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# Central banks are warned over high debt levels

By BRIAN BLACKSTONE

BASEL, Switzerland—The Bank for International Settlements delivered a stern message to central banks and governments that keeping interest rates low for too long, or failing to act quickly to cut budget deficits, could sow the seeds for the next crisis.

“The time has come to ask when and how these powerful measures can be phased out,” the BIS said in its annual report, referring to massive fiscal and monetary stimulus measures initiated to lift economies out of recession.

The warning amounts to a direct challenge to the European Central Bank and U.S. Federal Reserve, the world’s dominant central banks, both of which have held their main lending rates at record lows for more than a year. Neither

central bank is expected to begin raising rates until well into 2011 due to continued pressures in the financial system.

The BIS applauded central banks for cutting rates in response to the financial crisis, but cautioned that waiting too long to return to normal monetary policy could impose further damage on the global economy. “Keeping interest rates very low comes at a cost—a cost that is growing with time,” the BIS said. “Experience teaches us that prolonged periods of unusually low rates cloud assessments of financial risks, induce a search for yield and delay balance-sheet adjustments.” BIS said.

Central banks aren’t bound by the recommendations of the BIS. Yet the Basel-based organization’s stature as the “central bank for central

banks”—a reference to the role it plays handling transactions for central banks—gives it an important voice on matters related to monetary policy. The annual report was issued to central bankers from around the world, including Fed Chairman Ben Bernanke and ECB President Jean-Claude Trichet, who gathered for the BIS’s two-day annual meeting that ended Monday.

By keeping short-term rates low, central banks give financial institutions the opportunity to generate income by borrowing at low rates and buying higher-yielding long-term assets. That, in turn, Please turn to page 4

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- Weak euro softens Ireland’s austerity measures ..... 5
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## Serena Williams in top form at Wimbledon



Agence France-Presse/Getty Images

No. 1 seed Serena Williams of the U.S. jumps for joy after defeating Russia’s Maria Sharapova, the 16th seed, 7-6, 6-4 in the fourth round at Wimbledon on Monday. Her sister, Venus, the second seed, also progressed, with a 6-4, 7-6 win over Jarmila Groth of Australia. Get updates at [WSJ.com/sport](http://WSJ.com/sport)

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### The Quirk



Why children suddenly like eating onions. Cue Shrek, the ogre with many marketing layers. Page 33

### Editorial & Opinion

The high cost of pinching defense pennies. Page 13

## U.S. charges eleven as Russian spies

By EVAN PEREZ

WASHINGTON—U.S. authorities charged 11 people late Monday with being part of a Russian spy program.

The Federal Bureau of Investigation alleged the Russian intelligence service known as the SVR provided extensive training, including in foreign languages and the use of codes and ciphers, to the alleged agents before dispatching them to the U.S. over the past decade.

Once inside the U.S., the alleged agents took on aliases and “deep cover” assignments to become Americanized in order to gather and provide information about the U.S. and possibly recruit sources inside American “policy-making circles,” an FBI affidavit filed in New York federal court alleged. The case grew from a FBI probe of Russian espionage capabilities since the break-up of the former Soviet Union.

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## PAGE TWO

# Caruana certainly raises fear levels

## [ Agenda ]

BY PATIENCE WHEATCROFT



When he retires from the Bank for International Settlements, Jaime Caruana should consider a new career writing horror stories. The general manager of the BIS certainly has the skill to frighten an audience and leave them petrified about what may be lurking round the corner.

At the bank's annual general meeting Monday he just avoided hissing "Be afraid, be very afraid" but, as he summed up the state of economies and banks, his view was that the situation remained precarious and there could be plenty of nasty happenings ahead.

Grudgingly in some cases, countries are moving to deal with their budget deficits. The G-20 meeting at the weekend marked a further step in that direction, with the voice of reason, that cuts could not be delayed, prevailing over those who wanted to put off the pain.

Promises of action have now to be translated into deeds, which are harder and the prospects for some countries, most notably Greece, still look precarious. Nevertheless, the problems have been acknowledged and the need for change accepted.

So it was what Mr. Caruana had to say about banks that was most spine-chilling, not least because the BIS, the central bankers' bank, is well placed to have an informed view of the sector. It isn't a pretty picture. "Some banks have yet to recognize in a transparent way the scale of losses on their balance sheets," says Mr. Caruana.

This is surely the case. It is equally surely the case, as he points out, that governments have now exhausted their ability to wade in and alleviate the worst effects of another banking crisis. As the BIS annual report puts it: "Macro-economic policy is in a



BIS general manager Jaime Caruana delivers his speech on Monday.

vastly worse position than it was three years ago, with little capacity to combat a new crisis—it will be difficult to find a source of further treatment should another emergency arise."

There is plenty of work going on to impose new restraints on banks, both by individual countries and at an international level. This week, President Barack Obama will put his signature to

**His view was the situation remained precarious and there could be plenty of nasty happenings ahead.**

legislation that will significantly curb U.S. banks' proprietary trading activities and there is a widespread move toward insistence on much higher capital ratios. Many of the systemic flaws that led to the banking crisis are being gradually addressed: dangerous compensation structures, failures in risk management and dismal regulatory supervision. Yet the implication of Mr. Caruana's remarks is that some banks remain at risk. The BIS report raises the specter of further crisis-related losses yet to hit.

It is European banks, in particular, which are the object of its concern. There has been much

speculation that some European banks haven't yet acknowledged the losses that their property lending has incurred. When the BIS echoes that fear, it moves out of the realm of idle speculation to become informed comment. In Ireland and the U.K., for instance, commercial property prices have fallen by 39% and 46%, respectively, since their peak.

It is when property prices are at their peak that banks just seem unable to stop themselves from pouring in the cash rather than calling for a slowdown. The surest pointer to the imminent end of a property boom, and the crash that always follows, is when the landscape is covered with cranes funded by generous loans to developers from optimistic bankers.

This cycle has been true to the pattern. Now some banks are rolling over loans rather than foreclosing, postponing the day of reckoning that will inevitably have to come. "Losses on European bank balance sheets are expected to mount over the next few years," concludes the BIS.

Many of those same European banks have heavy exposure to some of the riskier European sovereign debt. At the end of 2009, five euro-area banking systems, those of Belgium, France, Germany, Italy and the Netherlands, held roughly 17% of all outstanding Greek government debt and they were similarly

exposed to Spain and Portugal, countries which not for nothing have been relegated to the PIGS category of economies.

"Some banks may find it difficult to earn their way out of the crisis, given the prospects of further loan losses, higher funding costs and significant refinancing pressure," said Mr. Caruana. And the BIS raises doubts about whether that refinancing, if required, will even be available, given the expected demand for funds from governments forced to raise cash.

Mr. Caruana tried to end his speech on a more optimistic note, talking enthusiastically of the financial reforms that are now in train. "The reforms will quickly generate significant benefits from enhanced resilience," he assured his audience. Any comfort that they might have taken from that sentiment, however, was quickly erased by his next sentence. "This is all the more true when—as now—the probability of further shocks is elevated."

Fear levels should certainly be elevated after hearing him.

## Rating a change

Governments fear being downgraded by the ratings agencies and seeing the cost of borrowing soar. The agencies' power persists despite their less than glorious role in the financial crisis. The BIS report succinctly sums up their position. "Ratings agencies, overwhelmed by the avalanche of complex structured products yet unable to resist the profits from taking on the business, failed to correctly evaluate the probability that borrowers would repay."

Now Peter Sands, the chief executive of Standard Chartered Bank, has come up with a proposal to bar the agencies from rating the most complex financial products in return for a fee from the issuer. He believes it would instantly discourage the creation of such products. That would be a positive. Yet having any rating paid for by the organization being rated has an inherent and uncomfortable conflict.

## What's News

■ **Switzerland-based Noble** agreed to buy drilling company FDR Holdings for \$2.16 billion, and signed related contracts with Shell that will guarantee some revenue stability while the drilling ban in the U.S. Gulf is in place. 22

■ **Turkey said it closed** its airspace to Israeli military flights in the wake of the Israeli commando raid on a Turkish aid ship. 10

■ **Germany's parliamentary** finance committee watered down a bill banning some "naked" short selling of securities. The bill heads to a lower-house vote Friday. 21

■ **Roche's strategy** of diversifying beyond cancer medicines appeared to stumble with the release of mixed data on a diabetes drug the company is developing. 19

■ **Standard Chartered** said it had a strong performance in the first half, although recent weaker market sentiment hurt momentum. 21

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Dan Michaels on the EU's negligible progress on preparing for a new crisis.



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NEWS

# Top sumo wrestlers barred from games

By MARIKO SANCHANTA AND MIHO INADA

TOKYO—A slew of top-division sumo wrestlers—including its second-ranked wrestler—won't compete in next month's Nagoya grand tournament, in an unprecedented decision, after 65 of the 700 active wrestlers admitted to illegally gambling on baseball and other games.

The Japan Sumo Association, known for its strict adherence to hierarchy and ritual, said the tournament would proceed on July 11, but without the participation of 14 top wrestlers, including seven in the top division called Makuuchi.

Kotomitsuki, a 34-year-old wrestler who reached the level of *ozeki*, or champion (one rank below *yokozuna*, or grand champion), is the highest-ranking wrestler barred from the tournament.

The once-sacred world of sumo

has been hit by a wave of high-profile scandals—the latest involving wrestlers admitting to illegally gambling—that threatens to derail the Nagoya tournament.

The Japanese media, including the nation's largest daily Yomiuri Shimbun, have reported that some of the gambling was through the *yakuza*, the Japanese mafia. The sumo association spokesman said he couldn't comment on the allegations, but added the association is cooperating with a police investigation of the matter.

The chairman of the Japan Sumo Association, Musashigawa, is also likely to be suspended, according to the Japanese media. Musashigawa couldn't be reached to comment. The association said it will release more details on July 4.

The sumo gambling scandal has grabbed headlines and gripped the Japanese public. Last week, the Ja-

pan Sumo Association, under increasing pressure, formed a special investigation committee composed of 10 outsiders to come up with recommendations for action.

The tarnished reputation of sumo contrasts sharply with the success of Japan's football team, which has reached the second round of the World Cup for the first time outside home territory.

Sumo has been steadily losing popularity in Japan in recent years to football and other sports, including baseball.

At the Aichi Prefectural Gymnasium, the venue of the Nagoya tournament, preparations to bring in dirt and build the sumo ring started Monday, as planned.

But a worker at Wakatake, an official ticket-selling venue, said sales were "bad" compared with last year.

—Tomomichi Amano contributed to this article.



The Sumo Association met Monday at the Ryogoku Kokugikan arena in Tokyo.

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Roger Federer attributes his many successes to an enduring love of tennis, to hard work and focus in the heat of competition. Through experience, Credit Suisse understands the many facets of success and the nature of successful people. The one thing common to them all is the motivation they derive from others. Credit Suisse, working to help its clients thrive since 1856.

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## EUROPE NEWS

# German ballot tests Merkel

Presidential election is seen as referendum on chancellor's ability to keep coalition together

BY MARCUS WALKER

BERLIN—German Chancellor Angela Merkel faces a test of her authority, and of her squabbling government's cohesion, when German lawmakers elect a new federal president on Wednesday.

The job of German president is largely ceremonial, but the election could severely embarrass Ms. Merkel if her coalition partners don't back her candidate, Christian Wulff, the conservative premier of the state of Lower Saxony.

A defeat would add to the public perception of chaos in the ranks of a center-right government that just last fall won a clear victory in national elections, but whose approval ratings are plunging amid insults and bickering.

Mr. Wulff is expected to win enough votes in the specially convened Federal Assembly, comprising federal lawmakers and delegates from Germany's 16 states, to become president, an outcome that would allow the chancellor to declare that talk of a government in crisis is misplaced.

But the voting arithmetic is uncertain, because some delegates from Ms. Merkel's junior partner, the pro-business Free Democratic Party, have said they will support a rival presidential candidate, Joachim Gauck.

In Germany, the president is a largely ceremonial head of state, but also has limited powers to block legislation and dissolve parliament. The post's present importance is mainly as a litmus test of whether Ms. Merkel can control her ranks.

What should have been a straightforward matter has turned into a tense contest due to the center-left opposition Social Democrats' decision to nominate Mr. Gauck—a popular former East German civil-rights activist with no party affiliation but strong sympathies on the German center-right.

German media have made much of the gap in charisma between the eloquent Mr. Gauck and Mr. Wulff, who has the pleasant-but-bland image of a career politician.

The chancellor's conservative Christian Democratic Union and its governing allies have a slender majority of 21 among the 1,244 delegates who will elect Germany's next



**The favorite: Christian Wulff**

**Age:** 51

**Career:** longtime conservative politician, premier of state of Lower Saxony since 2003

**Backed by:** Chancellor Angela Merkel's center-right coalition



**The outsider: Joachim Gauck**

**Age:** 70

**Career:** Pastor, civil-rights activist in East Germany, overseer of Stasi archives 1990-2000

**Backed by:** center-left opposition parties

president.

Analysts say Mr. Wulff is likely to win on Wednesday—at the latest in the third round of voting, when a candidate needs only a plurality, not an absolute majority of delegates.

"The probability of Wulff losing is low since it would require a united front of all opposition parties as well as many votes from the government camp to defeat him," says Karl-Rudolf Korte, a political scientist at Duisburg-Essen University. "If Gauck somehow wins, Merkel will try to embrace him as a champion of freedom and patriotism, but the loss of confidence in this government would deepen," he says.

Such a debacle would likely fuel talk that Ms. Merkel doesn't have her coalition under control, particularly the FDP and the Bavarian conservatives of the Christian Social Union, which have disagreements over economic and social policy.

Last week a senior CSU official likened FDP policies to those of former Chilean dictator Augusto Pinochet, continuing an exchange of invective in which the parties have branded each other "wild sows" and "a troop of gherkins."

The governing camp's public support has sunk to 35%, far down

from its victorious 48% of the vote in September's national election. New elections now would mean defeat for many center-right lawmakers, so that many observers believe party discipline will prevail on Wednesday.

"Party soldiers don't willingly kill their own government," says Josef Joffe, a political scientist at Stanford University and publisher of German newspaper Die Zeit.

Even if Ms. Merkel's candidate loses on Wednesday, that doesn't mean her government is doomed, as some foreign observers have suggested. Germany's constitution makes it extremely hard to bring down a government early or to trigger new elections.

"It's almost as hard to topple a German chancellor as an American president," Mr. Joffe says. "That was willed by the fathers of the constitution" after World War II, he says, in order to avoid the political instability of the interwar Weimar Republic.

For Ms. Merkel, the presidential problem has been a distraction from pressing economic issues including Germany's public finances and the debt crisis in the euro zone. Previous president Horst Köhler, a former

head of the International Monetary Fund, resigned abruptly on May 31 when he took offense at left-wing politicians' criticisms of his statements on foreign policy, catching Germany's political class off guard.

Mr. Köhler was Ms. Merkel's hand-picked candidate for president in 2004, when she touted his victory as a symbol of her center-right alliance's ascendancy. Now that her government is fast losing support, she tapped Mr. Wulff as a safe pair of hands to make sure the presidency didn't become a symbol of center-right disarray.

Mr. Gauck's problem is that even if he attracts some defectors from government ranks, most of the 124 delegates of the radical Left Party have pledged to vote against him and for a candidate of their own.

Some of Mr. Gauck's political views, including his support for welfare cuts and the war in Afghanistan, make him unpalatable for the Left. In addition, his record as an activist in the peaceful revolution of 1989 that brought down Communist East Germany, and subsequently as overseer of the Stasi secret-police archives, make him anathema for Left members with roots in the former Communist regime.

## Recovery of economy is faltering in Europe

BY NICHOLAS WINNING

LONDON—The euro zone's economic recovery is faltering, but a muted inflation outlook should allow the European Central Bank to keep interest rates very low into next year.

The Conference Board's leading economic index for the euro zone slipped to 109.7 in May, the first fall in 14 months.

The index, released Monday, is designed to predict future activity.

Jean-Claude Manini, the Conference Board's senior economist for Europe, said the drop suggested the rebound in euro-zone growth may have peaked during the second quarter.

"However, it is too soon to say that the recent improvement in the economy will subside strongly in the near term," Mr. Manini said in a note. "Employment may suffer from a wait-and-see attitude during the second half of 2010, but the effects of deficit-reduction measures will be primarily felt in 2011."

Despite the drop in May, the index is still substantially above its March 2009 trough. April's 110.2 reading was also the highest since August 2007, just before the global credit crisis hit.

The Conference Board says the index has signaled turning points in the euro zone's business cycle. It combines gauges including share prices, interest-rate spreads, manufacturing purchasing managers' surveys, economic sentiment and residential building permits.

Economists say euro-zone gross domestic product is likely to have grown around 0.5% on a quarterly basis in the second quarter after expanding 0.2% in the first.

But they warn that the expansion has been fueled by temporary factors—such as a construction rebound in Germany and restocking—and is unlikely to last.

One drag on the recovery appears to be easing. The ECB on Monday said there are signs that lending to companies may be recovering despite recent signs of strain in the interbank funding markets.

The ECB said lending to the private sector in May was 0.2% above May 2009, up from an annual growth rate of 0.1% the previous month.

Loans to businesses increased by €18 billion (\$22.29 billion), having contracted €14 billion in April. But over the year, lending to businesses was down 2.1%.

Loans to households increased €9 billion in May, having risen €16 billion in April.

The annual growth rate rose to 2.6% in May from 2.5% the prior month.

"The main take-away from today's release is that while credit growth is showing signs of improving, overall demand for credit remains weak," said Martin van Vliet, an economist at ING.

The ECB said M3, the broadest measure of money supply, fell at an annual rate of 0.2% for the second consecutive month in May.

—Roman Kessler in Frankfurt and Carolyn Henson in Brussels contributed to this article.

## BIS warns central banks on high debt levels

Continued from first page  
"may diminish the sense of urgency for reducing leverage and selling or writing down bad assets," the BIS said.

The Fed isn't following that advice. Last week, Fed officials reiterated their commitment to keep rates "exceptionally low...for an extended period." Fed watchers equate that with holding rates near zero—where they have been since the end of 2008—for many more months.

BIS officials endorsed Europe's plans for deficit reduction as soon as this year or 2011 but also expressed concern about the effect that soaring government debt levels will have on monetary policy and, ultimately, inflation.

It isn't a risk BIS officials see in the short term. "There's a fair

amount of slack out there" that should keep a lid on price pressures, said BIS chief economist Stephen Cecchetti.

### The ECB has bought about \$68 billion in bonds of Greece, Portugal and other vulnerable economies.

But things can unravel quickly when debt levels are so high. If investors are unwilling to buy a country's sovereign debt, then the central bank may have to step in and purchase government bonds, the BIS said.

The ECB has bought about €55

billion (\$68 billion) in bonds of Greece, Portugal and other vulnerable European economies since it began its controversial debt-buying program seven weeks ago.

The problem, according to the BIS, occurs if a central bank has to stem inflationary pressures by pushing up short-term interest rates, thus raising borrowing costs for already cash-strapped governments.

In addition, asset purchases and other measures have led to "sustained bloat" in central bank balance sheets, which in turn exposes them to "considerable credit risk," the BIS said, "which together with the changed balance-sheet composition may expose them to political pressures."

—Natasha Brereton contributed to this article.

### Risks abound

Quotes from the BIS's report

■ **On global recovery:** "Financial and economic recovery is under way, but it is both incomplete and fragile, at least in the major advanced economies."

■ **On central-bank bond purchases:** "The asset purchases have exposed central banks to considerable credit risk, which...may expose them to political pressures."

■ **On debt:** "High levels of public debt may lower long-term economic growth and ultimately endanger monetary stability."

Bank for International Settlements

EUROPE NEWS

# Ireland set to profit from weaker euro

By NEIL SHAH

The weakening euro may help the Germans sell cars, the French sell pharmaceuticals and the Greeks sell island vacations. But Ireland, above all others, will be the biggest beneficiary of the euro's recent fall.

The Emerald Isle has high unemployment and one of Europe's deepest budget deficits, and is taking some of Europe's harshest austerity medicine. Economists are starting to feel less dismal about Ireland's prospects, however, because of the unique nature of its export economy.

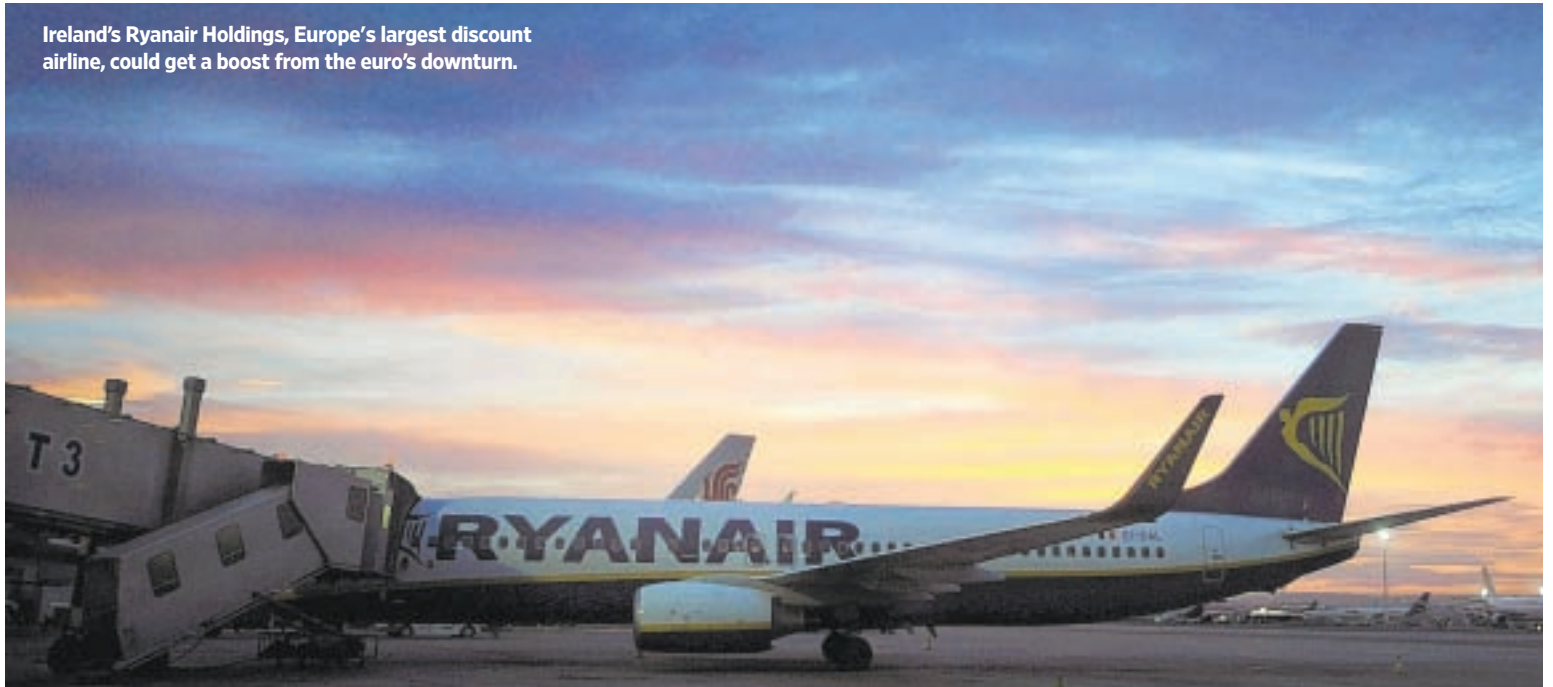
Exports account for more than 50% of Ireland's gross domestic product, ahead of even Germany. And while many euro-zone countries' exports go to their European neighbors, Ireland sends much of its chemicals, business services, technology and food to the U.S. and U.K. That maximizes the benefit of the falling euro, which has lost approximately 15% against the U.S. dollar and 8% against the British pound since the beginning of the year.

Ireland, which is set to announce its first-quarter GDP on Wednesday, is expected to announce that its economy grew at the beginning of the year from the last quarter in 2009, technically pulling it out of a recession. Economists now believe Ireland could grow 0.5% or 0.6% this year, reversing earlier forecasts that called for a full-year contraction.

"Things are clearly starting to look up," says Alan McQuaid, chief economist at Bloxham, Ireland's biggest independent stockbroker. "Assuming the euro-zone debt issue doesn't turn into a full-blown crisis, Ireland should be roaring back up over the next 12 months, led by a strong export performance."

Ireland's experience seems to suggest economies can recover even while slashing spending, though the path of the export-driven economy is one that may be harder for its euro-zone neighbors to follow.

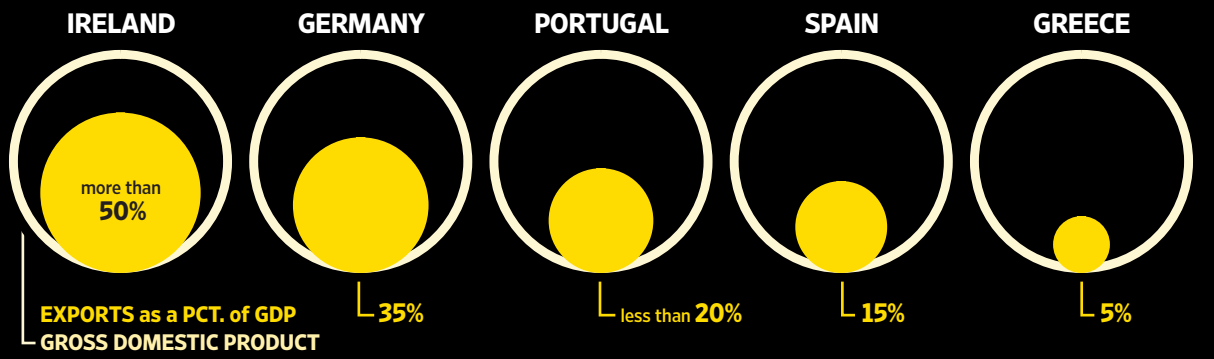
The country suffered one of Europe's biggest property and banking busts in the financial crisis, but it was among the first to tackle its recent debt problems. Starting in 2008, it instituted tax increases,



The upshot

Ireland's and Germany's export-driven economies could benefit from a weaker euro, which makes their exports cheaper and more attractive on the global market. Exports as a percentage of gross domestic product

Source: ING  
Photo: Bloomberg News



budget cuts and salary reductions that added up to 8% of its GDP—similar to an austerity plan the U.K. announced just last week.

Ireland isn't out of the woods yet. Financial regulators have put its biggest banks in intensive care, removing bad real-estate loans from bank books and onto the government's balance sheet. It is also unclear whether Irish banks will start providing enough credit to consumers to support domestic spending.

The country's labor market, too, isn't working. Its 13.7% unemployment rate is higher than the euro-zone average, while Irish households

tend to be even more heavily indebted than families in Britain, Spain and Portugal.

But economists and investors say unemployment may be peaking. This month, investors gobbled up newly issued shares of **Bank of Ireland PLC**, which has been forced along with others to raise more capital to gird itself against future crises.

Also, key manufacturing and services sectors have started to expand, while retail sales have held up reasonably well. Ireland's trade surplus has continued to grow throughout the downturn, hitting about €39 billion (\$48 billion) in 2009 from €29

billion a year earlier even as the economy shrank 7%, according to the Central Statistics Office.

The export picture looks encouraging, with demand rising in the U.S. and China. Prices and wages in Ireland, meanwhile, are falling, making Irish companies more competitive and encouraging foreign direct investment.

John Whelan, chief executive of the Irish Exporters Association, calls the weakening euro a "silver lining" that is helping Ireland-based corporations that trade with the U.S. and so-called indigenous Irish firms in food and tourism that hawk prod-

ucts to neighboring Britain.

Investors have started to back Ireland, especially compared with other indebted euro-zone countries. Ireland's blue-chip stock index has held steady this year—currently up 0.5%—while stock markets in Greece and Spain are down 34% and 19%.

"We're more favorably inclined towards Ireland," says Richard Batty, global investment strategist at Standard Life Investments, which manages £138 billion of assets, including shares of firms like low-budget airline **Ryanair Holdings PLC**, bank **Irish Life & Permanent PLC** and food firm **Greencore Group PLC**.

# U.K. discusses immigration cap with firms

By CASSELL BRYAN-LOW

LONDON—The U.K. government began a consultation with the business community over plans to impose an immigration cap on workers coming into the country, an idea that faces opposition from industry interests who say it will restrict the recruitment of key talent.

The debate underscores the difficulty Britain's new government faces in balancing public concern about immigration and a need to revive the economy.

The cap, which applies only to skilled and highly skilled workers coming to the U.K. from outside Europe, is due to take effect in April. The government said Monday that it is also imposing temporary limits, effective immediately, to avoid a rush on applications ahead of the permanent new rules.

David Cameron, who became prime minister last month, made immigration a key part of his election platform. His Conservative Party argued high immigration lev-

els have put pressure on public services and led to tensions in communities.

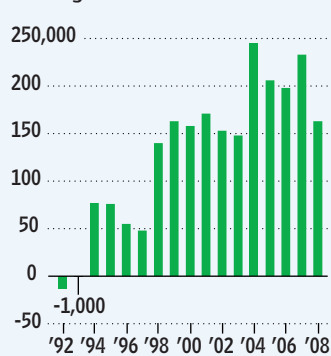
Workers coming to the U.K. from outside Europe account for less than 15% of all foreigners who arrive in the U.K. each year. The cap wouldn't apply to other large groups coming to the U.K., notably students and people from Europe.

Labour Party politicians and other opponents have called immigration caps arbitrary and unworkable, saying they would hinder Britain's economic recovery, among other things. They also say that the economy has benefited from the inflow of migrant workers to the U.K. over recent years.

The Liberal Democrats, with whom the Conservatives were forced to form a coalition government following inconclusive election results, had opposed an immigration cap during the election campaign. A party spokeswoman said the coalition effort involved compromises and that both parties were "united in seeking to meet the immense

Closing the door?

Net migration to the U.K.



Notes: Figures showing the difference between people coming to and leaving the U.K.; 2008 is most recent year for which data are available. Source: U.K. Office for National Statistics

challenges that face the country."

Nicolas Rollason, a London-based partner at law firm Kingsley Napley LLP whose clients include multinational firms in finance and other industries, says employers are con-

cerned about not being able to respond quickly enough when the economy turns around. "It will have a significant impact on businesses' ability to recruit—and plan recruitment—because you never know when it will run out," he said.

Among industries likely to be most affected are technology, finance and engineering, which rely heavily on overseas recruitment.

"It's a very, very crude tool," said Philip Trott, at the U.K.'s Bates Wells & Braithwaite LLP, in part because it doesn't take account of which industries are most in need of skills.

Mr. Trott points to experiences in the U.S., where caps on skilled worker visas typically have been heavily oversubscribed. U.S. high-tech companies have long been critical of the limits, arguing that they hinder employers' ability to secure qualified workers and that the U.S. risks losing its competitive edge in technology as a result.

"I recognize the importance of attracting the brightest and the best

to ensure strong economic growth, but unlimited migration places unacceptable pressure on public services," said Home Secretary Theresa May in a statement Monday.

The number of immigrants coming to the U.K. surged over the past decade under a Labour government, particularly following the European Union's 2004 enlargement, which opened the way for workers from Eastern Europe to freely move to Britain.

Net migration—the number of people who come to live in the U.K. minus those that move overseas—spiked to more than 200,000 annually in some years from less than 50,000 in 1997.

Those numbers have declined in recent years, falling by almost a third to 163,000 in 2008, the latest statistics available. Labour politicians credit tougher border controls, though immigration specialists say the economic downturn played a significant role because there have been fewer jobs to attract people from overseas.

## EUROPE NEWS



European Pressphoto Agency

New Prime Minister Petr Necas answers media questions at Prague Castle.

# Czech leader is sworn in, vows action

BY LEOS ROUSEK  
AND GORDON FAIRCLOUGH

PRAGUE—A veteran conservative politician, who has pledged to cut government spending, scale back welfare benefits and tackle corruption, was sworn in Monday as the Czech Republic's new prime minister, and he pledged to move swiftly to form a government.

Petr Necas, chairman of the right-leaning Civic Democrats, took the oath of office Monday in a former throne room in the Prague Castle, home to the president's office. Mr. Necas is expected to lead a coalition including two smaller center-right parties.

"We need a stable, hard-working cabinet that will quickly deal with the state budget," he said.

Alarmed by the fiscal crisis in Greece, Czech voters in May threw their support behind parties pledging to cut government spending and curb budget deficits. The Civic Democrats and their two likely partners hold a combined 118 seats in the 200-member lower house of Parliament.

The three parties have been negotiating a power-sharing deal since early June. Mr. Necas said Monday he hopes to have a cabinet in place by the middle of next month that

would be able to immediately start the work of drafting the government's 2011 budget.

If they manage to strike a coalition agreement, the Civic Democrats, Public Affairs and TOP 09 parties together would have the votes to push through sweeping changes to the country's pension and health-care systems. But it is not clear how far they will want to go.

The left-leaning Social Democrats won more seats than any other party in the May elections, though they fell far short of a majority and were unable to woo other parties to share power with them. Still, those votes for the Social Democrats indicate significant support among Czechs for leaving substantial social protections in place.

In any event, a governing coalition with 118 votes likely would be more stable than any in the new Czech Republic's history. The country, once part of the former Czechoslovakia, became independent in 1993. Since then, Czech politics has been characterized by shifting alliances and frequent changes of government.

At Mr. Necas's swearing-in ceremony, Czech President Vaclav Klaus noted that in just over seven years in office, he has appointed six prime ministers.

## Vatican appeal rejected

BY STACY MEICHTRY

The U.S. Supreme Court on Monday declined to review a Vatican appeal to dismiss a lawsuit accusing the Holy See of concealing alleged sexual abuse by a Roman Catholic priest.

The lawsuit, filed by one of the priest's alleged victims in 2002, accuses the Vatican and U.S. church officials of shielding the Rev. Andrew Ronan from allegations of sexual abuse by transferring the priest from one diocese to another—a practice that the complaint says allowed the priest to dodge his accus-

ers and abuse more children. The lawsuit contends the Vatican is liable for negligence, because it acted as the priest's employer.

The Vatican had filed a motion with the Supreme Court to dismiss the lawsuit on the grounds that the Holy See, as the Vatican is formally known, is a sovereign state that is immune to the laws of another country.

The Supreme Court's refusal to review the Vatican's motion paves the way for the case to return to the U.S. District Court for the District of Oregon for review. The case is *Holy See v. John Doe*, 09-1.



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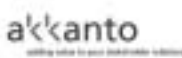
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U.S. NEWS

# Economic distemper imperils Democrats

[ Capital Journal ]

BY GERALD F. SEIB



Politically speaking, the Democrats' problem at the moment is pretty simple: Confidence in the economy has slumped, and at exactly the wrong time in the election calendar.

Blame it on Greece. For Democrats' prospects to improve in November's midterm elections, this is about the time voters would have to start feeling better about the economy's recovery under Democratic stewardship. And for a while this spring, it seemed that was starting to happen.

Not now. And, let's face it: It's still the economy, stupid, that matters.

Look inside the latest Wall Street Journal/NBC News poll to see the picture. Americans actually are feeling a little better about this year's big health-care overhaul legislation, which Republicans thought would be the Democrats' Achilles' heel this year. The share of Americans who think the bill was a good idea has ticked up steadily through the year, and a slight majority of voters now say they'd be more likely to vote for a Democrat who argues for giving the plan time to work rather than

a Republican who wants to repeal it. So Democrats are getting about the best they could hope for on health. But they're getting less than they expected on the economic outlook.

In just one month's time, between May and June, the share of Americans who say the economy will get better over the next 12 months fell to 33% from 40%. Last September, the share was even higher, 47%. In other words, even as the U.S. has technically been exiting the recession, optimism about the economy has declined—and the decline has become much more pronounced lately.

President Barack Obama is paying a price for this. Those who disapprove of his handling of the economy ticked up to 50% this month, from 46% in May. That's a big reason—likely the main reason—the Journal/NBC News poll found in June, for the first time, more people disapproving than approving of Mr. Obama's overall job performance. (Former President George W. Bush still is seen as slightly more responsible for current conditions.)

This is striking in part because confidence in Mr. Obama's handling of the economy actually rose between January and May of this year. If you're looking for a cause of this early-summer downer, the lovely nation of Greece would be a good place to start.

Just about the time Americans seemed ready to allow themselves to feel a bit better about economic recovery this spring, the shadow of a debt meltdown in Greece, which might spread across Europe, began creeping over the landscape.

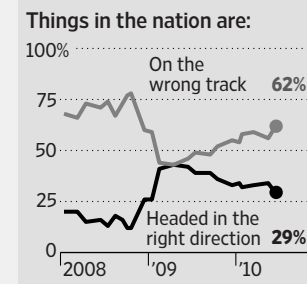
On April 27, Standard & Poor's Ratings Services downgraded Greece's debt to "junk" territory. The Dow Jones Industrial Average, which had climbed above 11,000, fell 213.04 points, and now hovers in the 10,000-point range. There followed some disappointing job-creation numbers in the U.S.

Average Americans certainly don't spend a lot of time worrying about Greece's bond rating, or the status of sovereign debt in the Euro zone. But they can sense fear in the air, and this spring brought a whiff of fear that a nascent recovery might be cut short because of international economic woes. It seems likely we're now seeing the direct and logical reaction to that change in psychology.

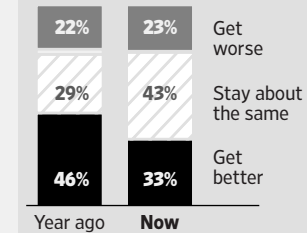
Yet the real dilemma for the Obama administration and the Democrats may lie in what Americans seem to perceive as a root of economic woes. They are concerned about sagging economic performance and job creation, but seem to have decided that spending and deficits are the cause, or at least a cause, of the problem. When voters were asked this month which attribute of a congressional candidate would

## Findings from the latest WSJ/NBC news poll

### The mood



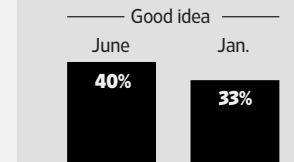
### During the next 12 months, the economy will:



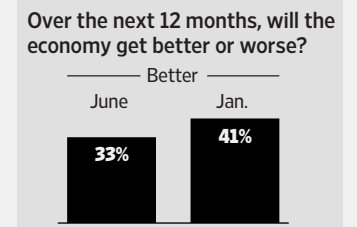
Source: WSJ/NBC News telephone polls; margin of error for June 2010 full sample: +/-3.1 percentage points

### Opposite reactions

Feelings about the health overhaul are improving... Was Barack Obama's health plan passed by Congress a good idea or bad idea?



Precisely as feelings about the economy are declining... Over the next 12 months, will the economy get better or worse?



make them enthusiastic about that candidate, support for cutting federal spending came out atop the list.

Now, if you believe that a gentleman named John Maynard Keynes knew something about economics, you'd argue that this is exactly the wrong time to make deficit-cutting a top priority—not when government spending might

be needed to speed the economy over the big recession hump once and for all.

And Democrats, of course, are more likely to buy that notion than are Republicans. So Democrats are in the uncomfortable position of seeing voters souring on the economy, while also growing skeptical about one of their prescriptions for curing it.

# Longest-serving U.S. senator, West Virginia's Byrd, is dead

BY KRISTINA PETERSON AND STEPHEN MILLER

Robert Byrd, the West Virginia Democrat who served in the U.S. Senate for 51 years, died Monday at the age of 92.

A family spokesman said Mr. Byrd died peacefully at about 3 a.m. at Inova Hospital in Fairfax, Va. He had been in failing health for several years.

A master of Senate procedures and orator whose Stentorian tones aimed to evoke the roots of the republic (if not Rome), Mr. Byrd served longer, voted more frequently, and probably used the arcane Senate rules to more effect than any previous denizen of the nation's upper legislative house.

Mr. Byrd inhabited numerous roles in a life that took him from a childhood in the coalfields of West Virginia to Senate majority leader. In his early years, he was a gas-station attendant, a welder, a self-taught butcher, then a West Virginia state legislator.

After he was elected to the House of Representatives in 1952, his political positions veered widely between the now almost extinct Southern conservative Democrats of mid-century to that of the more conventional liberal of today. But his reputation never rested on ideology.

Most salient were his two leading Washington roles.

First was the self-appointed champion of the Constitution, brandishing his breast-pocket copy of the government's foundational doc-



Sen. Robert Byrd in 2006.

ument on the Senate floor while inveighing against usurpation of the Senate's powers by the executive branch.

Second was the crafty legislative pro with one hand in the pork barrel, the Democratic majority leader and Appropriations committee chairman who managed to slip into legislation so many programs benefiting his state that more than 30 federally funded buildings were named after him.

A senator starting in 1959, Mr. Byrd at first voted the conservative Southern Democratic line. He strongly opposed the Civil Rights Act of 1964 and the Voting Rights Act of 1965.

Yet by the late 1970s, when he

was first elected Senate majority leader, the onetime klaner in the Ku Klux Klan had moderated his position on social issues.

When Mr. Byrd voted against measures authorizing both the Gulf War in 1990 and the invasion of Iraq in 2002, it was on the grounds that the Senate was giving up its constitutional power to declare war.

Residents of West Virginia rarely wavered in their support for Mr. Byrd. In 1970, he became the first politician to ever carry all of the state's 55 counties in an election.

Mr. Byrd fostered a reputation for legislative persistence and knowledge of Senate rules. In a closely fought 1971 race, he beat Sen. Edward Kennedy for the position of majority whip. He became majority leader in 1977, and helped push through President Jimmy Carter's energy package.

During the past decade, Mr. Byrd was among the most strident of the Bush administration's critics, repeatedly warning the president to read the Constitution or face impeachment himself.

Shortly after the 2008 election, facing rumblings over his age in the face of an economic crisis, Mr. Byrd announced he was stepping down after a decade as chairman of the Appropriations Committee.

"West Virginia has always had four friends," Mr. Byrd said after winning re-election in 2000. "God Almighty, Sears Roebuck, Carter's Liver Pills and Robert C. Byrd."

—The Associated Press contributed to this article.

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## U.S. NEWS

# Court rules in favor of gun rights

Justices say bearing arms is fundamental to American freedom; Stevens, in dissent, predicts 'confusion, upheaval'

BY NATHAN KOPPEL

WASHINGTON—The U.S. Supreme Court ruled for the first time that gun possession is fundamental to American freedom, giving federal judges the power to strike down state and local weapons laws for violating the Second Amendment to the Constitution.

In a 5-4 ruling Monday, the court held that the Second Amendment's right to keep and bear arms is a fundamental right that binds states.

"Self defense is a basic right, recognized by many legal systems from ancient times to the present day," wrote Justice Samuel Alito. He was joined in reaching the result by Chief Justice John Roberts and justices Anthony Kennedy, Antonin Scalia and Clarence Thomas.

In 2008, the Supreme Court struck down a handgun ban in the District of Columbia, a federal enclave. Justice Alito's opinion said that ruling "unmistakably" required the court likewise to overturn laws in Chicago and its suburb of Oak Park, Ill., that limited handgun possession.

Justice Thomas agreed with the majority on the result but wrote a concurrence offering different constitutional logic for viewing the right to bear arms as a fundamental right.

As it did in 2008, the court's majority cautioned that the right to keep and bear arms is not "a right to keep and carry any weapon whatsoever in any manner whatsoever and for whatever purpose."

Justice Alito wrote that despite "doomsday proclamations," the ruling "does not imperil every law regulating firearms."

The Supreme Court's ruling is likely to lead to years of litigation across the country as lower courts



Brent Willard helps a customer at a Wichita, Kan., gun shop in 2008. Monday's gun-possession ruling by the Supreme Court follows a 2008 ruling in which the court struck down a handgun ban in the District of Columbia.

decide how far the right to bear arms extends and which restrictions are unconstitutional.

Justice John Paul Stevens, in dissent, said the 2008 ruling has already triggered a "tsunami of legal uncertainty." He predicted more "confusion, upheaval and burden on the states."

Wayne LaPierre, executive vice president of the National Rifle Association, said: "The NRA has to make sure this is not a hollow victory that is nullified by a byzantine labyrinth

of regulations and laws."

Mr. LaPierre, whose group favors gun rights, criticized restrictions that Washington, D.C., put in place after the 2008 Supreme Court decision. Those restrictions have included a registration process and fees that Mr. LaPierre said can double the cost of some firearms.

Paul Helmke, president of the Brady Campaign to Prevent Gun Violence, said the ruling "does not prevent our elected representatives from enacting common-sense gun

laws to protect our communities from gun violence." Mr. Helmke's group favors stricter gun-control laws.

He predicted that legal challenges to gun laws less restrictive than those in Chicago "will continue to fail."

The legal question before the court had much to do with questions of constitutional history. Before the Civil War, courts held that the Bill of Rights applied only to the federal government. After the Union victory,

the Reconstruction amendments were adopted to elevate individual rights over state powers and cement the federal role in enforcing them.

The Supreme Court has subsequently held that many constitutional rights considered fundamental to American principles of liberty override state laws. However, more technical provisions—such as the Fifth Amendment requirement that grand juries approve criminal indictments—apply only to the federal government and don't necessarily bind states.

Monday's ruling elevates the Second Amendment right to bear arms to the status of a fundamental right that states can't abridge.

"It is clear that the framers and ratifiers of the Fourteenth Amendment counted the right to keep and bear arms among those fundamental rights necessary to our system of ordered liberty," wrote Justice Alito.

Justice Stephen Breyer, in a dissent joined by justices Ruth Bader Ginsburg and Sonia Sotomayor, said the majority ruling misinterpreted history. "[N]othing in 18th-, 19th-, 20th-, or 21st-century history shows a consensus that the right to private armed self-defense...is 'deeply rooted in this nation's history or tradition' or is otherwise 'fundamental,'" Justice Breyer wrote.

Justice Stevens, who served his last day at the court Monday, dissented separately.

"Recognizing a new liberty right is a momentous step," he wrote. He said he would have proceeded more cautiously and given more leeway to local governments. "[T]his is a quintessential area in which federalism ought to be allowed to flourish without this court's meddling," he wrote.

—Gary Fields  
contributed to this article.

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FULLY BOOKED

## Supreme Court adjusts Sarbanes-Oxley board

BY ERIN WHITE  
AND BRENT KENDALL

The Supreme Court ordered a technical change Monday to the Sarbanes-Oxley accounting rules, but left the broader law intact.

That means big U.S. companies will have to continue complying with the 2002 law—passed in the wake of several accounting scandals—which they have long criticized as overly burdensome.

The high court, in a 5-4 opinion by Chief Justice John Roberts, found that it was too difficult for the president to remove members of the Public Company Accounting Oversight Board, and gave the U.S. Securities and Exchange Commission the power to remove board members at will.

Previously, the SEC could remove members only for cause.

Congress had given the five-member board broad regulatory authority over accounting firms that audit publicly traded companies.

Chief Justice Roberts said the structure of the accounting board violated constitutional separation-of-powers principles because it was too difficult for the president to remove board members.

"The president cannot take care that the laws be faithfully executed if he cannot oversee the faithfulness of the officers who execute them," Chief Justice Roberts wrote.

The court, however, refused to strike down the accounting board in its entirety. Chief Justice Roberts said Sarbanes-Oxley "remains fully operative as a law."

The ruling keeps largely intact a system that removed self-regulation by auditors and improved the reporting of financial information. It makes it unlikely that Congress will re-examine the full Sarbanes-Oxley legislation, as some opponents of the law had hoped.

In terms of changing the way companies operate, "essentially this is a non-event," said Charles Elson, a director at HealthSouth Corp. and director of the John L. Weinberg Center for Corporate Governance at the University of Delaware.

The court's ruling fell along the court's ideological fault lines, with the conservatives in the majority and the liberal justices in dissent.

The case is *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 08-861.

—David Reilly  
contributed to this article.



U.S. NEWS

Rocky road | Some confirmation-hearing highlights of recent decades



September 1987

September 1987 Robert Bork says the right to privacy, cited in the *Roe v. Wade* decision, is a 'free-floating right not found in the Constitution.' Senate later rejects him.

October 1991

Clarence Thomas, after a grilling over sexual-harassment allegations, excoriates his confirmation process as a 'high-tech lynching.' He is confirmed narrowly

September 2005

John Roberts offers an analogy that is later repeated widely: 'Judges are like umpires. Umpires don't make the rules; they apply them.'

July 2009

Sonia Sotomayor retreats from suggestion that a 'wise Latina' would make better decisions than a white man, saying, 'I do not believe that any ethnic, racial or gender group has an advantage in sound judging.'

Sources: Senate Judiciary Committee, WSJ articles

Photos: Associated Press (Bork); Getty Images (Thomas, Sotomayor); Reuters (Roberts)

# Court nominee Kagan faces Senate

BY NAFTALI BENDAVID

WASHINGTON—U.S. Supreme Court nominee Elena Kagan on Monday sought to counter conservative critics' assertion that she is a liberal activist who would bring a political agenda to the court, promising to respect the "often messy" democratic process.

As Ms. Kagan's Senate confirmation hearing got under way, Democrats and Republicans drew contrasting pictures of her.

"Her legal qualifications are unassailable," said Judiciary Committee Chairman Patrick Leahy (D., Vt.), noting that she would be just the fourth woman ever to sit on the Supreme Court.

Sen. Jeff Sessions, the committee's top Republican, recited Ms. Kagan's career, from her college thesis, which he said "seems to bemoan" the demise of socialism in New York, to her current role as solicitor general.

"In many respects, Ms. Kagan's career has been consumed more by politics than law," Mr. Sessions said.

Ms. Kagan had been publicly silent in the weeks since her nomination, in keeping with tradition, and wasn't scheduled to speak until later Monday. But in excerpts released by the White House as the committee was convening, Ms. Kagan stressed that the role of a judge is "a modest one—properly deferential to the decisions of the American people and their elected representatives."

"The court must also recognize the limits on itself and respect the choices made by the American people," she added.

She also sought to counter her critics, especially regarding her lack of judicial experience, by saying that her stints in the executive and legislative branches have taught her respect for the court, and its limitations.

As if to underscore the importance of the issues Ms. Kagan would confront should she be confirmed, the Supreme Court issued a major ruling Monday extending gun rights to the states.

Republicans hailed the decision as an extension of a basic right, while Democrats on the committee said the ruling might eviscerate common-sense gun laws.

Ms. Kagan entered the hearing room a few minutes before the pro-

ceedings began, shaking the hands of senators from both parties. She stopped by the Oval Office at President Barack Obama's request before heading to the hearing, according to a White House official, "so that he could offer his encouragement and wish her good luck."

Ms. Kagan, 50, would succeed Justice John Paul Stevens, who was the leader of the court's liberal bloc in the years before his retirement. She is Mr. Obama's second Supreme Court pick, after Justice Sonia Sotomayor, and appears likely to be confirmed barring some last-minute problem.

Ms. Kagan would join Ms. Sotomayor and Justice Ruth Bader Ginsburg to become the third woman on the court, meaning one-third of the justices would be female, the "historical high-water mark," as Mr. Leahy noted. The only other woman to serve on the court is former Justice Sandra Day O'Connor.

Still, Ms. Kagan would be unlikely to change the court's direction in a significant way. She has never served as a judge, but her Democratic roots suggest she would often vote the same way as Justice Stevens did.

Senators of both parties commented on Ms. Kagan's previous remarks that the Supreme Court confirmation process can be "vapid" and "hollow," and would benefit from a more substantive discussion of the nominee's views. But as the nominee, Ms. Kagan finds herself under pressure to avoid clear statements on specific legal issues.

As the hearing unfolded, Republicans focused on Ms. Kagan's lack of judicial experience.

"Ms. Kagan has less real legal experience than any nominee in at least 50 years," Mr. Sessions said. "It's not just that she has never been a judge. She has barely practiced law, and not with the intensity and duration from which I think real understanding occurs."

Sen. Dianne Feinstein (D., Calif.) responded that Ms. Kagan's lack of experience as a judge is "refreshing," noting that the current Supreme Court is the only one in history composed entirely of former judges.

Democrats also stressed Ms. Kagan's other credentials, noting that she excelled at Princeton, Harvard and Oxford universities, clerked for



Key issues

Gays in the military

As Harvard law dean, Ms. Kagan opposed the military ban on open homosexuals and, while the issue was pending before the Supreme Court, restricted military recruiters from career fairs. Republicans will accuse her of being antimilitary, while Ms. Kagan is likely to call herself a strong supporter of the military.

Nature of hearings

Ms. Kagan wrote in 1995 that recent confirmation hearings 'have presented to the public a vapid and hollow charade' and called for 'exploring a Supreme Court nominee's set of constitutional views.' She'll be challenged to explain those comments, especially if she gives vague answers.

The Roberts Court

Democrats plan to raise recent Supreme Court decisions that they say show the court's conservatives siding with big corporations against the little guy. Republicans are likely to defend the court under Chief Justice John Roberts.

Photo: Associated Press

the legendary Justice Thurgood Marshall, served at high levels in the Clinton and Obama administrations, and was dean of Harvard Law School.

Mr. Leahy sought to head off Republican suggestions that her past work means she would be inappropriately loyal to the Obama administration or Democratic viewpoints. "There is no basis to question her integrity, and no one should presume that this intelligent woman, who has excelled during every part of her varied and distinguished career, lacks independence," Mr. Leahy said.

Sen. Jon Kyl (R., Ariz.) criticized Mr. Obama for what he described as

the president's belief that judges should reach certain results rather than impartially follow the law. "There are warning signs that she may be exactly the results-oriented justice President Obama is looking for," Mr. Kyl said of Ms. Kagan.

Democrats said the current Supreme Court under Chief Justice John Roberts has lost its moorings, and they derided especially the recent *Citizens United* decision, which lifted many restrictions on corporate spending in political campaigns.

"By acting in such an extreme and unjustified manner, the court badly damaged its own integrity," said Sen. Russ Feingold (D., Wis.).

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## WORLD NEWS



Agence France-Presse/Getty Images

Guinea's coup leader and transition president, Gen. Sekouba Konate, casts his ballot on Sunday in the capital, Conakry.

## Guinea vote count starts

*Amid transition to democracy, next president faces big challenges*

BY DAVID GAUTHIER-VILLARS  
AND WILL CONNORS

Guinea is poised to become the latest in a long line of African nations to reintroduce democracy after a period of military rule. But other African countries show how halting and problematic this transition can be.

On Monday, Guinea's National Independent Commission, or CENI, began counting about four million votes cast over the weekend in what international observers described as the first free elections held in the West African country after more than half a century of authoritarian rule.

The vote, said the U.S. Embassy in Guinea in a statement, went "extraordinarily well." African Union President Jean Ping welcomed the "neutrality" and "republican discipline" displayed by Guinea's army forces.

Since its 1958 independence from France, Guinea has been ruled mostly by dictators and leaders of military coups. Some have begun rejoicing that cycle may be coming to an end.

"For many years, free elections were a dream," said Abdoulaye

Baillio Diallo, aide to one of the 24 candidates, all civilians, running for president. "Now it has become a reality."

Preliminary results could be released by CENI as early as Wednesday. Unless Sunday's vote showed that one candidate garnered more than half the ballots, a runoff is expected to take place on July 18.

In the absence of reliable opinion polls in Guinea, analysts said the outcome of the vote was hard to predict. However, they said the following candidates could advance to a likely second round: longtime junta opponent Alpha Condé; Sidya Touré, who was Guinea's prime minister between 1996 and 1999; and Cellou Dalein Diallo, prime minister from 2004 to 2006.

Guinea's elections are being closely watched. Few African countries have been able to pull off a smooth transition from dictatorship to democracy.

There have been four coups in Africa in the last two years—in Guinea, Niger, Madagascar and Mauritania. While coup leaders often promise a quick transfer of power, restoration of democratic institutions and fast-tracked elections, most aren't following through with

those promises.

In Guinea, the next elected leader faces a tough road.

An immediate challenge, political analysts say, will be to make sure that Guinea's soldiers stay in their barracks. Just ten months ago, at a rally in favor of civic rights and democracy held in the capital, Conakry, Guinea's army shot into the crowd, killing more than 150 participants and wounding more than 1,000.

Another headache for Guinea's future president will be Latin American drug cartels, which are increasingly using West Africa and Guinea in particular, as a hub to export narcotics towards Europe, analysts say.

The main difficulty, however, could be jump-starting Guinea's economy.

The country has large potential riches, including the world's largest reserves of bauxite—used to make aluminum—but ranks among Africa's poorest.

During the campaign, most candidates have said their priority would be to study and perhaps renegotiate a number of large mining contracts that Guinea's junta signed in recent years, notably with Chinese companies.

## Turkey bans flights by Israeli military

Turkey said Monday it closed its airspace to Israeli military flights in the wake of the Israeli commando raid on a Turkish aid ship, further squeezing a military alliance that analysts say has become more useful for Israel than for Ankara.

By Marc Champion in Istanbul and Charles Levinson in Jerusalem

Yet three weeks after the May 31 boarding of the Mavi Marmara severely damaged the relationship between the two countries, Ankara remains cautious about completely severing its military ties with Israel.

On Monday, Prime Minister Recep Tayyip Erdogan told reporters after a Group of 20 summit in Toronto that Turkey has banned Israeli military flights from its airspace since the May 31 boarding of the Gaza-bound aid ship in which nine Turkish citizens and an American of Turkish descent were killed, the Associated Press reported. Mr. Erdogan was responding to questions about an Israeli plane carrying military personnel to Auschwitz, Poland, that was forced to divert earlier this month. A Turkish official clarified military flights would be considered on a case-by-case basis and civilian flights wouldn't be affected.

Immediately after the Gaza incident, Turkey canceled three scheduled military exercises with Israel. Since then, it has warned that ties could be further restricted if Israel fails to apologize to Turkey over the Mavi Marmara affair, among other conditions. But Turkey's government is wary of rushing to take steps that could harm relations with the U.S., or with its own military industry because of lost potential contracts, analysts say.

"If the U.S. has to choose between Israel and Turkey at one point, it would choose Israel, which would cause further stress" between Ankara and Washington, said Serdar Erdurmaz, an arms expert and former Turkish defense-industry executive at the Turkish Center for International Relations and Strategic Studies in Ankara.

Last week, U.S. officials issued statements to scotch speculation in Turkish media that a deadly attack by Kurdish rebels across Turkey's border with Iraq occurred because the U.S. withheld intelligence to

punish Ankara over its friendly policy toward Iran and shunning of Israel.

The recent divisions are a dramatic reversal from the mid-1990s, when Turkey's military turned to Israel to help upgrade its large but poorly equipped military. Turkey was at the time embroiled in a bloody war with Kurdish separatists, and in the late 1990s faced threats of war with both Greece and Syria.

Military contracts followed quickly on two 1996 defense-procurement agreements. Among the known deals were well over \$1 billion in advanced avionics, long-range fuel tanks and cruise missiles to outfit Turkish fighter planes; a deal to upgrade 170 M60 tanks; and another to provide Turkey with unmanned aerial vehicles. The UAVs are still being delivered despite the latest crisis.

Neither side has ever revealed the precise extent of their military relationship. One senior Israeli official said that at its height, Israel's annual military sales to Turkey easily exceeded \$2 billion a year.

"Everything our military had was on the table at one point," said former Israeli Defense Minister Ephraim Sneh, in an interview. "They were one of the top five clients of our defense industry."

Israel's air force used to train at least two or three times a year in Turkey, over wide-open territory that could simulate action over Iran. "The threats to Israel are now coming from a long distance away, so it's important for Israel to be able to train flying long distances," said retired Maj. Gen. Eitan Ben Elياهو, who commanded Israel's air force from 1996 to 2000.

Turkey, for its part, gained from Israeli intelligence. The 1999 capture of Kurdish rebel leader Abdullah Ocalan, who is still in a Turkish prison, was widely attributed to help from Israeli intelligence. Access to Turkey gave Israel's military a perch and listening post on the borders of Iraq, Syria and Iran, some of Israel's most worrisome foes.

Mr. Erdurmaz said the loss of Israel as a partner would hurt Turkish arms firms that have ties there, but not fatally. The companies have "matured" since the 1990s, he said, and because of technology transfers are able to operate and produce much of the Israeli equipment.

## Gillard announces Australian cabinet

BY JAMES GLYNN

SYDNEY—Australian Prime Minister Julia Gillard announced Monday a minor shuffle of the ruling Labor government's cabinet, cementing in place the team she will take to the next election, widely expected to be called within months.

Ms. Gillard, who rode a party revolt last week to oust Kevin Rudd from the country's top job, appointed veteran Simon Crean as minister for education, employment and workplace relations, and gave Foreign Minister Stephen Smith the additional portfolio of trade relations.

Mr. Rudd will be frozen out of the ministry until after the election, at which time Ms. Gillard said she

will "shake" the team a second time.

Ms. Gillard said "she would be absolutely delighted" to welcome

**The minimal shuffle ensures continuity for Labor ahead of what is expected to be a closely fought election, which is expected to be called within months.**

Mr. Rudd into a senior ministerial post if Labor secures a second term.

"This will be a close, hard-fought contest," she said.

Ms. Gillard said she thought time

on the sidelines would allow Mr. Rudd the opportunity to regroup with his family after his sudden toppling in a party coup last week.

The minimal shuffle ensures continuity for Labor ahead of what is expected to be a closely fought election. Freezing out Mr. Rudd will ensure the focus of attention remains on Ms. Gillard during the election campaign, expected to be around five weeks in length.

"I have elected to have as limited a reshuffle as possible, to keep the maximum stability amongst the team," she told reporters in Canberra.

In a seamless transition to office of prime minister since Thursday, Ms. Gillard's promotion has resulted in a sharp recovery in support for

Labor, indicating it is again on track to win a second term at the election.

Finance Minister Lindsay Tanner will remain in his job despite his announcement last week that he won't seek re-election. Mr. Tanner said then he was happy to serve until the election.

Mr. Crean is a former leader of the Labor Party and has held a number of cabinet posts, including as minister for employment in the previous Labor government under Prime Minister Paul Keating. Mr. Crean also was president of the Australian Council of Trade Unions.

"The modest changes I've made to my front bench indicate that my key focus is to have a steady hand, methodical work, delivering for Australians," Ms. Gillard said.

### Returning popularity

Poll results based on a survey taken June 25 to June 27

#### Preferred party\*

Labor	53%
Coalition	47%

#### Who do you think would make the better prime minister?

Julia Gillard	53%
Tony Abbott	29%
Uncommitted	18%

\*Based on a calculation of preference flows at the 2007 election

Note: Telephone polls of 1,142 respondents. The maximum margin of sampling error is plus or minus 3 percentage points.

Source: Newspoll/The Australian