists to participate in the project, which has already drawn support from Cisco and others. But the effort faces skepticism, in part due to fears that government bureaucracy or corruption may create hurdles for entrepreneurs.

At Twitter's headquarters in San Francisco, Mr. Medvedev took part in a 10-minute ceremony, during which he stood at a laptop and typed his first message, or "tweet," through a new Twitter account in front of journalists, bloggers and Twitter's 220 employees.

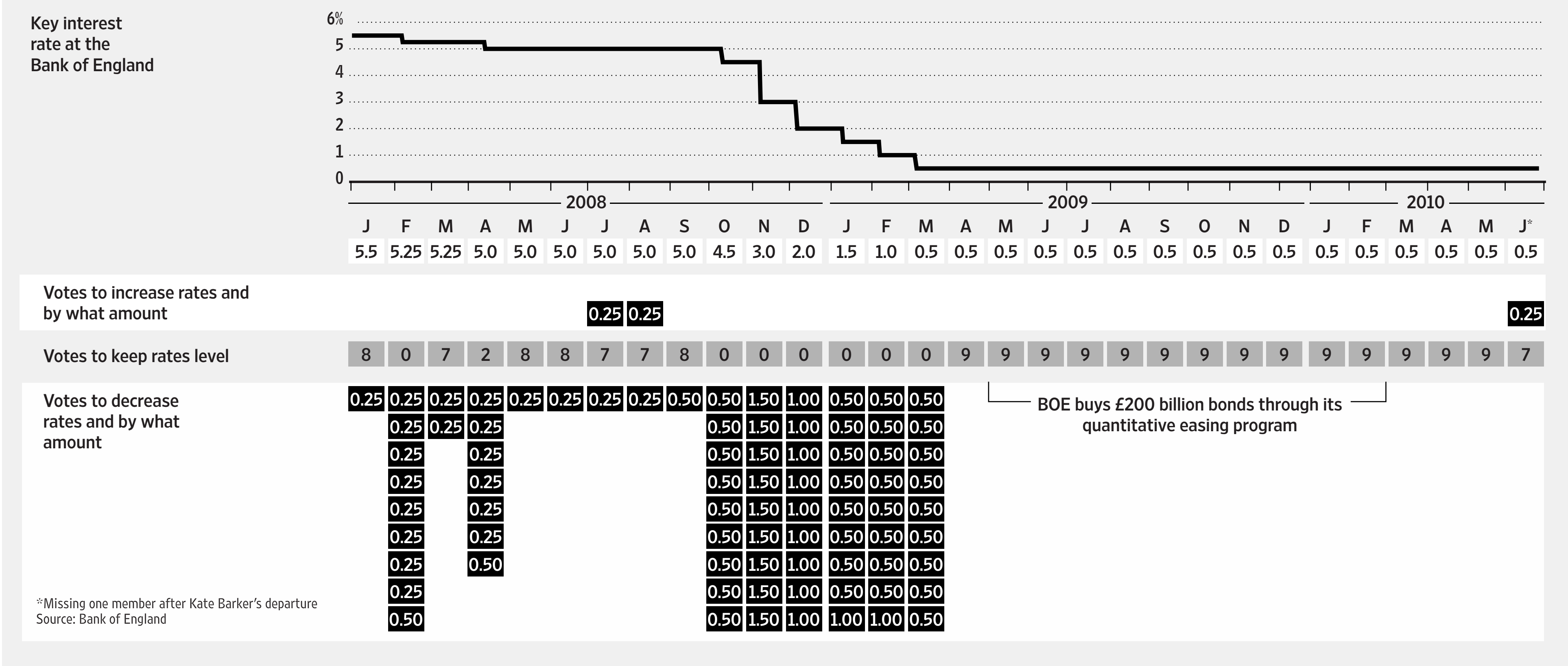
"Hello everyone!" he wrote. "I'm now at Twitter and this is my first tweet."

—Amir Efrati and William Mauldin contributed to this article.


Associated Press

Mr. Medvedev "tweets" Wednesday.

The hawk returns | Voting patterns for Bank of England Monetary Policy Committee members on interest rate policy



BOE minutes show a split on rates

By Natasha Brereton And Joe Parkinson

LONDON—The majority of Bank of England Monetary Policy Committee members voted to keep policy on hold in June, but Andrew Sentance called for a rate increase, marking the first time in almost two years that a policy maker has voted for tightening.

Minutes published Wednesday of the MPC's June meeting, at which it kept rates at a record low of 0.5% for a 15th straight month, showed an increasing degree of divergence among members' views on the medium-term path of inflation.

Members were unanimous in voting to leave the BOE's stock of £200 billion ($296.16 billion) bond purchases unchanged.

But Mr. Sentance called for the key interest rate to be lifted 0.25 percentage point, citing the resilience of inflation—which remained well above the BOE's 2% target at 3.4% in May—and a healthy recovery in demand. That marked the first call for higher interest rates since August 2008.

"Despite current uncertainties, for this member, it was appropriate to begin to withdraw gradually some of the exceptional monetary stimulus provided by the easing in policy in late 2008 and 2009," the minutes said.

Sterling received a boost and gilts prices slipped after the release of the minutes, as investors took the view that Mr. Sentance's vote brought forward the risk of monetary tightening. The pound rose around half a cent against the dollar to $1.4902, while the euro fell to £0.8252.

But economists played down the risk that Mr. Sentance's hawkishness would translate into an increase in the key interest rate anytime soon. "The impact on the broader policy discussion of this move may not be too great," said Stuart Green, chief U.K. economist at HSBC. "Importantly, the details of yesterday's budget were not available to the MPC members at this month's meeting, and the aggressive profile of spending cuts outlined by the chancellor should again help to reduce the potential for this single call for higher rates to spread."

June marks the first split in the interest-rate vote since former policy maker David Blanchflower called for a larger rate cut than other members in February 2009. In November of that year, members were split on the appropriate level of government bond purchases through the quantitative-easing program.

The latest minutes saw officials grappling with how to assess the relative importance of a host of conflicting risks. On the one hand, they noted that the recent economic recovery appeared to be more broadly based and less associated with a turnaround in the stock cycle than expected, which "could indicate that there was a greater degree of momentum to demand than previously thought."

On the other hand, they judged that two risks to the medium-term inflationary outlook had intensified.

Heightened investor concern about sovereign creditworthiness had led to more aggressive fiscal tightening, which could dampen demand from the U.K.'s major trading partner, the euro zone. Such worries, if persistent, could also reduce credit availability, the MPC warned.

With inflation likely to take some time to return to target, after an already extended period of elevated price growth, and the possibility of tax changes in the budget, there was "a risk that inflation would have a further tendency to remain above the target if the private sector's expectations of inflation over the medium term also rose," the committee said. "That might necessitate tighter policy than would otherwise be the case."

Tuesday's budget announcement included an increase in the sales tax to 20% from the current 17.5%, from the start of 2011. Britain's retailers still haven't fully recovered from the worst of the crisis.

Sales volume at U.K. retailers improved in June but remained negative compared with a year ago, a survey by the Confederation of British Industry showed Wednesday.

CBI chief economic adviser Ian McCafferty also warned that the value-added tax rise to 20% announced in Tuesday's emergency budget may boost sales this year, but the upward impact will likely end in January 2011, when the tax increase comes into effect.

The minutes confirmed that in the committee's central view, the large margin of spare capacity for production would mean that growth could return without causing inflation in the medium term.

—Ilona Billington contributed to this article.

EU proposes a compromise on financial supervision

By Matthew Dalton

BRUSSELS—The European Commission proposed a compromise on legislation that will overhaul the European Union's supervision of financial firms, hoping to break an impasse over how much power new EU-wide agencies should be given to regulate the industry.

The European Parliament and the European Council, which represents EU national governments, both have passed versions of the legislation. But the parliament wants to give three new agencies broad powers over the 27-nation bloc's banks, securities firms and insurance companies, while the council wants to keep much of this authority with the national governments.

The legislation, which also would create a European Systemic Risk Board to monitor "macrofinancial" risks, has been one of the EU's reform priorities in the wake of the global financial crisis, which saw national regulators often struggle to cope with the risks posed by banks with operations in multiple EU countries.

The proposal from the commission, the EU's executive arm, would allow the agencies to supervise financial firms directly in emergency situations, as sought by parliament. It also would allow direct supervision in cases where national regulators disagree about oversight of a cross-border financial institution.

To satisfy the council, the compromise would preserve a clause that no decision by the agencies could intervene on a national government's fiscal affairs "in any way." The compromise also allows the council to determine when an emergency exists that would give direct supervision powers to the new agencies.

It is unclear whether either side will accept the compromise, which will be discussed at a negotiating session Thursday.

EU leaders have recently turned up the pressure on negotiators, because the impasse is threatening to undermine plans to have the new agencies up and running at the beginning of 2011.

"Real progress has been made," Michel Barnier, the European commissioner in charge of financial regulation, said in a statement. "Only a few key points remain to be sorted."

Lithuania says gas spat slows Russian flow 40%

By Jacob Gronholt-Pedersen

MOSCOW—A gas-payment dispute between Russia and neighboring Belarus spilled over Wednesday into the European Union as Lithuania said its Russian gas supplies had fallen 40%.

The standoff has raised tensions between the two former Soviet states and traditionally close allies. Although the dispute is likely to be short-lived, it could further dent Russia's image as a reliable energy partner, analysts said.

Russia said earlier Wednesday it had cut gas supplies to Belarus by 60% as it seeks repayment of outstanding gas bills. Moscow had already cut deliveries to its neighbor Monday by 15% and has squeezed volumes each day since.

Belarus responded by ordering a halt to westbound shipments of natural gas, and Lithuania reported the reduction to its own gas flows Wednesday. Lithuania relies almost entirely on Russia for gas supplies piped via Belarus and acts as transit route for gas to Kaliningrad.

The European Commission is considering whether to send experts to assess the real gas flows between Russia and the European Union via Belarus, Energy Commissioner Günther Oettinger said Wednesday in a press briefing, after Lithuania said its supplies had dwindled.

Mr. Oettinger said the dispute between Minsk and Moscow is a price and business issue for those two capitals, and the EU shouldn't be drawn into it.

Russian state gas firm OAO **Gazprom** had planned to ship 44.5 billion cubic meters of gas through Belarus this year, about a quarter of its total exports to Europe.

EUROPE NEWS

Merkel rejects Obama's call to spend

German chancellor rebuffs pressure to boost domestic demand, not exports; warns Europe's crisis is far from over

By Marcus Walker
And Matthew Karnitschnig

Maurice Weiss Ostkreuz for The Wall Street Journal.

Ms. Merkel in her chancellery on Tuesday: 'Artificially reducing Germany's competitiveness would be of no use to anyone.'

BERLIN—Chancellor Angela Merkel roundly rebuffed U.S. President Barack Obama's call for Germans to aid the global recovery by spending more and relying less on exports, even as she warned that Europe's own financial crisis is far from over.

In an interview with The Wall Street Journal in her Berlin chancellery, an unapologetic Ms. Merkel said the nations that share the beleaguered euro have merely bought some time to fix the flaws in their monetary union. She called on the Group of 20 industrial and developing nations meeting in Toronto this weekend to send a signal that tougher financial-market regulation is on its way to dispel the impression that momentum is fading amid resistance by big banks.

She took aim at an idea voiced by France, the U.S. and others that Germany could help global producers by spurring its persistently weak consumer demand. The latest call came in a letter last Friday from Mr. Obama to the G-20, in which he asked big exporters—Germany, China and Japan—to rebalance global demand by boosting consumer spending rather than exports.

Ms. Merkel countered that Germany's growth and employment are rising—and therefore the world's fourth-largest economy has no reason to rethink its dependence on its powerhouse industrial sector and large trade surplus.

"German export successes reflect the high competitiveness and innovation strength of our companies," she said. "Artificially reducing Germany's competitiveness would be of no use to anyone."

Ms. Merkel's defense of Germany's export-heavy model marks Berlin's second rebuff to international demands in recent days. Early this week, Ms. Merkel rejected calls for Germany to prolong fiscal-stimulus measures in the short term.

Germany has faced rising criticism from major economies that want to see the country end its dependence on unsustainable spending elsewhere and become more of a source of growth. Berlin's reluctance threatens to isolate it within the G-20, likely making it difficult for Germany to win support for tougher financial-market regulation and its other priorities.

Germany is at the center of attention now that China, whose growth also depends largely on trade surpluses, has defused some of the U.S.-led pressure to rebalance its economy by announcing a more flexible exchange-rate policy.

A report published Wednesday as a "primer" for G-20 governments by the Center for Economic Policy Research, a European network of leading economists, accused Germany of doing less than China to redress global imbalances, which the report called a threat to global economic stability.

Ms. Merkel denied Germany is under pressure to change, predicting "a very relaxed discussion about this topic in Toronto." She suggested that the prevailing economic theory on stimulus—that increased deficit spending promotes growth—doesn't apply in Germany.

Continuing to run big deficits could backfire here, she said, because of Germans' angst about their aging society and rising public debt. Fear that the German welfare state will run out of money in the future leads individuals to save their income as a precaution, she said. If Germany cuts its budget deficit instead, "then the citizen is more willing to spend money," she said, "because he knows that he can count on the pension, health and elderly-care systems."

However, acknowledging some of the criticism, the chancellor said Germany still needs more "structural reforms," especially to "improve the incentives to take up work and to strengthen the services sector." Many economists say German service industries are overregulated and underdeveloped compared with those in the U.S. and other advanced economies.

Berlin's emphasis on fiscal discipline received support from top European Union officials Wednesday in a letter to the G-20 that said the "global recovery is progressing better than anticipated," so that the time for stimulus is ending. Leading economies should agree to consolidate budgets "starting at the latest in 2011," EU President Herman Van Rompuy and European Commission President José Manuel Barroso wrote in the letter.

Germany's anemic consumer spending, which could be further weakened as budget cuts kick in starting in 2011, is causing frustration in crisis-hit EU countries such as Spain and Greece, which need a boost from Germany as they take drastic measures to repair their public finances.

Many economists believe Berlin could stoke private demand by putting more money in Germans' pockets through measures such as tax cuts and by delaying planned austerity measures.

In the interview, Ms. Merkel said Germany has made "an important contribution to overcoming the global economic crisis in the last two years." She pointed to Germany's continuing fiscal-stimulus measures, which come to over 2% of gross domestic product in 2010, according to the International Monetary Fund.

"That's more than in many other countries," where stimulus policies are ending earlier, she said. But with Germany's economy expected to grow by close to 2% this year, she said the time has come to remove the stimulus "step by step" from 2011.

Ms. Merkel, a 55-year-old former physicist who grew up in Communist East Germany, has been chancellor since 2005 and won a decisive re-election victory last year as head of a conservative-led coalition. Since then, however, her own and her government's popularity have fallen amid internal squabbling between her cabinet allies.

Many German voters are also angry that Ms. Merkel agreed to the €110 billion ($135 billion) EU-IMF bailout of highly indebted Greece, and to the creation of a €750 billion rescue facility for other euro-zone countries that might hit financial trouble. Opinion polls suggest the euro-zone crisis has hardened Germans' negative view of the euro.

Ms. Merkel denied that her compatriots are turning euro-skeptic. "Germans knows the value of all things European," she said. "All of the current discussion about the euro is taking place on the basis that we want to make the euro stronger, not to call it fundamentally into question."

Germans also complain frequently about the costs of German unification, but that doesn't mean that want to reverse it, Ms. Merkel pointed out.

However, Ms. Merkel warned that the euro zone hasn't ended the financial crisis that gripped Greece this spring and threatened to spread to other countries such as Spain and Portugal. "We have calmed down the situation through the rescue facility," she said, adding: "We now have the possibility, and have won time, to remove structural weaknesses in the euro zone and its framework of rules."

EUROPE NEWS

The world's biggest coin and a vanished fortune

[Letter from Vienna]

By Flemming Emil Hansen

Were a pithy metaphor needed for the global economic crisis and classical Austrian investors' virtues, look no further than the tale of Wolfgang Auer von Welsbach's downfall and his gigantic gold coin, which has grown in value thanks to the crisis that exposed the ruins of Mr. von Welsbach's fortune.

Mr. von Welsbach, the great-grandson of a 19th century Austrian industrialist who invented the lighter flint and the gas mantle, founded the investment firm AvW in 1991. On May 4, **AvW Group** filed for bankruptcy, by which time Mr. von Welsbach had already been taken into custody on suspicion of fraud and embezzlement.

Mr. von Welsbach had propped up his investment group by selling up to €400 million of participation certificates, a form of shares with no voting rights, which investors believed would be bought back by the company when they wanted out. But when the crisis hit, the bull market turned bearish and the real estate and equity stakes portfolios stopped performing, it turned out there were no funds left to do this, and the company had a total investment portfolio of €229 million. The Prosecutor's Office is investigating irregularities around AvW and its chief executive, ranging from trading securities without a license, through stock price manipulation, to illegally skimming company funds. Mr von Welsbach is being detained in jail pending charges.

The Maple Leaf coin is part of AvW's remaining assets, which also include sizable stakes in a handful of publicly listed companies in Austria and a large real estate portfolio. The coin makes up only a fraction of the estimated €103 million worth of assets in AvW, but it may well turn out to be the most profitable investment Wolfgang Auer von Welsbach ever made.

Bought in 2007 directly from the Royal Canadian Mint, the gold coin, some 53 centimeters in diameter—about the size of an automobile wheel—and three centimeters thick, was one of only five made, each with a face value of one million Canadian dollars, at that time worth around €660,000. It hasn't been disclosed how much Mr. von Welsbach paid for the coin, but based on the gold price at the time, it would likely have been between €1.5 million and €1.8 million.

At today's prices, the gold alone is worth an estimated €3.2 million, but considering the exclusivity of the coin it might well fetch around €4 million on a good day, estimates Michael Beckers, a coin expert at auction house Dorotheum, which has been entrusted with the sale of the Maple Leaf by AvW's liquidators.

The entire insolvency proceedings are likely to take another three to five years, but the liquidators have been advised that the current high gold price and bullish demand constitute a chance they shouldn't pass up, said Ernst Malleg, one of the two insolvency administrators. "We are assuming that the sale will bring in considerably more than the current gold price," Mr. Malleg said, adding that the coin was indeed a "very, very good investment."

The Austrians generally love gold in any form, Michael Beckers from Dorotheum said, especially in a time of macro-economic turbulence. Analysts say the average Austrian investor is ultra-cautious, and a chart of demand for gold is like a seismograph of confidence in the financial system. Right now, demand for gold coins is practically inexhaustible, Mr. Beckers said.

Austrian Mint, the world's largest marketer of pure gold coins, has seen demand for gold coins skyrocket over the past few months, according to Marketing Director Kerry Tattersall. "We saw a very heavy demand build in May due to Greece," Mr. Tattersall said. In 2009, on the heels of the banking crisis, Austrian Mint had its busiest year in decades. Demand subsided again when the global economic outlook started gradually improving toward the end of last year, but then the Greek sovereign-debt crisis broke and immediately demand soared, not least within Austria itself, Mr. Tattersall said. "We see a strong demand among professional investors, but also among the general public."

The 800-year old Austrian Mint turned out 485,000 ounces of gold in May alone, compared with 85,000 in May 2009, and had to ramp up production to run three daily shifts to keep up.

Demand for the Philharmonic coin has, however, eased, going into June, Mr. Tattersall said, so he'll be following the auction of Wolfgang Auer von Welsbach's Maple Leaf coin with interest. "Although," he said, "I'm not really sure you can call it a coin. When you need a truck to carry it away, is it still a coin?"

Then why make such a coin in the first place? Mr.Tattersall believes the Canadian coin was made simply to outdo Austrian Mint, which held the previous size record with a 31-kilo pure gold Philharmonic coin. "To be honest, I think it got up the Canadians' nose that these small Austrians had the biggest coin. I think that's why they made it."

Dorotheum

The Canadian Maple Leaf from 2007

U.S. NEWS

BP containment effort threatened

Underwater collision forces temporary removal of cap, possibly derailing the company's oil-capture plan

By Susan Daker

A key component of **BP** PLC's efforts to control the massive Gulf of Mexico oil spill was shut down Wednesday, threatening to derail the company's ambitious plan to nearly double the amount of oil it captures by next week.

An underwater robot collided with a cap placed atop the leaking deepwater well on Wednesday morning, forcing the company to halt the operation of the Discoverer Enterprise, the larger of two vessels currently capturing oil in the Gulf.

The cap connects with the vessel via a mile-long pipe, helping siphon up to 18,000 barrels of crude a day. If the cap isn't replaced quickly, BP will be unable to stick to its plan of capturing 53,000 barrels a day by early next week, the U.S. Coast Guard said.

Coast Guard Adm. Thad Allen, who leads the federal oil-spill response effort, said the cap could be replaced in a few hours, but if ice-like crystals called natural-gas hydrates are found within the cap, it could take much longer.

The other oil-collecting vessel, the Q4000, is still capturing, and flaring, about 10,000 barrels of oil a day.

The underwater collision, and its uncertain outcome, is the largest setback for BP's oil-collection efforts since the company installed the containment cap over the leaking well nearly three weeks ago. It's not likely to be the last: The region is bracing for the height of hurricane season, in which powerful storms could disrupt spill-containment operations for several days at a time, as the flotilla of response vessels scrambles for safety.

The disruption follows an interruption aboard the Discoverer Enterprise last weekend, when bad weather and a malfunction led to a 10-hour shutdown.

BP is under increasing pressure to contain the growing spill, which was caused by the explosion and sinking of the Deepwater Horizon drilling rig in late April. The company has been ramping up its containment efforts as it continues work on relief wells that officials hope will enable them to kill the flow from the Macondo well.

In recent weeks, the oil-collection efforts have been overshadowed by political drama, as the Obama administration demanded BP pony up $20 billion for a fund to cover costs associated with the spill and embattled Chief Executive Tony Hayward testified before Congress.

Adm. Allen said at a midday news conference that the containment cap was being checked.

"They will attempt to reinstall the containment and begin producing later on today," he said. But if there are hydrates, responders will have to reinsert the pipeline connecting the vessel to the containment cap, "and that will take a considerable amount longer," Adm. Allen said.

In the past, Adm. Allen has warned about possible collisions among the 15 or so subsea remote-controlled vehicles that operate near the Macondo well. Authorities have also raised concerns about the large number of ships in the 2.5-mile (four kilometers) radius on the surface above the well site and the number of airplanes patrolling the area.

That's on top of worries that the well could spring another uncontrolled leak at anytime and that a hurricane could roar through the region.

On Tuesday, Adm. Allen said he and other oil companies are working on a plan to try and divert some of the oil from the well through nearby platforms and pipelines, which could prevent an uncontrolled gusher from the well in the event of a major storm.

Associated Press

This image from a live BP video feed shows the well after the cap was removed.

Government and independent scientists estimate that about 35,000 to 60,000 barrels of oil a day are flowing from the well.

A third containment vessel is due to arrive Tuesday, Adm. Allen said. When all three ships work in conjunction, BP should be able to capture about 53,000 barrels a day, a goal the company said it would meet by the end of June.

However, if the Discoverer Enterprise doesn't resume operation quickly, this goal may not be met, said Lt. John Budiao of the U.S. Coast Guard.

On Tuesday, BP collected a total of 27,090 barrels, the company said on its website. The U.K. oil giant flared 10,425 barrels of oil and captured 16,665 barrels of oil. These figures beat BP's numbers from Monday, when the company captured 25,830 barrels a day.

Meantime, two people working on the oil-spill response effort died, but neither of the deaths were work-related, Adm. Allen said.

One of the deceased was working on a "Vessel of Opportunity" in the Gulf Shores, Ala., area, Adm. Allen said.

The Vessel of Opportunity program is designed by BP to hire shrimpers and other boat owners to patrol the sea and look for oil. Baldwin County Coroner Stan Vinson said the worker appeared to have died from a self-inflicted gunshot wound.

The other death was the result of a swimming-related accident. Adm. Allen didn't say where the swimming death occurred.

Separately, New York's state comptroller said its pension fund will sue BP for what he called the company's "disastrous" management of the oil spill in the Gulf.

The New York State Common Retirement Fund, with $132.6 billion in assets, owned more than 19 million shares of BP on April 20, when an explosion on a rig leased by BP killed 11 workers and left an undersea well spewing out of control. BP's shares since then have lost about half of their value. The stock is widely held by pension funds.

"BP misled investors about its safety procedures and its ability to respond to events like the ongoing oil spill and we're going to hold it accountable," said New York Comptroller Thomas P. DiNapoli.

A BP spokesperson wasn't immediately available to comment on the lawsuit.

The fund provides benefits to more than one million active and retired state and local government employees, police officers and firefighters.

—John Kell contributed to this article.

■ BP and Chevron pursue a joint project in China 19

Obama picks Petraeus to command Afghan war

Continued from first page

mand, including Mr. Obama. Gen. McChrystal is quoted belittling Vice President Joseph Biden and other members of the administration, including Ambassador Richard Holbrooke, the top U.S. civilian on Afghan policy.

Mr. Obama's decision was fraught with political and strategic peril. Just last year, he relieved Gen. McChrystal's predecessor in the middle of the Afghan campaign, a move defense officials at the time compared to President Harry Truman's sacking of Gen. Douglas MacArthur during the Korean War.

He had picked Gen. McChrystal, the chief designer of a manpower-intensive counterinsurgency strategy, and further endorsed that strategy with a surge of 30,000 troops to Afghanistan.

Gen. McChrystal's remarks about senior officials exposed what has been an open secret in Washington and Kabul for months: The fissures that emerged during the Obama administration's three-month review of war strategy last year remain, and many of the personalities involved have strained relations that have festered for months.

Associated Press

Gen. McChrystal arrives at the White House Wednesday for a meeting with the president, who accepted his resignation.

The comments' impact has been magnified by a series of public setbacks for the war effort that has produced a widely held perception in Washington that the war isn't going well: continuing violence in Marjah; the firing by Afghan President Hamid Karzai of two highly regarded Afghan security officials; and a delay in operations in Kandahar.

Mr. Obama made clear that Gen. McChrystal's resignation didn't signal a change in strategy. "This is a change in personnel but it is not a change in policy," he said. He asked the Senate to confirm Gen. Petraeus "as swiftly as possible."

Afghan officials said before the announcement that firing Gen. McChrystal would disrupt progress in the war and could jeopardize pivotal operations in the south.

In the U.K., the second-largest contributor of troops to Afghanistan, Gen. McChrystal was popular with troops. The announcement that Gen. Petraeus had been selected to lead the war effort elicited "a sigh of relief [that] could almost be heard throughout" the U.K.'s ministry of defense, a British official said.

Gen. Petraeus's success in Iraq has turned him into something of a hero with congressional leaders in both parties. "He deserves great credit for his leadership in helping to stabilize Iraq and bring it to a critical transition point this summer," House Minority Leader John Boehner said of Gen. Petraeus. "I believe he is the right person take over this command."

U.S. NEWS

Fed wary on U.S. growth, as low rates seen lasting

By Jon Hilsenrath

The Federal Reserve offered a subdued assessment of the economy Wednesday and affirmed that short-term interest rates would remain near zero for "an extended period," which most economists now believe could mean well into 2011 and possibly into 2012.

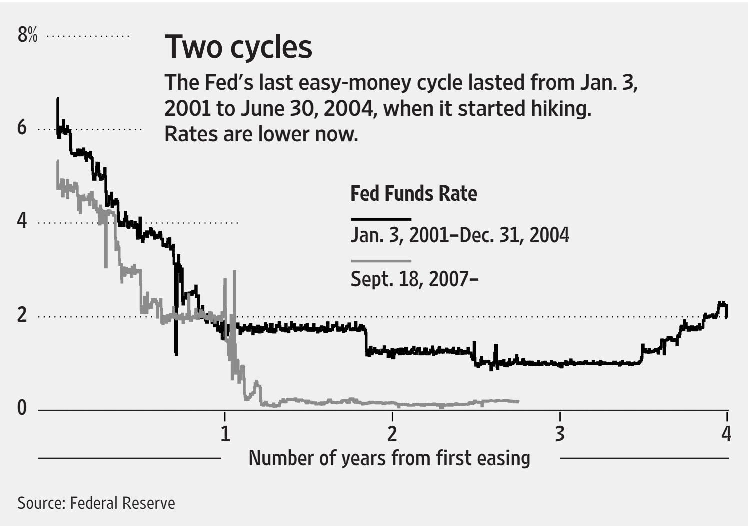
"Financial conditions have become less supportive of economic growth on balance, largely reflecting developments abroad," namely in Europe, the Fed said after a two-day policy meeting.

Market expectations for when the Fed will raise interest rates have already shifted notably in the past two months, amid economic turmoil in Europe and signs that the U.S. economy hasn't built much momentum after turning around in mid-2009.

The Fed said Wednesday that the recovery from the deep recession is "proceeding," a departure from its assessment in April that the recovery "continued to strengthen." Consumer spending is "increasing but remains constrained," housing is "depressed" and inflation—already low—has "trended lower," it said.

The federal-funds interest rate—a Fed-influenced rate at which banks lend to each other overnight—has been between zero and 0.25% for 18 months. Economists, on average, expect the Fed to keep it there until March 2011, according to a survey conducted by The Wall Street Journal this week.

In the past three weeks, 15 of 44 economists surveyed regularly say they have delayed their prediction for when the Fed will raise rates further into the future. As recently as April, the bulk of the forecasters expected the Fed to move before the end of 2010; now a few say it won't happen until 2012.



The Fed's statement did little to dissuade economists from their latest views. "We're looking at this as a very slight downgrade of their business conditions assessment," said Maury Harris, chief U.S. economist for UBS Securities, which pushed its forecast of a rate increase to January 2011; two weeks ago, it predicted September 2010.

"High unemployment and low inflation will keep the Fed sidelined," said Bruce Kasman, J.P. Morgan Chase's chief economist. He moved his forecast to November 2011 from April 2011.

Most Fed officials are in a wait-and-see mode, trying to preserve their flexibility to raise rates soon if employment grows and financial markets settle down, or to hold off further if joblessness proves stubborn or the economic outlook deteriorates. At some point after raising rates, Fed officials also are inclined to gradually sell their massive holdings of mortgage-backed securities.

Speedy action looks increasingly unlikely. Several officials said before this week's meeting that financial turmoil in Europe could slightly dent U.S. growth, and they reaffirmed that worry with their latest reference to developments abroad.

Meantime, persistently high levels of Americans seeking unemployment insurance have been a worry.

In a new sign of the economy's fragility, the Commerce Department reported Wednesday that sales of new homes fell 33% in May as a tax credit for home purchases expired.

Some Fed officials still want to raise rates soon. The president of Kansas City Federal Reserve, Thomas Hoenig, dissented from the Fed's decision for the fourth time this year, arguing the Fed's assurance that rates would remain low for a long time wasn't now warranted.

Small banks and big risk, in slippery game of pretend

[Capital]

By David Wessel

Congress is planting the seeds of the next big bank bailout.

Attention is focused on the House-Senate conference on a once-in-a-generation rewrite of the rules of finance. But a provision added, almost unnoticed, to a help-small-business bill that passed the House last week would allow all but the 100 largest banks to pretend they haven't made bad loans. The goal is to prompt them to lend more to small businesses.

The provision would permit more than 7,800 banks, with nearly $3 trillion in assets, to spread losses on bad real-estate loans over six to 10 years instead of recognizing reality immediately.

This wink-wink accounting, letting banks act as if they have bigger capital cushions than they do, is a remake of an old movie: the savings-and-loan horror show of the 1980s and the Japanese banking monster of the 1990s.

Allowing a bank that is broke or near-broke to pretend otherwise in the hope that temporarily depressed commercial real-estate prices will eventually rise sounds nice. But history shows that too many such bankers realize the only survival strategy is to make more risky loans and pray they're paid back. If they aren't, well, the government deposit-insurance fund, not the shareholders, gets the tab.

Treasury Secretary Timothy Geithner thinks this is an awful idea. "Could increase costs for the taxpayer by raising the likely losses from future bank failures," he wrote to House leaders. Federal Reserve Chairman Ben Bernanke thinks this is an awful idea: "Banks that are allowed to carry these losses do not engage in sound lending."

Comptroller of the Currency John Dugan thinks this is an awful idea: "Will undermine the efforts of ... regulators to shore up investor confidence in the banking system." Sheila Bair, chairman of the Federal Deposit Insurance Corporation, thinks it is an awful idea: "Encourages ... executives to take excess risks with the hope that these bets will pay off. ... The taxpayer remains liable for any losses, but the shareholders profit if these investments result in gains."

"When I get a call from Tim Geithner or I hear from Ben Bernanke, you bet I sit up and take notice," says Rep. Ed Perlmutter (D., Colo.), chief sponsor of the provision. "But after all the testimony I've heard—after my own experiences as a lawyer representing banks, insurance companies, real-estate companies, which gives me some perspective that maybe they don't have—I think this is an approach that we need for these smaller bankers and smaller businesses, to get everybody back on their feet and creating jobs."

Mr. Perlmutter and his allies—Democrats Luis Gutierrez of Illinois, Steve Kagan of Wisconsin and Ron Klein of Florida—don't want to cause a costly banking crisis, of course. They are responding to yelps from small businesses that say they can't get credit and managers of small banks who say they can't make loans because bank examiners are forcing them to value real estate at today's improbably low prices. Small banks, they say, didn't cause the global financial earthquake, but they felt it.

"Those aftershocks are still being felt by small businesses and small banks all across the country," Mr. Perlmutter says.

The administration's response: Put $30 billion in taxpayer capital into these community banks so they have the wherewithal to lend. The House has OK'd this; the Senate hasn't.

That's not enough for the small-bank lobby, whose power derives from the presence of at least a few community banks in every congressional district.

"We're talking about banks that are well run, well managed, victims of their local area where the real-estate market has just tanked," says Cam Fine of the Independent Community Bankers of America. "Poorly run banks are going to fail anyway," he says, and this won't change that.

Backers cite precedent, a 1980s analog. But that initiative was restricted to really small banks, deemed "well-managed" by regulators, that lent heavily to farmers. Only 334 banks with total assets of $13.5 billion participated, far fewer than would be eligible under the House bill. (Of those, the FDIC says, 20% failed eventually.)

Here's another precedent: The Congressional Budget Office estimates that more than half the $212 billion (in today's dollars) cost of the savings-and-loan rescue is attributable to letting thrifts live instead of closing them when they became insolvent.

The political dynamic here is clear. Big banks are popular villains; small banks are heroes. Big banks—think **Citigroup** Inc.—are too big to fail; small banks aren't. Big business arouses suspicions among the public; small business seems friendly and entrepreneurial. Big companies can borrow from the bond market when banks are picky; small companies cannot, and thus can't expand and hire readily if they want to. Elected politicians want to do something, anything, to help.

But pretending helped get us into this mess: pretending that putting enough subprime loans into one security made it AAA, that people without incomes could make mortgage payments, that house prices would never fall across the country, that the CEOs of gargantuan financial institutions could manage risks they didn't fully understand, that supposedly sophisticated investors understood what they were buying.

Pretending that banks haven't lost a bundle on commercial real-estate loans does not seem a smart way out of this mess.

WORLD NEWS

Australia's Rudd faces insurrection

First-term prime minister who ended conservative rule will face deputy in vote for leadership of ruling Labor Party

By Rachel Pannett

CANBERRA—Australian Prime Minister Kevin Rudd is fighting for his political life after a mutiny broke out in his governing party Wednesday that could see the once-popular leader replaced by the country's first female prime minister.

"I was elected by the people of Australia to do a job," a defiant Mr. Rudd told a late-night news conference after Deputy Prime Minister Julia Gillard challenged him for leadership.

He said he would take on the Welsh-born 48-year-old former trial lawyer in a ballot Thursday morning for leadership of the governing center-left Labor Party, a post that carries with it the premiership.

But the fight looks tough for Mr. Rudd, who swept to power in November 2007, ousting the long-ruling Liberal-National coalition of center-right parties. He has seen his popularity slide in recent months after a series of policy missteps.

Ms. Gillard's insurgency is backed by the Labor Party's right wing but also by key unions on the left, which many commentators say gives her the numbers to topple Mr. Rudd.

Her challenge marks an unprecedented fall for the man who ended nearly 12 years of conservative government in Australia. The party fears that Mr. Rudd, a 52-year-old Chinese-speaking former diplomat, will lead them to defeat in national elections that could come as soon as August.

"At this stage, it looks as though Australia will have a new prime minister tomorrow morning," said Roland Randall, a strategist at TD Securities in Singapore. "In Australian politics, it is almost unprecedented that a first-term prime minister is dumped by his own party."

But Mr. Randall said in a note to investors that "for markets, this should not be a destabilizing event" as the ballot was being held right away, and as Mr. Rudd and Ms. Gillard aren't far apart on policies.

Reuters

Australian Prime Minister Kevin Rudd announces the Labor Party leadership ballot in Canberra on Wednesday.

Driving Mr. Rudd's reversal have been a decision to shelve a proposed carbon cap-and-trade system meant to fight climate change and a planned tax on "super profits" by Australia's mining companies—a critical industry for the resource-rich country.

The tax, which the government thought would win popular support by spreading the wealth from the booming mining sector, has instead backfired as the public worries it will damage Australia's credibility as an investment destination. Mining giants **BHP Billiton** Ltd. and **Rio Tinto** Ltd. warned that billions of dollars of investment are at risk, and they have led a fight against the 40% levy, saying it would make Australia one of the highest-taxed jurisdictions in the world.

This criticism has resonated with many Australians who own shares in mining companies, often through pension funds. Mining, a top export sector, helped Australia sidestep the global recession, thanks to demand from developing countries like China and India for the country's vast stores of iron ore and coal.

Still, Wednesday's political uprising came as a shock. As recently as Monday, Finance Minister Lindsay Tanner said talk of Ms. Gillard taking on Mr. Rudd was "complete nonsense." Just hours before Mr. Rudd's news conference, key Labor figures were denying that any challenge was afoot.

Ms. Gillard, who hadn't recently expressed any desire for the top job, seemed a reluctant fighter. "I confirm that I will be a candidate in tomorrow's ballot," she told reporters after Mr. Rudd's announcement. "I haven't got any other statement at this time."

Mr. Rudd, striking a presidential tone, sought to portray himself as above party squabbles. "I was not elected by the factional leaders of the Australian Labor Party to do a job—though they may be seeking to do a job on me," he said. He said he is "quite capable" of winning the ballot, pointing to his stewardship through the global financial crisis, which Australia shrugged off with only a brief slowdown in economic growth.

The prime minister said he was "fundamentally proud" of "navigating this economy through the worst crisis the world has seen" and of "keeping hundreds of thousands of Australians in jobs that would otherwise have been on the unemployment queue."

Mr. Rudd's current plight would have been unthinkable a year ago when his approval rating was well above 60%. A prominent poll this week found Labor eking out a 52% to 48% edge against the Liberal-National bloc, calculated on the basis of Australia's preferential voting system. On a straight matchup, Mr. Rudd's party was trailing 40%-35%.

Critics say Mr. Rudd has squandered the political goodwill awarded to him for bringing Labor in from the political wilderness with a landslide victory. The career bureaucrat's aloof demeanor and tendency to immerse himself in policy has drawn parallels with U.S. President Barack Obama, with whom he struck up an early friendship.

Mr. Rudd's tendency to announce rather than consult with the party on policy has also irked some. It may have made it easier for his detractors to level blame and ultimately undermine him once his authority was called into question.

Ms. Gillard, elected to Parliament in 1998, has risen swiftly through the Labor ranks and holds the key portfolios of education, employment and workplace relations in the current government.

She has shown sharp political elbows in the past. When a political opponent said in 2007 that the unmarried lawmaker wasn't qualified to lead the country because she had chosen not to have children, Ms. Gillard shot back that her accuser was "a man of the past, with very old-fashioned views."

Markets initially took the Labor Party mutiny in stride, with the Australian dollar trading higher overseas as the initial shock wore off. Rio Tinto and BHP shares rose in London trading on speculation a leadership change could cause Labor to revisit its controversial mining-profits tax proposal.

If Ms. Gillard wins, said the strategist Mr. Randall, "markets are likely to rally" on hopes that she will drop the mining tax. Unlike Mr. Rudd, he said, Ms. "Gillard has not been steadfastly inflexible in her position and would not look weak if she chooses to compromise on the tax."

—Lyndal McFarland in Melbourne contributed to this article.

Japan's Noda seeks to tax the wealthy

By Yuka Hayashi
And Takashi Nakamichi

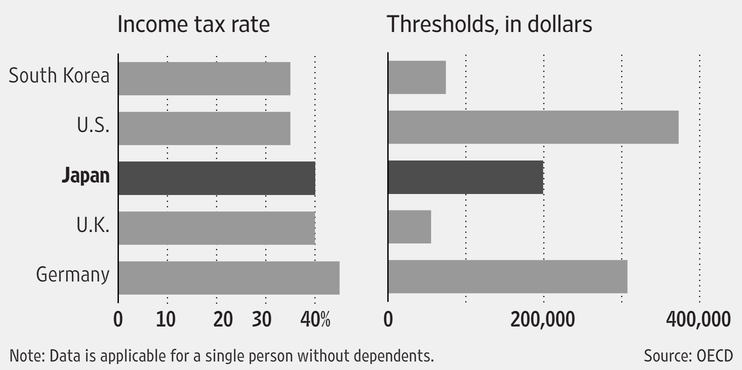
TOKYO—Japan's new finance minister said he will push to increase taxes on high earners, not just to raise revenue but to narrow the country's income inequality.

"I believe we are at a stage where a little bit of egalitarian thinking ... should guide our tax policy," Yoshihiko Noda said Wednesday in an interview with The Wall Street Journal. "In that sense, our tax reform will be designed with an eye toward restoring its income-redistribution function."

While Prime Minister Naoto Kan and his aides have talked openly about raising the consumption tax, Mr. Noda's added focus on income taxes suggests a more ambitious revenue-raising package is in the works. Earlier this year when he was finance minister, Mr. Kan endorsed a higher income tax. But Mr. Noda's comments were the first such public remarks from a leader

A taxing burden

Personal income-tax rates for wage income and the income thresholds applied for 2009



Note: Data is applicable for a single person without dependents. Source: OECD

in the Kan administration.

"Japan used to derive its strength from its deep and broad middle class, but unfortunately, the income gap has grown, and so many people have been left behind," said the 52-year-old minister, alluding to widely cited data showing some growing pay disparities between households. "Restoring the middle class is key to rebuilding Japan's strength."

Mr. Noda didn't discuss the specific timing or rate he was considering, but said the government's tax panel will accelerate discussions on a broad tax-reform plan after parliamentary elections scheduled for July 11.

The minister's comment comes as Mr. Kan's Democratic Party of Japan gears up for the elections with a pledge to reduce the government's massive debts to avoid falling into a Greek-style debt crisis. Surprising voters, Mr. Kan said last week the nation's broad sales tax will be doubled from the current 5%, though it may take " two, three years or maybe longer" until the increase is implemented.

Mr. Noda insisted that Japan isn't just focused on shrinking its debt, addressing concerns from the U.S. that Japan may be placing budgetary rehabilitation over policies to spur growth.

The trade-off between growth and debt reduction is expected to be a big debate at the summit meeting of the Group of 20 nations in Canada June 26-27.

"Japan's position is to try to achieve both economic growth and fiscal reforms," Mr. Noda said. "We will explain to other G-7 and G-20 nations that we are set on finding ways to help growth areas and revise the distribution of government resources."

India debates Kashmir policy

Special-powers act is at center of controversy, as critics say it gives cover to rights abuses

By Tom Wright


ZUMApress.com

An Indian soldier stands guard in Srinagar, India, during the second day of a strike called by Muslim Kashmiris.

SRINAGAR, India—India's establishment is split over how to deal with a separatist insurgency in its side of Kashmir, as the disputed Himalayan territory emerges as a critical issue in peace talks with Pakistan.

At the center of the debate in India is the future of the Armed Forces Special Powers Act, which gives India's security forces extraordinary powers to combat Pakistan-backed insurgents fighting against Indian rule in predominately Muslim Kashmir since 1989.

The act permits the forces in Kashmir to search, detain and kill "any person who is acting in contravention of any law" during civil disturbances. Critics say it is fanning anti-India sentiment in the state at a time when violence between the army and insurgents is at its lowest level in two decades.

Opponents of the act, which include the state's pro-India government and the United Nations, say it has been used as a cover to hide scores of human-rights abuses by security forces and to shield them from prosecution.

"The act is clearly not designed to give immunity to officers who are giving their uniforms a bad name, but that's how it is being used," says Omar Abdullah, the chief minister of Jammu and Kashmir, whose National Conference party backs India's control of the state.

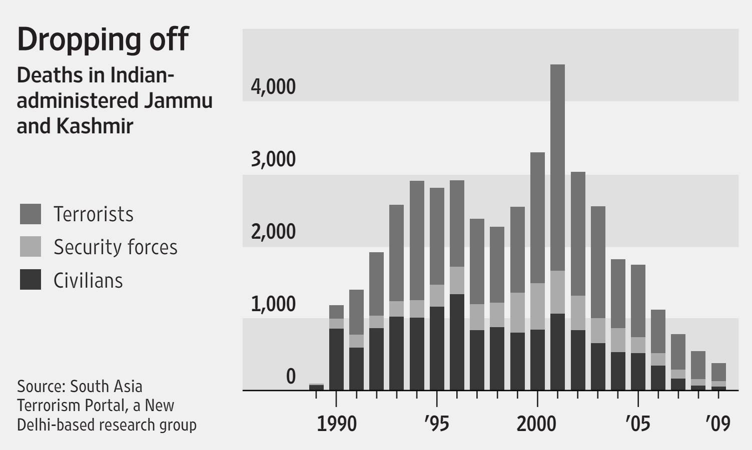
Internal divisions over how to deal with the Kashmir issue could complicate India's efforts to engage Pakistan in peace talks. Officials from both nations' foreign ministries will meet in Pakistan this week to push forward a dialogue started in February.

The issue has taken on greater urgency in recent weeks after the killing in April of three Kashmiri villagers from near the town of Sopore by soldiers who later claimed the victims were Pakistani militants. Police say evidence points to their wrongful killing and they have asked for the right to prosecute the case locally.

After mass protests, the army suspended two senior officers involved in the incident and launched an internal inquiry, which continues. India's Home Ministry recently circulated a discussion paper on amending the act to the Defense Ministry and other related arms of the government. The paper discusses "how to prevent misuse" of the act by armed forces, a senior ministry official said.

Mr. Abdullah, who is involved in the Home Ministry-led discussions, said the state government should be allowed to prosecute crimes committed by armed forces personnel, which include the army and paramilitary units. Under the current act, the Srinagar government must seek permission from New Delhi, and that is rarely given, he said.

But India's armed forces have publicly opposed any watering down of the act, saying it would put soldiers at risk. Lieut. Gen. B.S. Jaswal, head of the army's northern command that controls Kashmir, earlier this month likened the immunity act to a "pious document" and pledged to internally punish any armed forces personnel who commit abuses. A spokesman for the Defense Ministry declined to comment.



The former princely state was divided between India and Pakistan in 1947, and both nations claim the territory in its entirety. In the 1990s, Pakistan's intelligence agencies armed and trained insurgents in Indian-administered Jammu and Kashmir state, helping to fuel a conflict which has left 60,000 people dead.

Although Kashmir hasn't been center stage in the India-Pakistan talks, India's Foreign Secretary Nirupama Rao said in a speech last week that India and Pakistan had made progress on Kashmir before attacks in 2008 on Mumbai by Pakistan-based armed militants. Both nations had agreed the borders in Kashmir are unlikely to change but could be made irrelevant through trade and the free movement of people.

"We have to build on these achievements," Ms. Rao said.

Prime Minister Manmohan Singh has promised a "zero tolerance" policy toward human-rights abuses committed by the half a million security forces stationed in Indian-held Jammu and Kashmir, home to 10 million people. Mr. Singh visited Srinagar under high security this month, but separatist political leaders declined to meet him until India revokes armed-forces immunity.

"We're far away from dealing with New Delhi on a serious level," says Muslim Kashmiris' spiritual leader, Mirwaiz Umar Farooq. "Let New Delhi start with the revocation of the Armed Forces Special Powers Act."

The army and Indian government officials say Pakistan continues to train and finance insurgents, and hundreds are waiting to cross the so-called Line of Control—the de facto border between the two nations in Kashmir.

On Tuesday, police said they killed a senior Pakistani leader of Lashkar-e-Taiba, a Pakistan-based group that sends fighters to Kashmir, after a gunbattle in Sopore in which a policeman also was killed.

Others say the threat from insurgency is at its lowest point since the rebellion began in 1989. About 500 active militants are now active in Kashmir, about half of them Pakistanis, compared with thousands of local militants at the height of the rebellion to Indian rule in the 1990s, according to local police and government officials. There were 62 cases of Pakistani militant infiltrations from January to March this year, from 433 infiltrations in the whole of 2009, according to security force data.

The reduction in violence, and record-low civilian deaths last year of fewer than 100 fatalities, "is a golden opportunity to rebuild trust between the security forces and the people," says Farooq Ahmad, chief of police in Indian-held Kashmir.

Alleged kingpin in Jamaica to face request for extradition

By Nicholas Casey

Jamaican authorities captured accused drug lord Christopher "Dudus" Coke at a checkpoint outside Kingston on Tuesday, ending a monthlong manhunt that pitted residents against soldiers and left more than 70 civilians dead.

Mr. Coke, 41 years old, is wanted on drug- and arms-trafficking charges in a New York district court and faces a U.S. extradition request.

Mr. Coke is expected to make his first court appearance within 48 hours, Information Minister Daryl Vaz said Wednesday, according to the Associated Press. Mr. Vaz said authorities haven't confirmed a report that Mr. Coke didn't want to fight extradition.

Police said at a news conference Tuesday that Mr. Coke was handed over to authorities by the Rev. Al Miller. Rev. Miller said on a local radio program that he had been taking Mr. Coke to the U.S. Embassy when his car was stopped at a checkpoint, possibly indicating that Mr. Coke had intended to give himself up to authorities.

A U.S. Embassy spokeswoman said Tuesday that the embassy is closely following the reports of Mr. Coke's arrest. A U.S. attorney for the Southern District in New York said "we look forward to working closely with the Jamaican authorities to bring Coke to justice."

Capturing Mr. Coke took a heavy toll on Kingston, Jamaica's capital. But it could mark a turning point for the island nation where drug lords have seized power from politicians in recent years.

Last month, Prime Minister Bruce Golding issued a warrant for Mr. Coke's arrest and sent police into Mr. Coke's Kingston stronghold to find him. Residents loyal to Mr. Coke fought back against security forces with arms that may have been provided by Mr. Coke himself. By the time authorities took control, Mr. Coke was nowhere to be found.

Strongmen like Mr. Coke have been seen as a growing threat to law and order in Jamaica since the 1980s.

Known on the island as "dons," they control neighborhoods in the capital and outlying areas.

Mr. Golding has portrayed his decision to arrest Mr. Coke as a first step in a larger war against organized crime.


Reuters

Christopher Coke in an undated photo released by Jamaican police in May.

Diamond talks stall in Zimbabwe

By Sara Toth Stub

TEL AVIV—Talks at the Kimberley Process conference about whether to certify diamonds exported from Zimbabwe's Marange mine are at a standstill as the international group's annual meeting draws to a close, participants said.

"We so far haven't been able to reach consensus on the Zimbabwe issue," said Boaz Hirsch, chairman of the Kimberley Process, a group made up of government, human-rights and diamond-industry officials representing 75 countries. It tries to prevent the trading of conflict diamonds that might be used for financing wars. Israel holds the group's rotating chairmanship.

Members meeting in Tel Aviv were set to reconvene in another closed session on Wednesday evening, in hopes of reaching a decision. The issue of whether or not the Kimberley Process should certify diamonds from the Marange mine has taken up much of the discussion.

The Kimberley Process suspended its approval of diamonds exported from Marange in 2009, but a recent Kimberley report said the mine has met minimum standards and exports should resume.

However, several human-rights groups and some in the diamond industry have called for the Kimberley Process to oppose exports from the Marange mine, saying it is a site of forced labor and funds the government of President Robert Mugabe.

One participant said the U.S., Australia, Canada and the European Union don't support resuming exports of Marange diamonds, while most African countries, Brazil, China, Russia, India and the United Arab Emirates do.