DJIA 10841.21 ▲ 0.05% Nasdaq 2397.41 ▼ 0.06% Stoxx Eur 600 264.79 ▲ 0.99% FTSE 100 5727.65 ▲ 0.88% DAX 6132.95 ▲ 1.56% CAC 40 4000.48 ▲ 1.28% Euro 1.3346 ▼ 0.01% Pound 1.4884 ▼ 0.18%

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WEEKEND JOURNAL

Dubai becomes generous with new debt proposal
HEARD ON THE STREET 18

THE WALL STREET JOURNAL.

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Greek aid plan wins backing

By Charles Forelle
And Marcus Walker

BRUSSELS—The nations of the euro zone backed a deal under which they and the International Monetary Fund would play a joint role in any bailout of Greece.

Agreement on the terms of aid—even without a deal to pull the trigger—is a breakthrough for the 16-country euro zone, which has been riven for weeks with disagreements over how to deal with its fellow member's debt turmoil.

The compromise solution that brings reluctant Germans on board for a possible Greek aid package also puts the wealthy bloc in the embarrassing position of turning to an organization that typically engineers rescues in the developing world.

French President Nicolas Sarkozy and German Chancellor Angela Merkel, who met here ahead of a summit of all 27 EU leaders, reached an accord under which EU nations would direct a potential bailout of Greece—and contribute a majority of its funding—and the IMF would play a supporting role. France and other euro members had resisted bringing in the IMF, but it became evident that was Germany's price for its participation. The accord was later backed by leaders of all the euro-zone countries.

The aid for Greece would not be automatic, European officials said, and would come only if Greece needs it.

The Franco-German compromise gives Greece long-sought specific assurances of European aid—but also preserves for Ms. Merkel the ability to have the final say on whether to pull the trigger: Euro-area countries must agree unanimously before dispensing any aid, according to the agreement.

The text leaves deliberately vague what would constitute a need for aid, saying it would come only as a last resort—as Ms. Merkel has insisted—and if market financing proves "insufficient."

In the end, the need for unanimity means it will effectively be up to Germany to decide whether Greece gets funds.

Greece has argued for weeks that the interest rates of over 6% that it current must pay to borrow money from bond markets are unacceptable. Prime Minister George Papandreou has been pressing his EU peers for weeks to help reduce Greece's borrowing costs.

But a senior German official said high borrowing costs would "certainly" not be enough to trigger the rescue package. "'Insufficient' should not be understood to mean 'uncomfortable' or 'burdensome,'" the official said.

Loans from EU countries would be at rates high enough to prod Greece back to the

Please turn to page 4

Reuters

French President Nicolas Sarkozy and German Chancellor Angela Merkel at the start of an EU leaders summit in Brussels on Thursday.

Dubai to repay creditors in full

Dubai unveiled plans to restructure $23.5 billion of debt for its flagship conglomerate, saying it would recapitalize **Dubai World** and its main real-estate subsidiary with up to $9.5 billion in fresh funding and propose repaying Dubai World creditors over as many as eight years.

By Chip Cummins in Dubai and Ainsley Thomson in London

Markets had priced in expectations that Dubai was leaning toward making creditors whole over the long run. But investors saw the proposal as more generous than anticipated, bidding up local stocks and driving down the cost of insuring against a Dubai default.

"I think it surpasses expectations," said Farouk Soussa, an analyst at Standard & Poor's Ratings Services.

One big question still hanging over the proposal is how the government plans to fund the recapitalization at the heart of the restructuring plan. Dubai said it would use $5.7 billion remaining from a loan made by Abu Dhabi in December. The balance would come from "internal Dubai government resources," according to a statement.

That represents a sizeable commitment at a time when the government itself and other Dubai-controlled entities are facing their own significant debt-repayment deadlines. Dubai borrowed $10 billion in emergency funding from the federal government of the United Arab Emirates in February 2009 and another $10 billion from the government of Abu Dhabi, the capital, in December, to help pay debt and unpaid bills.

Excluding debt from Dubai World and the real-estate developer **Nakheel** included in

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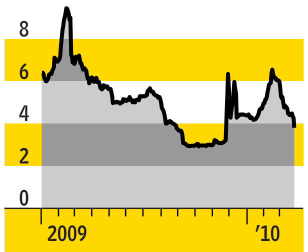
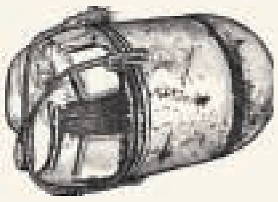
Towering debts

Cost of insuring $10 million of debt against default, in percentage points



Source: Markit

The Quirk



Movie monitors: Eagle-eyed cinema fans catch thousands of film flubs. Page 29

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

The problem with David Cameron. Page 12

FSA suspects made well-timed bets

The Financial Services Authority's clampdown on insider trading this week is shining a spotlight on a small London market that specializes in speculative companies.

By David Enrich, Sara Schaefer Muñoz and Carrick Mollenkamp

Two of the seven men arrested in the FSA investigation appear to have made similarly timed stock purchases ahead of gains in stocks listed on AIM, a 15-year-old **London Stock Exchange** market that specializes in smaller, often untested companies. None of the seven has been charged with a crime.

While firms such as **Goldman Sachs Group** Inc. and **Barclays** PLC dominate sales and trading in London, the business of helping small companies raise money is populated by smaller, British firms attracted to London's access to global cash.

Those firms, little-known outside the City, have carved out a lucrative world by selling and trading shares of oil, coal and biotechnology companies.

A review of public records shows two men by the same names of those arrested—Iraj Parvizi and Ben Anderson—invested in AIM stocks, including two of the same small, thinly traded U.K. companies,

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U.K. must deal with insider trading

[Agenda]

By Patience Wheatcroft

Insider trading used to be perfectly respectable. In the days when the City of London would boast that "my word is my bond," there was a widely held view that it would be silly to deal unless one had inside information. It was only in 1980 that U.K. law moved toward U.S. thinking and made insider dealing a criminal offense.

Yet a lack of prosecutions appear to have encouraged some insiders to continue their trading. In the U.K., share prices have an uncanny knack of bounding ahead in advance of a bid being announced and, far from being a dying habit, it is growing. According to the Financial Services Authority, there were suspicious movements in stocks in 23.7% of bids in 2005, 28.7% in 2007 and 29.3% in 2008.

At last, it seems that some of that prescient activity might be about to be explained. This week the FSA and the U.K.'s Serious Organized Crime Agency swooped down and arrested seven men, with links to a major U.S. hedge fund and a couple of leading European banks. This was the culmination of an investigation that had begun in 2007.

Less than two weeks earlier, a former banker from hedge-fund operator Shore Capital and his wife were charged with 13 counts of insider trading. That case breaks new ground for the FSA since it has, for the first time, sought to extradite a third suspect who was arrested in the Comoros Islands, a French territory off the coast of Africa.

These developments, coming in the same month that a former partner of upmarket stockbrokers Cazenove was jailed for insider trading, demonstrate the FSA is well and truly on the warpath. Chief Executive Hector Sants, who has announced he will be leaving

Bloomberg News

Hector Sants will be leaving the FSA and plans to take a few scalps with him

the organization this summer, clearly intends to take a few scalps with him.

Tracking down insider dealers can be a long and painstaking business. According to Margaret Cole, the director of enforcement at the FSA, there is rarely "a smoking gun" resting in the hand of the culprit. Generally, cases have to rely on circumstantial evidence, which can be extremely

In the U.K., share prices have an uncanny knack of bounding ahead in advance of a bid being announced

complicated. Juries that have eventually to weigh up that evidence can find it confusing. Ms. Cole, a former partner in the U.S. law firm White & Case, has suggested one of the reasons the U.S. appears to have a better track record of penalizing insider dealers is its ability to use plea bargaining.

In the absence of that system in the U.K., the FSA is continuing to look for tools that might help its endeavors. This month it has launched a consultation paper on the taping of mobile-phone calls. Although the organizations that come within the FSA's ambit are obliged to record phone conversations of staff, cellphone conversations are currently exempt from the requirement.

The FSA now argues that with so many business calls being made on cells, the distinction should be abolished and mobiles used for business purposes should also be recorded.

The logic is inarguable but it does beg the question as to why any relatively intelligent insider dealer would be using a business phone of any sort to share information or act upon it. The FSA's stated hope that firms will "take all reasonable steps" to ensure business-related calls take place on phones provided by the employer, and thus taped, sounds destined for disappointment. Those who are tempted to break the rules will, no doubt, be happy to do so on the private phone they have for keeping in touch with the family.

So, while it seems unlikely the FSA will be refused what it deems as another weapon in its battle against the cheats, the estimated £18 million a year costs to the City may not lead to an immediate increase in arrests.

What stands more chance of being effective, though, is evidence of insider dealers being caught and punished. After a career spent at Cazenove, Malcolm Calvert is unlikely to find Her Majesty's prisons congenial lodging places. Should the FSA's latest arrests result in some hefty sentences, then those who may have thought insider trading a relatively risk-free enterprise may have to reconsider.

View from the east

The deputy governor of the People's Bank of China doesn't appear to have shown any particular insights with his comments on European economies. Nevertheless, Zhu Min's reported view that Greece's difficulties might be "just the tip of the iceberg" dealt a nasty blow to the ailing euro.

Mr. Zhu can't have been much impressed with the squabbling that has gone on as the euro countries have tried to work out what to do about Greece's plight.

Even last night, as attempts to put on a show of unity among EU ministers preceded their summit, it was unclear whether the agreement that had been reached between France and Germany amounted to much more than an agreement to postpone further disagreement.

German Chancellor Angela Merkel's determination that the International Monetary Fund must be involved in reshaping Greece's finances has prevailed, even though many of her fellow leaders felt bringing in that organization would be an admission of defeat for the single currency.

It is certainly an admission that the euro project has to be reformed. Ms. Merkel sees the IMF as an ally in her drive to impose tighter discipline on the rest of the euro zone.

Like Mr. Zhu, she is aware that Greece is unlikely to be the only euro country in trouble.

Hence, although she appears to have conceded, there could be funds from euro colleagues to help bail out countries in extremis, but only if the IMF were involved. And she has added a rider that this solution would only be employed if no other were available.

With Portugal's debt now downgraded and Spain looking vulnerable, there is still plenty of scope for Ms. Merkel to argue against Germany digging deep into its pockets.

What's News

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■ **Fed chief Ben Bernanke** nudged the U.S. central bank toward selling some of its $1.25 trillion portfolio of mortgage securities. **9**

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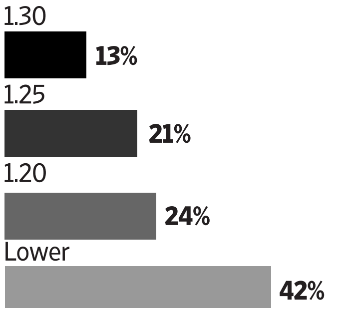

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French arrest for Obama tweet hack

By Max Colchester

PARIS—A Frenchman will face trial after hacking into Twitter accounts, including that of U.S President Barack Obama, a French prosecutor said.

The 24-year-old man from central France was arrested on Tuesday and could face up to two years in prison in France for fraudulent access to a computer system. The arrest followed a joint operation between the Federal Bureau of Investigation and the French police, according to French state prosecutor Jean-Yves Coquillat.

The man, whose name hasn't been release, is charged with having hacked into the **Twitter** Inc. social-networking accounts of famous people. He did this in April 2009 after posing as a site administrator, said Mr. Coquillat. As well as Mr. Obama's account, he hacked into that of the singer Britney Spears, he said.

The man, who used the pseudonym "Hacker Croll," hadn't aimed to profit financially by hacking into the accounts, which people use to post short messages online. Nor did he post anything on the accounts, Mr. Coquillat said. Instead he simply wanted to prove he was capable of hacking into the accounts. Indeed, the technical prowess that so often gets associated with high-profile hacks across borders was absent in this case.

"The man in question had no training in computers," said Mr. Coquillat. "He was just very cunning."

The hacker guessed the "secret" question that companies ask when users forget their password. He spent three hours visiting several Twitter pages before the company was alerted to the problem, Mr. Coquillat said. He took screen shots of the pages he visited and posted them on Internet chat forums, the prosecutor said.

The hacker hasn't yet found a lawyer and an email seeking comment wasn't returned.

The French investigation started after the FBI traced the infraction back to France in August. Earlier this week, three FBI agents coordinated with the French police to arrest the man, who currently lives with his parents in the Puy-de-Dôme of central France, Mr. Coquillat said.

French police brought him in for questioning on Tuesday. He was released on Wednesday evening and will come before a French court on June 24. In addition to prison time he could face a fine of up to €30,000 ($40,000).

A spokesman for the FBI in Paris declined to comment on the case as it is an ongoing investigation.

In December 2009, San Francisco-based Twitter was hit by a cyber-attack that temporarily redirected visitors to a Web site with anti-American messages.

Agence France-Presse/Getty Images

The unemployed 24-year-old man, above. also hacked the account of singer Britney Spears.

Nakheel Sukuk investors to reap big profit

By Margot Patrick
And Ainsley Thomson

Hedge funds and other investors who bought into Dubai government-linked corporate debt at distressed prices are sitting on a mint after Dubai on Thursday said they will be fully repaid under a restructuring of **Dubai World** and its Nakheel unit.

Holders of the Nakheel Sukuks, or Islamic bonds, due in 2010 and 2011 will be paid in full and on time, a far rosier outcome than had been anticipated when Dubai rocked financial markets in November by saying it needed creditors to stay their claims. Only days ago, people involved in the negotiations had said it was unlikely the Sukuks would be repaid in full, and holders faced the prospect of having to wait years to get some money back.

Now, anyone who bought the Sukuks when they were trading at less than half their face value stands to have doubled his investment in just a few months, making it one of the credit market's most profitable trades so far this year.

After Dubai World's announcement in late November that it was asking creditors for a debt standstill, Nakheel's 2010 and 2011 Sukuks plummeted to about 38% of face value from 90% before the announcement, according to data provider Markit.

Two weeks ago, the Sukuks were still trading the distressed prices of about 50% of face value.

The two Sukuks' value surged 25 percentage points following Dubai World's announcement that both would be repaid in full and on time. The 2010 Sukuk now trades at 96.5% of face value, while the 2011 one is at 95.25%, market participants said.

According to Data Explorers Flow Analysis, a company that tracks how much of a company's stock or bonds are out on loan, said there had been little shorting of Nakheel's 2010 and 2011 Sukuk, indicating the market is confident they will be repaid.

However, there still remains one caveat on the full repayment of the Sukuks: It is dependent on the creditors agreeing to the restructuring proposal.

Goldman Sachs economist Ahmet Akarli said the restructuring plan is still lacking in detail and that there remains some uncertainty. "But what is becoming clear is that the U.A.E. authorities are working hard to carefully balance Dubai World's restructuring process and stand ready to commit considerable resources to smooth out any potential financial burden to fall on investors," he said.

—Clare Connaghan contributed to this article.

Dubai World to get $9.5 billion aid, to repay creditors

Continued from first page

the restructuring, Dubai entities still owe another $3.55 billion in publicly disclosed debt this year, according to Standard & Poor's and Wall Street Journal research. Next year, that jumps to $13.29 billion, including a $6 billion facility borrowed by Dubai's main investment vehicle, the **Investment Corp. of Dubai**.

A Dubai government official said the commitments to Dubai World and Nakheel would be made over several years. An advisor to the government said disposals of Dubai World assets could also contribute to the funding, but said that Dubai wouldn't sell assets at fire-sale prices.

The government official declined to comment about any other entities' debt burdens but said the government has "reviewed other situations, and we're comfortable."

Dubai proposed on Thursday to pay back principal owed to Dubai World creditors in full by issuing two tranches of new debt maturing in five and eight years. It said it would pay two, large bonds maturing this year and next, owed by Nakheel, in full and on time and pay other financial creditors of Nakheel 100% of principal by rolling over debt maturities.

It also said it would convert its own sizable lending to Dubai World and Nakheel into equity. In addition to boosting the companies' balance sheets, the move effectively subordinates the government's claims to those of other creditors.

Dubai didn't disclose specific terms of the repayment plan, including what interest it would offer. While the proposal promises to pay 100% of principal, creditors could still suffer losses if interest payments are less favorable than previously agreed.

The coupon on the two new Dubai World tranches, for instance, are likely to be "nominal" and not at commercial rates, according to a person familiar with the situation.

A spokeswoman for KPMG, which represents a lenders' committee, declined to comment. Big lenders include **HSBC Holding** PLC, **Standard Chartered** PLC, **Lloyds Banking Group** PLC and **Royal Bank of Scotland Group** PLC.

Another person familiar with the situation said discussions were continuing between banks and Dubai over the coupon on the proposed new tranches of Dubai World debt. A final deal could still take months, this person said.

Dubai said it would pump $1.5 billion into Dubai World, a conglomerate whose businesses span ports, real estate and private equity. It said it would also convert some $8.9 billion in debt owed by the company to the government into equity.

Dubai said it would also pump $8 billion into Nakheel and convert to equity some $1.2 billion in debt owed to the government. Nakheel, which built Dubai's well-known palm-shaped island, said it would use the money to help pay down its two big bonds, restructure debt with other financial creditors and pay off unpaid bills.

Nakheel said it would offer cash payments, up to 40% of claims, to contractors and suppliers, and pay off the remaining claims by so-called trade creditors with a "publicly traded security." Analysts saw those measures—along with Nakheel's commitment to finish many of its development projects—as a potential stimulus to Dubai's real-estate-dependent economy.

In late November, Dubai shocked financial markets by saying it would ask creditors of Dubai World for a debt standstill. Dubai, which lacks the oil wealth of some of its Mideast neighbors, borrowed heavily to fuel supercharged growth in recent years.

When the global financial crisis hit, a crashing real-estate market triggered a vicious cycle of debt that crippled the government and some of its biggest state-run developers. Companies laid off workers, cancelled or postponed developments and stopped paying contractors.

EUROPE NEWS

ECB gives Greece more time to heal

Trichet doesn't end softened collateral rules for sovereign debt, which would have put Greek bonds close to the edge

BY BRIAN BLACKSTONE AND GEOFFREY T. SMITH

FRANKFURT—ECB President Jean-Claude Trichet kept in place a key lifeline for Greece on Thursday, announcing an extension of the ECB's relaxed sovereign-debt collateral rules past 2010.

The decision gives Greece more time to bolster its debt rating and removes a major uncertainty for Greek banks and other holders of that country's bonds. If the standard ECB rules were put back into force, Greek bonds would be on the cusp of ineligibility. The extension applies to all euro-zone members but Greece is its primary beneficiary.

Greek bonds reacted positively to the extension and to signs that a consensus was building among European leaders over a mechanism to help Greece ahead of a summit in Brussels. Yield spreads on Greek 10-year bonds over safer German equivalents, a measure of risk, narrowed about 0.10 percentage point. Still, Athens still must pay over three percentage points more than Germany to roll over old debt and issue new securities, making its deficit-reduction efforts even harder.

Separately, the ECB said lending to the private sector remains very weak, suggesting minimal economic growth and an absence of inflation. That should keep ECB interest rates on hold at least until the end of the year, economists said.

The ECB plans to keep the minimum threshold in its collateral framework at investment grade level, or BBB-minus, "beyond the end of 2010," Mr. Trichet told the European Parliament on Thursday after hinting earlier in the week that such a change was a possibility. Under old rules, debt needed a rating of A-minus by at least one of three major agencies. Two of them—Fitch and Standard & Poor's—rate Athens below that at BBB-plus. The other, Moody's Investors Service, has it just two notches above at A2.

Mr. Trichet also signaled the ECB won't lend as much against lower-rated bonds as it will against ultra-safe, AAA-rated bonds like Germany's by instituting what he called a "graded haircut schedule," which means discounts would be applied to lower-quality debt.

Economists worry Ireland may prove to be a more troublesome model for Greece and others in Southern Europe.

Thursday's announcement, while not specifically citing Greece, is an about-face for Mr. Trichet, ECB watchers said. Two months ago, Mr. Trichet said, "we will not change our collateral framework for the sake of any particular country. ... That is crystal clear." As recently as Monday, Mr. Trichet signaled that he assumed an extension wouldn't be needed for Greece.

"It's a reputation loss" for Mr. Trichet, said Carsten Brzeski, economist at ING Bank in Brussels, especially after Mr. Trichet's adamant stance against IMF assistance for Greece appeared unable to sway top European officials like German Chancellor Angela Merkel, who insist on joint EU-IMF involvement.

Athens has redeemed itself in Mr. Trichet's eyes since January. A tough package of spending cuts and tax increases aimed at narrowing a nearly 13%-of-GDP budget deficit have been praised as "courageous and convincing" by Mr. Trichet, who has said he expects financial markets to eventually arrive at the same conclusion.

There appears to be little risk that the relaxed rules will lead to inflation via any rapid expansion of lending. Bank lending to the private sector fell 0.4% last month from a year ago, the ECB said Thursday, only a slight improvement from January's 0.6% decline. The broadest gauge of money supply, M3, fell at a record-high rate of 0.4%.

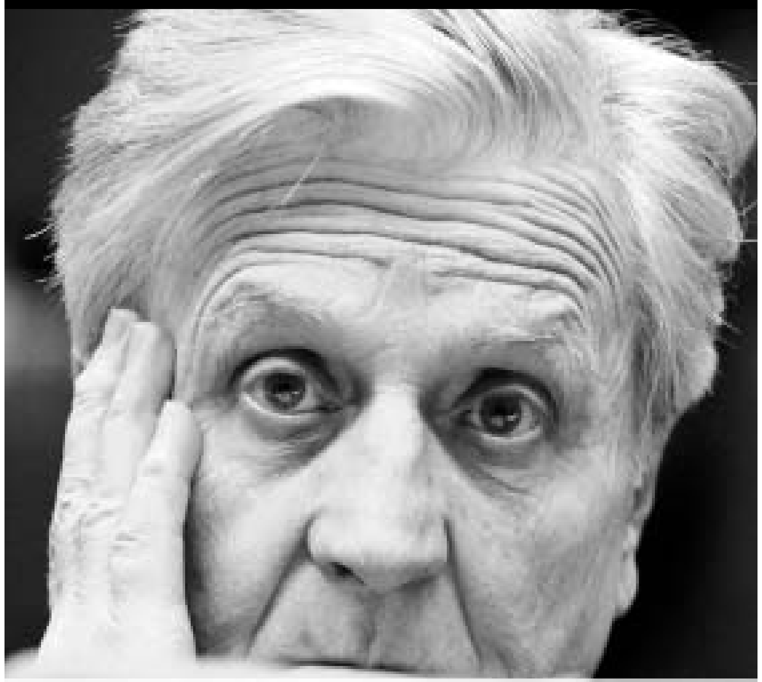
The data are "consistent with very subdued medium term inflationary pressures," said BNP Paribas economist Eoin O'Callaghan. Annual inflation in the 16-member bloc is just 0.9%, less than half the ECB's target of just under 2%.

Fresh economic data from Ireland on Thursday highlight risks to the region's already fragile recovery. GDP plunged nearly 9% on an annualized basis in the fourth quarter, according to calculations based on data from Ireland's statistics office. GDP slumped 7.1% in 2009, the worst in the euro zone.

Ireland has taken steps to cut a double-digit deficit despite its severe recession, earning applause from Mr. Trichet, who on Thursday called Ireland a "role model" for Greece.

But economists worry Ireland may prove to be a more troublesome model for Greece and others in Southern Europe, since cutting deficits may prolong their economic downturns, making it even more difficult to generate tax revenues and cut social spending.

Extending a lifeline



Despite recent downgrades, Greek debt is still several notches above the ECB's relaxed collateral threshold, which the ECB says will be extended.

Euro-zone sovereign long-term debt ratings

Debt rating	MOODY'S	S&P	FITCH	Notches from ineligibility: A-	Notches from ineligibility: BBB-
Germany	Aaa	AAA	AAA	7	10
Italy	Aa2	A+	AA-	5	8
Portugal	Aa2	A+	AA-	5	8
Greece	A2	BBB+	BBB+	2	5

A-: Old collateral minimum; BBB-: Current one under relaxed rules

Source: RBS Global Banking & Markets Photo: Agence France-Presse/Getty Images

European Central Bank president Jean-Claude Trichet, above

Aid plan for Greece would involve EU and IMF

Continued from first page

capital markets , according to the agreement, which gave no figures and said nothing about the size of any financing package. The IMF, which lends under its own rubric, would almost certainly provide better terms for its tranche. The IMF on Thursday declined to comment.

Earlier Thursday, several European leaders, including Spanish Prime Minister José Luis Rodríguez Zapatero, the prime minister of the Netherlands and the finance minister of Austria, had signaled they'd be open to a joint EU-IMF plan.

Aid is deeply unpopular in Germany, which is proud of its fiscal frugality. For others, like France and Luxembourg, which regard the euro as the bloc's greatest creation, defending the currency's stability is an end worth paying for.

Euro zone countries have struggled for more than a month to figure out the means of providing aid, after saying, vaguely, in February that they would do something if necessary. There is no instruction manual for rescuing a euro-zone country nearing default, and the EU's treaties contain provisions restricting countries from assuming their troubled peers' obligations.

Those provisions are largely the result of German resistance, at the common currency's birth, of being importuned to use its hard-won economic muscle to help a less-frugal peer.

Precisely that situation came to pass this year when it became clear Greece, saddled with mounting debt and deficits, might not being to refinance its borrowings at the high rates that markets—newly sensitive to risk—were now charging.

Germany, reluctant to bear a substantial burden in a Greek rescue, held out against aid. But it signaled this week that it would lend support to a last-resort system of loans from stronger countries to Greece. Its price: The IMF had to be involved, too.

A month ago, that was anathema to many on the Continent—particularly the French, who saw it as an admission that the euro zone couldn't handle its own affairs. Luxembourg Premier Jean-Claude Juncker, the president of the council of euro-zone finance ministers, called the idea of IMF involvement "absurd," comparing it to the U.S.'s turning to the fund for a bailout of California. Mr. Sarkozy was reluctant to give a big role to the IMF, whose chief, not incidentally, is a political rival.

But in a sign of Germany's economic sway over the bloc, it got its way. Ms. Merkel, before leaving for Brussels Thursday morning, told the German parliament that she was in favor of an aid plan that "in an

Bloomberg News

PBOC Vice Gov. Zhu Min,

emergency" would include both loans from EU countries and "substantial" help from the IMF.

Ms. Merkel also said that after Greece's debt woes have abated, the 16 nations sharing the euro must reopen EU treaty negotiations to impose tough new measures and sanctions to prevent such crises in the future.

"We've seen that the euro zone's current instruments are inadequate," Ms. Merkel said.

Greece's government deficit hit nearly 13% of gross domestic product last year, way over the 3% limit prescribed by euro-zone rules. Its debt was 113% of GDP, against a 60% limit. Years of efforts by EU officials to nudge Greece into changing its ways have had little effect.

Ms. Merkel said she supported German Finance Minister Wolfgang Schäuble's proposal for a European Monetary Fund, and the power to exclude profligate countries from the common currency bloc—both radical new measures that would require a lengthy ratification process and the approval of all 27 EU member states.

"I will also champion the necessary treaty changes," Ms. Merkel said.

The troubles in Greece, which represents just 2% of the EU's economy, have weighed heavily on the common currency. The euro is off 7% against the dollar since the beginning of the year. It took a hit Thursday in Asia after a top Chinese central banker criticized the EU's handling of Greece.

"Greece is only one case, but it's only a tip of the iceberg," said People's Bank of China Vice Gov. Zhu Min said in a speech in Hong Kong. "We don't see decisive action that tells the market, 'We can solve it, we can close it,' so the market is very volatile," Mr. Zhu said. He said the "main concern today obviously is Spain and Italy."

Those comments followed a downgrade Wednesday in the credit rating of Portugal, another euro-zone member with weak fiscal figures—though not as dire as Greece's. Fitch Ratings cut Portugal to AA-minus and said a further slide was possible if the country doesn't do more to bring down its budget deficit. The Portugal downgrade was a reminder of why the EU is keen to contain Greece's troubles. Spain's deficit last year approached 10% of GDP, and Italy's debt is over 100% of GDP.

Berlin's strong-arming of its EU partners over Greece is leading to open expressions of bitterness by politicians from other euro-zone countries, breaking Europe's diplomatic etiquette.

Luxembourg's Foreign Minister Jean Asselborn told German radio station Deutschlandfunk on Thursday that Germany's mixed messages over Greece have contributed to "a cacophony".

Berlin has simultaneously said Greece won't get aid, that the IMF must be involved, and that Europe needs its own monetary fund, Mr. Asselborn complained. He also took the German government to task for appeasing German voters' antipathy to a Greek bailout.

The EU and its single currency are "a peace project, a community of destiny," an emotional-sounding Mr. Asselborn said, adding Germany has a duty to act if a fellow euro member needs help.

—Andrea Thomas, Adam Cohen and Aries Poon contributed to this article.

EUROPE NEWS

Europe's next great test: a competitiveness crisis

[Brussels Beat]

By Stephen Fidler

European leaders may have bought some time by backing in principle a bailout for Greece, but even if the money is handed over, it will be no silver bullet for Greece or for the euro zone.

That's because the euro zone's problems are not limited to Greece and not solely related to government debt and budget deficits.

Right now, Greece's debt burden is unsustainable. With government debt equivalent to more than the country's annual output and the government paying close to 6.5% to borrow money, Greece's debt burden is not just growing but accelerating dangerously.

The best a bailout can do is to buy time to reduce those interest rates to give the government time to slash its deficits and set the debt on a downward path.

Yet it is the euro zone's second challenge that is at once more widespread and more intractable. That is the euro zone's competitiveness challenge: structurally weak economies, in Southern Europe and elsewhere, locked by a common currency to Germany's low inflation rate and economic stringency.

Though it may not have been evident to politicians or populations at the time, governments joining the euro were tying themselves to the modern equivalent of the gold standard, the monetary link to the yellow metal that guided the international financial system for more than a century.

In what may be a depressing parallel for the euro zone, that arrangement was ended by the Great Depression of the 1930s. And the lesson that many economic historians have drawn from that era was that sticking to the gold standard was a hugely painful and ultimately unsuccessful strategy.

"The historical record seems very clear," says Nicholas Crafts, an economics history professor at Warwick University. "In the 1930s, the countries that left the gold standard early did better on average than those who left it later."

The U.K. abandoned the gold peg in March 1931, while Scandinavian countries left in the same year. For those countries that left later, the U.S. in 1933 and France only in 1936, economic recovery was delayed.

In a world of free movement of capital, the gold standard meant that governments couldn't set interest rates independently.

Responding through an expansionary fiscal policy was regarded as unorthodox and likely to be punished by outflows of gold—which would be deflationary. The only economic adjustment left was to push wages downward to reduce costs and increase exports. Most countries found that easier to accomplish by devaluation than by a process of forcing workers to accept lower wages.

There is a parallel with the current economic problems of the countries of Southern Europe. Interest rates are set in Frankfurt by the European Central Bank. Governments have very limited capacity for a more expansionary fiscal policy because bond investors would likely react by further pushing up government borrowing costs.

As for devaluation, this would be a more difficult option in the euro zone than it was under the gold standard. Given that domestic contracts and most international debt is in euros, debt default and a financial and banking crisis would almost certainly ensue.

"The euro exchange rate is a tighter grip than the gold standard was," says Mr. Crafts.

Whether devaluation would work, as it did in the 1930s, would depend on how wages reacted. If a sliding currency set off a round of wage increases, as some economists think it would, it would yield no competitive advantage.

That would mean the only practical prospect is for economies to regain their competitiveness against Germany, which has been the low-inflation anchor of the euro, the hard way.

Unless the European Central Bank deliberately relaxed monetary policy to set off a round of inflation—very unlikely—the alternative is for Greece and the other uncompetitive southern economies to embark on wage cuts that push inflation lower than Germany's over many years.

That is a gloomy prospect for governments and populations.

Greece's budget problem is the one that the architects of the euro thought about in the early 1990s. To stop it, they created rules, enshrined in what they called the Stability and Growth Pact, to limit annual budget deficits to 3% of gross domestic product and government debt to 60%.

The rules weren't followed, in part because governments couldn't agree to enforce them.

The competitiveness problem—afflicting Spain, for example—is one that they didn't consider. Only now is Europe beginning to talk about it, as a letter this week to European leaders from EU President Herman Van Rompuy shows.

"While budgetary developments have been monitored under the Stability and Growth Pact, insufficient attention has been given to divergences in competitiveness within the EU economies and externally," he wrote.

"The need for policy action is particularly pressing in member states showing persistently large current account deficits and large competitive losses."

He didn't spell out either how this change would come about, what variables would need to be monitored and how it would be enforced.

It's a start, but too late to help extricate countries from their current predicament.

Agence France-Presse/Getty Images

Yanukovych offered a plan to smooth gas flows to Europe via a trans-Ukraine pipeline, seen here near Romania in January.

Kiev offers pipe deal

Ukraine, seeking gas price cut, says Russia could help run pipeline

By Richard Boudreaux And James Marson

MOSCOW—Ukraine has offered Russia a share in the management of a network of pipelines that carry Russian gas westward across its territory, a move that could head off midwinter price disputes and gas cutoffs that at times leave European homes without heat.

As the two countries' prime ministers met Thursday to open talks on the offer, Russia indicated it would consider giving Ukraine what it wants in return, a lower price for its own gas imports.

"We agreed that no issue is closed to us," Russian Prime Minister Vladimir Putin told reporters after a meeting with his Ukrainian counterpart, Mykola Azarov. Mr. Putin called the two countries' gas contract "balanced" and profitable for Russia but agreed it could be reviewed.

"If we aim to reconsider the price, the question is what we will get in return," Mr. Putin said.

Officials of both countries say tough negotiations lie ahead, despite warmer ties ushered in by Ukraine's election last month's of Moscow-friendly president Viktor Yanukovych. Mr. Yanukovych takes over after years of sparring between the Kremlin and pro-Western leaders of Ukraine's 2004 Orange Revolution.

Those tensions led to three gas wars between Russia and Ukraine and disruptions of supplies to Europe, which gets about one-fifth of its gas through Ukraine.

Russian officials welcomed Mr. Yanukovych's election while defending a 10-year gas pricing agreement that he has vowed to undo. The 2009 accord phased out subsidies and now obliges Ukraine to pay European prices, $305 per 1,000 cubic meters, for Russian gas. It is a burden that Mr. Yanukovych says Ukraine's economy, which shrank 15% last year, cannot bear.

Mr. Yanukovych is seeking a one-third reduction in that price, which would save Ukraine about $30 billion a year. He campaigned on the promise that he could achieve a lower price by giving Russia a stake in its pipeline network.

The plan would bring in Russia's gas monopoly OAO Gazprom and a European company, as yet undesignated, to pay for upgrading the network. Each would get a one-third share of a management consortium that would operate the pipelines under a Ukrainian government concession.

Russia and Ukraine explored a similar arrangement in 2002, but the idea died when the Orange Revolution leaders came to power and balked at giving Russia control of the pipelines.

In reviving the idea, Ukraine's new leaders have emphasized that the state would retain ownership of the pipelines. But the issue of Russian influence is sensitive in a country mindful of its long domination by Moscow.

"Handing over management of the gas transport system is the same as handing over management of Ukraine," said former Prime Minister Yulia Tymoshenko, who lost the election to Mr. Yanukovych.

Such opposition in Ukraine makes Russian officials wary, said Alexander Burgansky, head of oil and gas research at Renaissance Capital in Moscow. "They have a huge interest in Ukraine's pipelines, because they want to make sure their customers in Europe get their gas," he said. "But they are cautious because Ukraine proved in the past to be an unreliable partner."

Valery Yazev, Russia's deputy parliament speaker and also Gazprom's chief lobbyist, said the company was interested in managing Ukraine's pipelines but was reluctant to agree to price reductions that would cause the company to incur losses.

—Jacob Gronholt-Pedersen in Moscow contributed to this article.

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De Villepin to launch new party

As France's 2012 vote approaches, former premier says he offers an 'alternative' to Sarkozy's policies

By David Gauthier-Villars

PARIS—Former French Prime Minister Dominique de Villepin said he will launch a new center-right political party, a move that could split French conservatives and hurt President Nicolas Sarkozy's chances of re-election.

With the 2012 presidential election in sight, Mr. de Villepin said in a speech Thursday that he represents "an alternative" to Mr. Sarkozy, whose ruling conservative party was trounced in last week's regional elections.

"I can't do miracles but I believe in France," said Mr. de Villepin, a lawyer, who is still a member of Mr. Sarkozy's party, the UMP, or Union pour un Mouvement Populaire.

The 56-year-old Mr. de Villepin's defining moment came in 2003, when as France's foreign minister he gave a speech to the United Nations urging the U.S. not to invade Iraq. He is returning to the political arena two months after he was acquitted in a slander trial in which Mr. Sarkozy was a plaintiff.

A comeback by Mr. de Villepin could complicate the president's efforts to push through unpopular measures, such as raising France's retirement age, during the remaining two years of his mandate.

Mr. de Villepin said his rival was headed in the wrong direction on all issues. Mr. Sarkozy has reduced some taxes, hoping this would help energize France's economy. But Mr. de Villepin called Thursday for higher income and corporate taxes to help narrow the gap between rich and poor. While Mr. Sarkozy is cutting civil-service jobs, saying France needs to slim down its bulging state sector, Mr. de Villepin said the French need more state nurses, teachers and policemen.

Mr. Sarkozy has proposed anchoring France's secular values by banning the head-to-toe burqa worn by some Muslim women. Mr. de Villepin said it was dangerous to stigmatize a particular community. "I don't feel at ease with the policies being conducted by the majority," Mr. de Villepin said.

His tenure as prime minister from 2005 to 2007 was marred by a failed attempt to pass a bill aimed at easing the entry of young people into the job market with a contract that would make it easier to hire and fire people. The proposal caused such a popular uproar that then-President Jacques Chirac dropped the bill.

But Mr. de Villepin said Thursday that he had changed his mind, and no longer believed loosening labor laws would help create jobs. "If we want French people to accept taking risks, we must provide them with guarantees," he said.

Mr. de Villepin, who has never been elected to political office, said his "inexperience" wouldn't be a drawback because he had "vision."

A presidential bid by Mr. de Villepin could cause a rift within the UMP. It would put the two men on a collision course, 15 years after their mentors—former Prime Minister Édouard Balladur for Mr. Sarkozy and Mr. Chirac for Mr. de Villepin—fought in the 1995 presidential election.

French conservatives have traditionally split into two main factions: One heralds Gen. Charles de Gaulle's heritage of heavy government intervention, while the other, closer to Christian Democratic parties in countries such as Germany, favors free-market policies. The creation of the UMP in 2002 was an attempt by Mr. Chirac, soon after his re-election, to unite the groupings that form the French right.

Mr. de Villepin said he would formally create and announce the name of his party on June 19—a day after the anniversary of Gen. de Gaulle's "Appeal of June 18" in 1940, when he called on the French people to resist the German occupation.

Associated Press

Former Prime Minister Dominique de Villepin, in Paris on Thursday, said he is launching a new center-right political party.

U.K. budget's tough cuts

By Laurence Norman

LONDON—The Institute for Fiscal Studies, a U.K. think tank, laid out the pain that could lie ahead for the governing Labour Party if it wins the upcoming election.

In a report, the institute said inflation-adjusted central government spending cuts would need to total some £46 billion ($68.46 billion) by the fiscal year ending March 2015, down 3.1% in each of the four fiscal years from 2011 through 2015 in real terms, or adjusted for inflation. That implies cumulative spending cuts of some 11.9% in real terms in the period.

IFS Director Robert Chote offered some praise for the proposed budget, which he said didn't include large giveaways to voters weeks before the election. He called it the "most parsimonious" pre-election budget in more than 20 years. But he said that "judged against the more testing yardstick of providing a detailed picture to voters and financial market participants of the fiscal repair job in prospect beyond the election, the budget will have fallen short of many people's hopes."

In an acknowledgment of just how painful cuts will be for Britons, Chancellor of the Exchequer Alistair Darling didn't deny an assertion during an interview on the British Broadcasting Corp. that Labour's planned spending cuts would be "deeper and tougher" than the cuts pushed through by former Prime Minister Margaret Thatcher in the 1980s, during a government the U.K. still associates with steep cuts.

Mr. Darling's admission is in contrast to the Labour government's election campaign line, proved popular with voters, that it will protect public service more than the opposition Conservative Party. The Conservatives leapt on the admission with the party's treasury spokesman George Osborne saying it "blew apart" the Labour claims on spending cuts. "Labour has been found out," he said.

In his budget announced Wednesday, Mr. Darling trimmed his projected net borrowing targets for the coming years and reduced his predictions for the structural deficit—the budget gap left when the economy returns to growth.

Prime Minister Gordon Brown's government has said it will protect certain departments from spending cuts, including education, overseas aid and health. The institute said if the government sticks to those goals, spending from "unprotected" departments would have to be cut between 5.3% and 7.1% in each fiscal year from 2012 through 2015.

A Treasury spokesman didn't comment on the IFS figures, but said the government has "already set out over £20 billion of savings and cuts to go towards reducing borrowing and protecting front-line services, even before a full spending review is held."

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Europe and U.S. update open-skies agreement

By Carolyn Henson And Josh Mitchell

European Union and U.S. negotiators secured a new draft deal Thursday to liberalize trans-Atlantic air travel and preserve their existing pact. The two sides hope to finalize by June a pact that skirts the issues that have divided them in over a decade of talks, but keeps the improved access airlines gained in the existing 2007 agreement.

Negotiators faced a November deadline to reach a new deal or face a termination clause that could have seen some the withdrawal of some route rights, notably to and from London's Heathrow Airport.

If approved by EU transport ministers and the U.S., the second-stage deal would neutralize a termination clause that could have unwound their existing 2007 pact.

The second-stage open-skies deal charts a "process" for lifting restrictions on airline ownership and domestic market access that the EU has sought from the U.S. but stopped short of making any commitments. U.S. lawmakers and labor groups vehemently oppose any such changes.

Similarly, the EU agreed to try to ease restrictions on night flights at some airports in the region, but still lacks the authority to enforce restrictions.

The new deal would include efforts to move toward allowing majority control by overseas investors, but U.S. lawmakers are expected to continue their resistance to any such move.

John Byerly, the U.S. deputy assistant secretary of state for transportation affairs, said the pact gives U.S. carriers more protection against rules in EU cities restricting night flights.

The deal "will fulfill the mandate from President Obama" to meet to deadline for having a second phase of the open-skies pact in place by this year, Mr. Byerly said.

The pact also foresees increased cooperation on regulatory and environmental matters, as well as a "social dimension" stressing the importance of "high labor standards" in the industry.

—Josh Mitchell and Daniel Michaels contributed to this article.

EUROPE NEWS

Vatican defends pope over U.S. abuse case

By Stacy Meichtry
And Joe Barrett

VATICAN CITY—The Vatican on Thursday defended Pope Benedict XVI's handling of a sex-abuse case involving a priest who allegedly molested hundreds of students decades ago at a Milwaukee school for the deaf.

In unusually swift response to a report in The New York Times, the Vatican's official newspaper, L'Osservatore Romano, published a front-page editorial, denouncing "the evident and ignoble intent to wound Benedict XVI and his closest advisers at any cost."

Meanwhile, a group of Americans who say they were sexually abused by clerics staged a news conference outside St. Peter's Square in Rome to denounce the pope's handling of the case and gave reporters what they said were church and Vatican documents on the case, the Associated Press reported.

Italian police detained four Americans for two and a half hours because they lacked a permit for the news conference and suggested they get a lawyer in case a judge decided to press charges, the Americans said.

In a report based on internal church records published Tuesday, the Times disclosed that Benedict XVI, who was then Cardinal Joseph Ratzinger, failed to heed 1996 queries from the Archdiocese of Milwaukee seeking advice on whether to defrock the Rev. Lawrence Murphy, a priest in the archdiocese, despite decades of Church documentation detailing the priest's alleged sexual abuse. Father Murphy, who died in 1998, never faced criminal charges in connection with his alleged abuse.

In the editorial, the Vatican newspaper responded that there "has been no cover-up," adding that "the prevalent tendency in the media to obscure facts and force interpretations with the aim of spreading an image of the Catholic Church as if it were the only one responsible for sexual abuse, an image that doesn't correspond with reality."

Diane McNulty, a spokeswoman for the New York Times, said the article "was the result of meticulous reporting. Some of the particulars were confirmed by the church, and so far no one has cast doubt on the facts we reported."

The scrutiny of Benedict XVI's response to Father Murphy's case is the latest chapter in a global sex-abuse scandal involving priests that is engulfing Benedict XVI's papacy. The Vatican has been on the defensive for weeks as hundreds of allegations of abuse have surfaced across Europe, including the pope's homeland of Germany. The pope recently issued an apology to Catholics in Ireland where thousands of abuse cases have been documented in recent years by government-appointed investigators.

In the Milwaukee case, lawyers for Father Murphy's alleged victims obtained extensive documentation of correspondence between the archdiocese and the Vatican's Congregation for the Doctrine of the Faith, the office headed by the then-Cardinal Ratzinger.

The lawyers have filed four lawsuits against the Archdiocese of Milwaukee for allegedly failing to take sufficient action to stop Father Murphy. Starting in the early 1970s, archdiocese officials began receiving reports from students at a school for deaf children that Father Murphy ran from 1950 to 1974, according to the documents.

Allegations from about 200 children were eventually reported to the archdiocese, according to the documents. Allegations of sexual abuse were also reported to Milwaukee police, but charges were never brought against the priest.

Father "Murphy's actions were criminal and we sincerely apologize to those who have been harmed," the Archdiocese of Milwaukee said in a statement Thursday, encouraging potential victims of Father Murphy to report any alleged abuse. The archdiocese didn't address the lawsuits or the Vatican's handling of the alleged abuse cases.

Associated Pressx

Protesters near the Vatican show images of people they called abuse victims.

Spain nears charges against noted judge

Associated Press

MADRID—Spain's Supreme Court cleared the way Thursday for the judge known for indicting Osama bin Laden and Augusto Pinochet to be charged with abuse of power in a probe of Spanish civil-war atrocities.

The decision by a five-judge panel to continue the case is a stinging setback for Judge Baltasar Garzón, a deeply polarizing figure who is accused of knowingly overstepping the bounds of his job in 2008 by investigating the atrocities.

Judge Garzón, 54 years old, denied any wrongdoing, saying he would "continue to defend my absolute innocence."

The ultimate decision on whether to charge and put Judge Garzón on trial is up to an investigating magistrate at the Supreme Court. That judge, Luciano Varela, said in a ruling in February that Judge Garzón consciously ignored an amnesty decreed by Parliament in 1977 for civil war-era crimes. Judge Garzón appealed that ruling, denying any wrongdoing.

Thursday's decision rejecting his appeal allows the case to proceed and puts it back in the hands of Judge Varela, whose call has the potential to end Judge Garzón's career.

Judge Garzón, who has prosecuted Islamic extremists, Basque separatists and Argentine "dirty war" suspects, is arguably one of Spain's most divisive figures.

Over the past decade, he gained fame world-wide as the most prominent symbol of Spain's doctrine of universal jurisdiction, which holds that heinous crimes like torture or terrorism can be tried in the country even if they had no link to Spain.

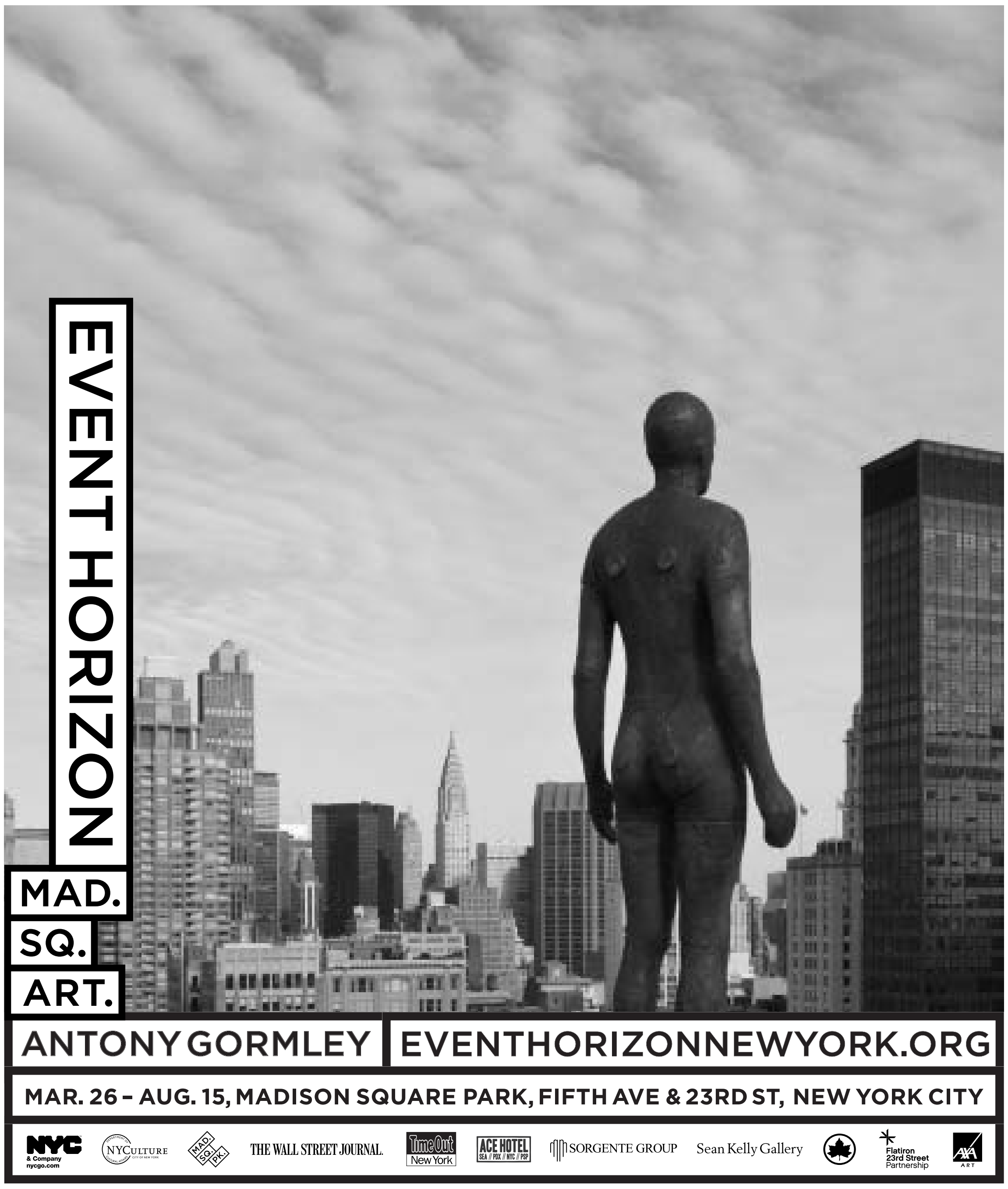

Reuters

Spanish Judge Baltasar Garzón

Judge Garzón's aborted probe centered on the killings of tens of thousands of civilians by supporters of Gen. Francisco Franco during the 1936-39 civil war and in the early years of his right-wing dictatorship.

An obscure far-right group called Manos Limpias, or Clean Hands, filed a complaint against Judge Garzón for having launched the probe and the Supreme Court agreed to study it.

If Judge Garzón is convicted of knowingly acting without jurisdiction, he can be suspended from the bench for 10 to 20 years.



U.S. NEWS

Health-overhaul bill nears final vote

U.S. Senate sends bill of fixes to House after marathon series of votes on amendments; 'this is a game changer'

By Patrick Yoest

WASHINGTON—A bill containing important tax and Medicare changes to the $938 billion health-care overhaul law passed the U.S. Senate on Thursday. The bill was returned to the House for a second vote before heading to the White House.

By a 56-43 vote, the Senate passed the supplemental bill, which rewrites several provisions of a broader health-care overhaul signed into law earlier this week. The bill of fixes was already approved Sunday in the House, but it will require another House vote because Senate Republicans successfully argued that two minor student-loan provisions should be struck from the measure.

Senate rules attach special requirements to bills considered under budget reconciliation—a fast-track legislative tactic that has been deployed by Democrats to pass the bill. Senate parliamentarian Alan Frumin ruled early Thursday that the two provisions must be stripped from the bill, after Republicans pointed out that they would have minimal revenue effect and were therefore extraneous.

The bill, removed of the two provisions, was passed after senators held a marathon series of votes on amendments to the measure. In all, 42 votes were held on the measure in the Senate before it was passed.

Associated Press

Majority Leader Harry Reid speaks at a news conference Thursday, after the Senate passed the bill by a vote of 56-43.

All Republicans present opposed the measure in the final vote, while only three Democrats voted against it: Arkansas Sens. Blanche Lincoln and Mark Pryor, and Nebraska Sen. Ben Nelson.

The House was expected to take up the bill later Thursday and will almost certainly pass it.

The votes will culminate a precarious, but ultimately successful strategy put into motion after Democrats lost their filibuster-proof majority in the Senate with the January election of Sen. Scott Brown (R., Mass.).

While a larger health-care bill signed into law by President Barack Obama on Tuesday had already been approved in the Senate before Mr. Brown's victory, the second, smaller bill was devised to accommodate changes sought by House Democrats to the original bill. The nonpartisan Congressional Budget Office estimates that, together, the bills will extend insurance coverage to 32 million Americans.

"This is a game changer even more than Medicare and Social Security [were]," said Senate Finance Chairman Max Baucus (D., Mont.).

Perhaps most notably, the bill Thursday would scale back an excise tax on high-cost health insurance plans and delay its effect until 2018. Another provision would make the legislation's subsidies to purchase private insurance more generous.

With the loss of a Senate seat in the Massachusetts special election, Democrats currently hold a 59-41 majority in the Senate, while 60 votes are needed to break a filibuster. So they moved to pass the second bill under budget reconciliation, which allowed them to bypass a filibuster and pass the measure by a simple majority of 51 votes.

The reconciliation bill closes a politically unpopular gap in prescription-drug coverage under Medicare, the federal health-insurance program for seniors.

House Democrats emphatically opposed a provision in the first bill that would give Nebraska aid to pay for all of the costs of an expansion of the low-income Medicaid program. In the reconciliation bill, that provision was extended to all states.

Republicans sought to scuttle the reconciliation bill by amending it, which required the long string of votes on the measure. Their amendments ranged from symbolic to substantive, but Democrats were able to defeat every one of them.

—Corey Boles contributed to this article.

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Palin's fans uneasy as she backs McCain

By Tamara Audi

PHOENIX—Like many of his fellow Tea Party activists, Lee Earle adores former Alaska Gov. Sarah Palin. But when Ms. Palin shows up at a pair of rallies in Arizona on Friday and Saturday, he won't be attending.

That's because Ms. Palin is coming to stump for her former running mate, Sen. John McCain. Mr. Earle is backing J.D. Hayworth, Mr. McCain's challenger in the Republican primary. Mr. Hayworth, a former congressman and talk-show radio host, has also become a darling among some in the Tea Party movement.

"Most of the Tea Party people I know are disappointed with her decision" to support Mr. McCain, says Mr. Earle. "But we understand she's fulfilling an obligation to Sen. McCain for pulling her from obscurity."

Associated Press

Sarah Palin in Florida in February.

While Ms. Palin is in Tucson on Friday, Mr. Earle will be at an anti-tax rally in Phoenix with tax protester Samuel Joseph Wurzelbacher, "Joe the Plumber," who gained fame during the 2008 election. When Ms. Palin is in Mr. Earle's hometown of Phoenix Saturday, Mr. Earle will be at a Tea Party event 30 miles away. "But I still love Sarah," he says.

Mr. Earle's position illustrates how much the political order has been transformed since the last election. While Mr. McCain was the Republican nominee for president in 2008, he is now fighting off an aggressive primary challenge in a state he has represented since 1983.

A Rasmussen Report released March 18 shows Mr. McCain ahead by seven points, with a margin of error of plus or minus four points. Earlier polling had showed Mr. McCain ahead by 22 points.

Bringing in Ms. Palin is a slightly awkward move by the McCain camp. Since the presidential campaign ended, McCain aides have aired a lot of dirty laundry about the former running mate.

However, neither Ms. Palin nor Mr. McCain has criticized each other directly. Mr. McCain's campaign is banking on Ms. Palin's visit to help capture some of the political energy generated by the Tea Party movement, which advocates limited federal government.

—Laura Meckler contributed to this article.

Reuters

Federal Reserve Chairman Ben Bernanke testifies before a House panel in Washington on Thursday.

Fed closer to asset sales

Bernanke shifts toward support of effort to get policy back to normal

By Jon Hilsenrath

Federal Reserve Chairman Ben Bernanke nudged the U.S. central bank Thursday toward gradually selling some of its $1.25 trillion portfolio of mortgage securities, an idea he had been lukewarm about before.

Mr. Bernanke's stand on the issue is important to millions of U.S. homeowners and many investors because sales of the securities could push down their prices and push up mortgage rates. Still, Fed officials are tiptoeing in that direction as a way to gradually get monetary policy back to normal.

"I anticipate that at some point we will have a gradual sales process," Mr. Bernanke said at a House hearing.

The Fed has been buying mortgage-backed securities guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae since December 2008 to help drive down mortgage rates and spur a housing recovery. In addition to the $1.25 trillion in mortgage-backed securities, the Fed has soaked up $175 billion of the big mortgage firms' debt, which could be part of an asset-sales program.

Fed officials have been debating for several months whether to sell the assets as the economy heals. The large mortgage portfolio makes it harder for the Fed to manage short-term interest rates because buying the securities meant flooding the financial system with cash. Because of all that extra cash in the system, it might be hard to get banks to lend it out at higher rates when the Fed wants to raise them.

Mr. Bernanke made clear that he was in no rush to act. Economic data released Thursday pointed to a firming job market. The number of Americans who started lining up for unemployment benefits fell by 14,000 to 442,000 last week, the third decline in the past four weeks.

However, inflation data have moderated recently. That gives the Fed reason to keep short-term interest rates near zero for "an extended period," central bank shorthand for at least several more months.

Mr. Bernanke's views about mortgage-securities sales appear to have shifted at the Fed's policy meeting in mid-March.

Before the meeting he said, "I currently do not anticipate that the Federal Reserve will sell any of its security holdings in the near term, at least until after policy tightening has gotten under way and the economy is clearly in a sustainable recovery."

In his latest testimony, he dropped those words, and said the timing of such sales would depend on "economic and financial developments and on our best judgments."

The Fed has more than $2.3 trillion in assets. Before the crisis, it had less than $1 trillion, a level Mr. Bernanke says he wants to return to over time.

The Fed has already decided to let about $200 billion of its mortgage securities mature without being reinvested by the end of 2011, which will help shrink its holdings. But because many of its securities mature in as much as 30 years, a natural unwind could take decades.

The Fed chairman was careful to reassure lawmakers that when the Fed does sell securities, it will do so gradually and cautiously. If the economy weakened, he added, the Fed wouldn't sell.

The housing sector is still fragile. Data on home prices, after firming last year, have begun to soften and sales figures have weakened.

Mr. Bernanke offered an upbeat assessment of the health of the mortgage market. "We do believe that mortgage markets are performing better," he said, adding that there's been "very little negative reaction" in markets as the Fed has stopped buying mortgage securities. Housing more broadly has become more affordable as home prices and mortgage rates have come down, he added.

Iran's regional ambitions fuel concerns in the U.S.

[Capital Journal]

By Gerald F. Seib

Afghanistan, site of many a surrealistic scene over the years, produced another one earlier this month.

U.S. Defense Secretary Robert Gates visited the Afghan capital of Kabul, asserting along the way that Iran next door was trying to undermine the American effort to bolster Afghanistan's leaders. Iran's mischief, Mr. Gates indicated, includes providing at least some arms and money to the Taliban fighters trying to kill American soldiers in Afghanistan.

As soon as Mr. Gates left Kabul to visit some of those American troops in the field, another visitor arrived—none other than Mahmoud Ahmadinejad, president of Iran. Afghan President Hamid Karzai gave the Iranian leader a warm welcome, called Iranians his "brothers" and stood by quietly as Mr. Ahmadinejad publicly suggested that American soldiers—the very soldiers fighting and dying to keep Mr. Karzai in power—had no business being in Afghanistan at all.

American officials play down the significance of Mr. Karzai's symbolic embrace of Iran's leader, describing it as the sort of thing he has to do to cope with a powerful neighbor that isn't going away.

Still, the byplay illustrates why Iran's nuclear program isn't the only Iranian problem American leaders have to worry about. The broader concern is Iran's interest in becoming a more powerful regional player able to eclipse Western interests in the area.

Indeed, Iran's nuclear program may be most worrisome precisely because a nuclear-armed Iran would be even better able to intimidate its neighbors and expand its influence.

America's post-9/11 wars in Iraq and Afghanistan have only made it easier for Iran to spread its wings in the region. Whatever else one may think of those conflicts, one of their unfortunate side effects was to eliminate nettlesome opponents on two of Iran's borders.

To the west, Iraq's Saddam Hussein, for all his grievous sins, was the most powerful counterweight to Iranian influence in the neighborhood. He's gone now, replaced by an embryonic Iraqi democracy whose most prominent leaders have a history of working with, rather than battling, Iran.

To the east, Afghanistan's Taliban regime, before it fell to American forces, was another needle in Iran's side. The Taliban's brand of Sunni extremism was distasteful to Iran's Shiite leaders, while Taliban mistreatment of Shiites and ethnic minority groups sent refugees fleeing into Iran and produced a tense border for Tehran to worry about.

Now, of course, Iran has to worry instead about tens of thousands of American troops next door in Afghanistan. But Iran's leaders, like those in Afghanistan itself, know those American soldiers won't be around forever, and the question is whether Iranian influence will fill the vacuum when GIs begin to depart Afghanistan next year.

Thus, one of the more intriguing subplots playing out amid the new American offensive in Afghanistan is what kind of relationship Mr. Karzai's government will develop with Tehran.

On the one hand, there is the concern Mr. Gates articulated, that Iran is trying to undermine the American effort to build a stable Afghanistan friendly to the West.

Mr. Gates accused Iran of playing a "double game" in Afghanistan, trying to maintain good relations with Mr. Karzai's government while simultaneously seeking to undermine the American and other international forces trying to build up that same government.

Other U.S. officials said the aid coming from Iran includes provision of weapons, training and ammunition to the Taliban, as well as some financing.

Yet the Iranians also appear to be taking care not to be too provocative. Mr. Gates described the Iranian support to the Taliban to be at a "relatively low level." Other officials say that, significantly, U.S. forces haven't seen signs that Iran is providing the Taliban the so-called explosively formed penetrator devices, which insurgents in Iraq have used to damage American armored vehicles.

Moreover, some analysts argue that Iran and the U.S. actually share the same long-term goal in Afghanistan, which is to see a stable government emerge. For the U.S., achieving that goal is crucial to ensure that al Qaeda and other extremist groups don't regroup in an Afghan power vacuum. For Iran, it's important to ensure a stable border free of both refugee problems and drug trafficking.

In fact, George Gavrilis, a fellow at the Council on Foreign Relations, argued in a paper last year that Iran has, overall, behaved responsibly toward Afghanistan. "Iran works furiously to protect its vast boundary with Afghanistan, responds to unrest in its border provinces with an iron fist, and avoids major intrigues in Kabul," he wrote.

As a result, Mr. Gavrilis argued, "it's high time for the United States to engage Iran over Afghanistan in a way that is public, decisive, and comprehensive. Strategic cooperation is possible because the United States and Iran have converging interests and common aversions in Afghanistan."

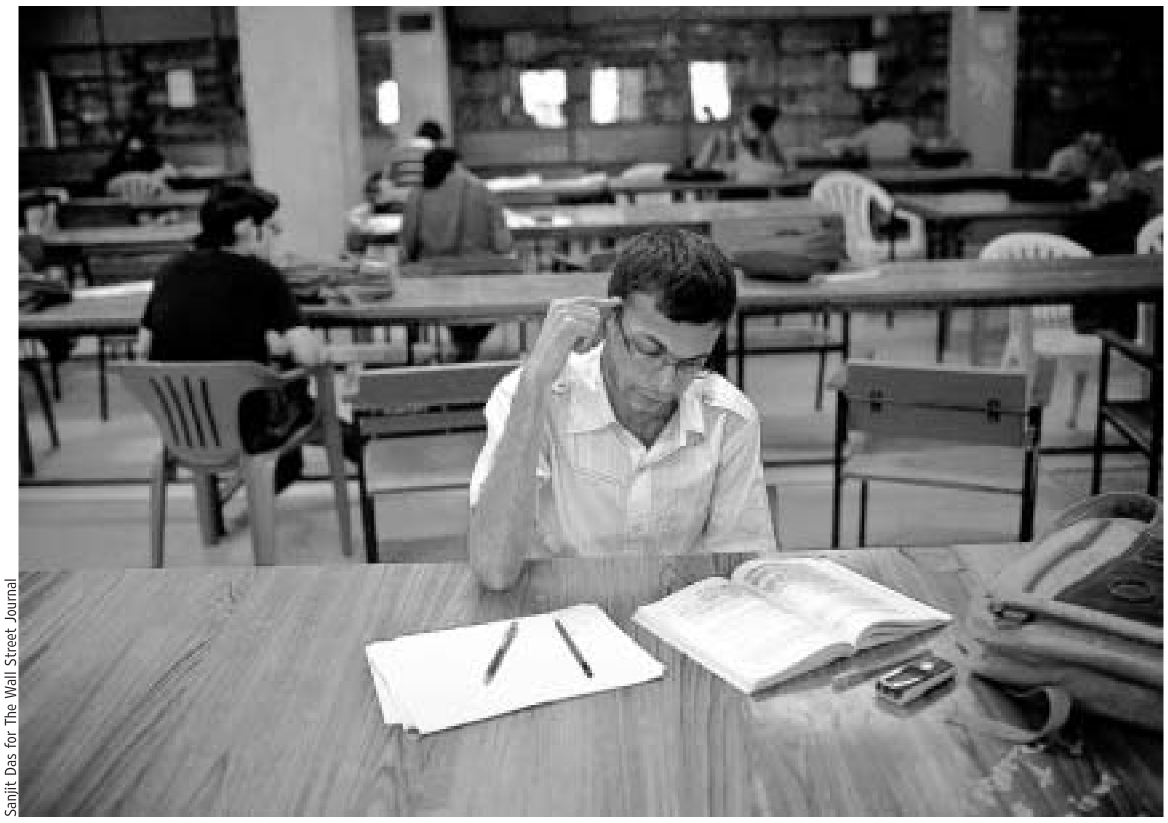
Given the current state of tensions over Iran's nuclear program, that kind of engagement seems unlikely now. In the long run, on the Afghan question as on the nuclear question, America's best bet may be that the internal unrest now coursing through Iran will produce a different kind of regime there that could serve as a partner rather than an adversary.

WORLD NEWS

Foreign colleges study India plan

Opening full campuses easier with new law

By Arlene Chang



Sanjit Das for The Wall Street Journal

Engineering students studying at a university in New Delhi.

MUMBAI—Foreign universities are responding cautiously to India's proposed legislation that would make it easier for them to set up full-fledged campuses here.

Foreign universities want to expand their presence in India, senior administrators at these universities say, but they don't expect to immediately build their own campuses even if the law passes. The proposal was approved by India's cabinet last week and is expected to be introduced in Parliament next month.

"We are waiting and keeping in touch with companies and the ministry to see how the legislation plays out and what options might emerge," said Mark Kamlet, provost and senior vice president at Pittsburgh's Carnegie Mellon University.

The legislation would potentially open a huge market to international educational institutions. But university administrators say the law likely won't give them enough flexibility in admissions and hiring to set up stand-alone degree programs. Many say they would rather increase collaborations with Indian universities, which is permitted under the current regime.

A similar bill introduced earlier was blocked by the government's former leftist coalition partner. The chances for the bill succeeding this time are greater because the left is no longer part of the coalition.

"I think if the legislation does pass, our discussions will get fairly serious fairly quickly, and we would be interested in deep cooperation," Mr. Kamlet said. "But we might still find it easier to collaborate."

While India has a huge population and an unmet need for educational institutions, many challenges remain to setting up university campuses, according to Madeleine F. Green, vice president for International Initiatives at the American Council on Education, a Washington-based group of U.S. colleges and universities. Among those hurdles are quality control, accreditation and regulations, she said.

"My research has shown that there is tremendous interest in India and a whole gamut of potential ways to interact, but setting up a campus in India is not what every institute is interested in doing," Ms. Green said, adding that the interest in India is more in research partnerships and cooperation.

Earlier this month, Carnegie Mellon signed an agreement with the Punjab government to help start an international university in a new township in the industrial city of Ludhiana. But Carnegie Mellon's role is limited to advising the university on its computer software and information systems.

New York's Columbia University this week opened its fourth international center for research and regional collaborations in Mumbai, but it doesn't plan to have its own campus here.

"It is very important to spread the benefits of education—there's no question about that," said Lee Bollinger, president of Columbia University. "But, to set up a branch campus is very difficult, to make it a self-sustaining financial system ... unless you have some major external funding."

Brown University, in Providence, R.I., will send a delegation to India soon to explore other opportunities and expand its existing partnerships. University officials say the timing of their visit is coincidental to the bill's being passed by the Indian cabinet.

"We are interested in talking with the government, we are eager to talk to people in India about the various roles they see for us," said Matthew Gutmann, vice president for international affairs at Brown University.

During its visit to India, the Brown University delegation is expected to renew its existing student and faculty exchange programs with St. Stephen's College in New Delhi, Mr. Gutmann said.

American university officials say hurdles remain to recruiting world-class faulty and providing research grants. Officials at top foreign universities say they could establish stand-alone campuses here only if they have the flexibility to pay the competitive salaries needed to attract top faculty and allocate research grants on merit.

Indian government regulations restrict almost every aspect of university administration, from tuition rates to salaries to research grants. Yale University is currently in discussions with India's Ministry of Human Resources and Development, which oversees education, to advise the government on its plans to set up 14 new national universities in the next few years.

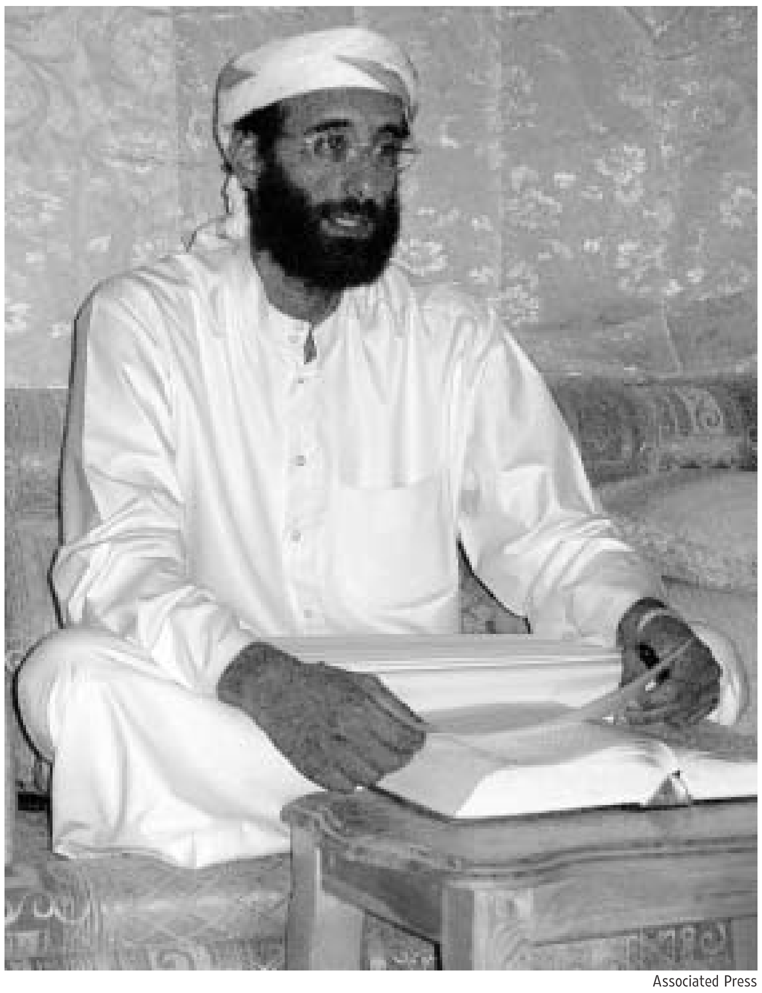
"We are in discussions to formulate a curriculum on institutional governance, faculty development and other topics," said George Joseph, assistant secretary for international affairs at Yale University. He added that Yale isn't considering a stand-alone campus at present.

Other countries, including Australia, are also interested in expanding their higher education links with India. Kelly H. Raj, education counselor for the Australian High Commission, said her country is waiting to see the details of the legislation to assess opportunities.

India, with more than 490 universities and 20,769 colleges, has among the largest number of higher education institutions in the world, according to a report by the Ministry of Human Resources and Development. But the quality is low at many of these institutions, critics say, and many graduates' skills are so poor they are unemployable.

About 160,000 students a year leave India to study abroad, according to the National Knowledge Commission, an advisory group to the prime minister.

Thus far, foreign education institutions have made a foray into India, but their involvement is limited. There are more than 100 foreign educational institutions offering programs in India, but most are vocational or technical and run for only a few weeks or months.



Associated Press

Anwar al Awlaki, shown in a file photograph from October 2008.

U.S. seeks cleric backing jihad

By Keith Johnson

WASHINGTON—One of the U.S.'s prime terrorism suspects doesn't carry a rifle or explosives. But U.S.-born cleric Anwar al Awlaki's prominence as an apologist for jihad—especially in the English-speaking world—has put him squarely in the cross hairs of the antiterror effort.

Mr. Awlaki, born in New Mexico in 1971 to Yemeni parents and believed to be hiding in Yemen, is the most prominent of a handful of native-English-speaking preachers, whose calls for jihad, or holy war, are helping to radicalize a new generation through the Internet, investigators say.

He exchanged dozens of emails with Fort Hood shooter Maj. Nidal Hasan in the months before the November killing spree at a U.S. army base. He calls Umar Farouk Abdulmutallab, the underwear bomber who allegedly tried to blow up a Detroit-bound airliner on Christmas Day, "my student." His writings helped to radicalize several Canadians, at least one of whom went to fight for al Qaeda in Somalia.

"He's clearly someone that we're looking for," said Leon Panetta, director of the Central Intelligence Agency, in an interview last week. "There isn't any question that he's one of the individuals that we're focusing on."

Mr. Panetta cited Mr. Awlaki's role in inspiring past attacks as well as his efforts to "inspire additional attacks on the United States."

In a statement disseminated widely on pro-Jihadi Web sites last week, Mr. Awlaki ratcheted up his calls for jihad against the West, especially the U.S., and said that thanks in part to the spread of his ideas, "Jihad is becoming as American as apple pie and as British as afternoon tea."

Mr. Awlaki's importance as an instigator of jihad has increased at the same time that al Qaeda has become more decentralized. Recent terrorist acts against the U.S. have been attempted or carried out by individuals with little or no formal connection to al Qaeda's core, some of whom may have become radicalized by reading English-language versions of violent treatises, such as Mr. Awlaki's "Constants on the Path of Jihad."

U.S. officials aren't making that distinction. "He's considered al Qaeda," a senior intelligence official said, adding that the U.S. government doesn't let terrorist suspects "self-define."

Shortly after the Sept. 11, 2001, attacks on the U.S., a presidential covert action finding signed by George W. Bush authorized the capturing or killing of al Qaeda operatives, including Americans. At the time, Congress authorized the president to use all necessary force against groups or persons linked to the 9/11 strikes.

An order to kill an American, however, "has to meet legal thresholds," the official said. He declined to be more specific.

Mr. Awlaki burst into the spotlight after the Fort Hood shootings, when it emerged that he had counseled Maj. Hasan by email about the immorality of a Muslim serving in the U.S. Army.

But Mr. Awlaki's links to radical Islam go further back. In the late 1990s, while living in California, he was investigated by the Federal Bureau of Investigation for ties to the Palestinian group Hamas. After 9/11, he was questioned by the FBI about his relationship with two of the hijackers, whom he met while serving as imam at a mosque in northern Virginia. Mr. Awlaki was close to another Virginia imam—Ali al Tamimi—who was convicted in 2005 for recruiting local Muslims to fight U.S. forces in Afghanistan.

—Siobhan Gorman contributed to this article.