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Germany recommits to the euro



German Chancellor Angela Merkel in the Bundestag in Berlin this month. Under Ms. Merkel's leadership, Germany has given ground on tough demands for austerity to gain euro-zone consensus.

BY MARCUS WALKER

BERLIN—Germany's insistence that Ireland, Greece and the euro zone's other fiscally feeble members adopt punishing austerity regimes has fueled concern across Europe that the bloc's biggest member is souring on the euro.

But Sunday's agreement among euro-zone leaders to establish a permanent rescue facility for overly indebted members suggests that far from turning its back on the euro, Germany is doubling its bets. Put simply, Chancellor Angela Merkel and her allies have concluded that the euro is essential for Germany's continued prosperity.

To appease a domestic audience deeply opposed to rescuing profligate euro-zone members, Germany's leaders have vowed to push for harsh punishments on both governments and investors. Yet time and again in recent months, Berlin has sacrificed its tough public demands for backroom euro-zone consensus.

The fine print of the week-end agreement commits Germany to do what its leaders insist they want to avoid—prop up the weakest countries of the euro zone in future debt crises, even after Europe's current, €750 billion (\$993.21 billion) bailout facility expires in 2013.

In return for that open-ended promise to other euro nations, Germany gave up its

Sharing the pain

Top contributors to the European Financial Stability Facility rescue package for Ireland, in billions

Germany*	€6.39
France	4.80
Italy	4.21
Spain	2.8
Netherlands	1.35
Belgium	0.82

*Germany also contributes €4.28 billion through the EU Commission portion and €1.35 billion through the IMF portion of the package.
Source: European Commission

don-based think tank. "They have compromised on their demand that haircuts for bondholders should be automatic," he says.

Berlin's readiness to compromise in order to get an agreement with France and other euro countries reflects the still-strong belief of Germany's governing class that saving the common currency is a vital national interest.

The euro has allowed Germany's export-dependent industries to sell their wares in their main European markets at stable prices, free from the currency appreciations that afflicted them in the days of the Deutsche mark.

Most German business people agree that a revived mark would be too strong for comfort, jeopardizing Germany's booming trade with China and other emerging economies, and wiping out a decade of efforts to make German companies more competitive.

In addition, an unraveling of the common currency would leave Germany's banking system holding hundreds of billions in distressed assets in countries that dropped out of the euro.

That could force the German government to spend far more on propping up its banks than it must now lend

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insistence that investors automatically share in future losses.

Instead, Berlin won a watered-down agreement that will force investors to shoulder losses only if a member state is declared insolvent by a unanimous vote of all euro-zone members.

That political concession sets a high bar for including shareholders in future restructurings. Currently, for example, euro-zone leaders insist that even Greece remains solvent, despite its massive debts and poor growth prospects.

"The Germans have accepted that there will be more bailouts," says Simon Tilford, chief economist at the Center for European Reform, a Lon-

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U.S. calls leaks an 'attack'

A Wall Street Journal Roundup

Secretary of State Hillary Clinton Monday said the U.S. "deeply regrets" embarrassment caused by the release of a quarter-million classified State Department documents and said the government is taking "aggressive steps" to prevent future leaks.

The Obama administration ordered a government-wide review of how agencies safeguard sensitive information.

The publication of the sensitive diplomatic cables Sunday by the website WikiLeaks exposed years of U.S. foreign-policy maneuvering. Among activities detailed in the documents was the extensive, and increasingly successful, push by the U.S. for an international consensus to confront Iran's nuclear program.

The director of the White House's Office of Management and Budget, Jacob Lew, said in ordering the agency-wide assessment Monday that the disclosures are unacceptable and will not be tolerated.

Mrs. Clinton called the disclosure an "attack" on America and the international community. "It puts people's lives in danger, threatens our national security and undermines our efforts to work with other countries to solve shared problems," she told reporters at the State Department.

She acknowledged that the newly released cables that revealed deep concerns among Arab world leaders about Iran's nuclear ambitions have a basis in reality. "It should not be a surprise to anyone that Iran is a great concern."

A WikiLeaks spokesman said publication of secret cables will continue into the new year, with new batches coming in the next few days.

Italy's foreign minister, Franco Frattini, described the leaks as the "Sept. 11 of world diplomacy."

Rep. Peter Hoekstra of Michigan, the senior Republican on the House Intelligence Committee, called the release very damaging. "The catastrophic issue here is just a breakdown in trust," he said, adding that many other countries.

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PAGE TWO

Dr. Doom delivers unhappy diagnosis

[Agenda]

BY PATIENCE WHEATCROFT



Lost confidence cannot be retrieved for such a lowly sum as €85 billion (\$112 billion). After the negative response to Ireland's hastily cobbled together bailout package, it is impossible to judge just what sum might be required to restore tranquility to the euro zone. The markets are convinced that Portugal will need the same treatment as Ireland and the panic meter remains hovering over Spain, with Italy regaining some attention.

The essence of the problem is that the bailout in itself is not a solution. The heavy interest rate it carries is an almost built-in guarantee of failure. The market doesn't believe that Ireland will be able to afford its new funds. That Greece has extended the terms of its rescue loans over a further six years, taking it to 2021, but only on condition that it too agrees to the same high level of interest payment as Ireland only exacerbates its own prospects of default.

The generally accepted question now is when default and restructuring will come, not if. Nouriel Roubini, the New York University economist who was one of the first voices to predict the economic crisis, was living up to his "Dr. Doom" nickname on Monday. Speaking at a conference in Prague, he warned that Spain could soon need a bailout.

Although Spain doesn't have the gaping deficits of some of its European neighbors, its dire unemployment levels, with youth unemployment now above 40%, and collapsed property market make for a grim outlook. Its banking sector is still in need of restructuring and the costs could be high.

Mr. Roubini warned that the eventual cost of sorting out Spain's financial system would be



Nouriel Roubini, chairman of Roubini Global Economics.

much higher than Madrid had estimated and that Europe's newly created safety net wouldn't be wide enough. "The official funds are not sufficient for also bailing out Spain," he declared.

According to the latest numbers from the European Commission, Spain remains in recession while most of the rest of

The generally accepted question now is when default and restructuring will come, not if.

Europe has clambered out. The commission isn't optimistic about the prospects for those countries currently in receipt of bailout funds or thought to be in the queue. Greece is expected to record a fall of 4.2% in its GDP for the current year, a further 3% the next year, and stagger up to a positive performance of just 1.1% in 2012. Ireland it says will see gross domestic product fall 0.2% in the current year, then grow by 0.9% and 1.9% in the next two years. Those numbers, however, cannot take account of the latest addition to its debt burden or the cuts that will have to be made to try to service it.

The outlook for Italy is hardly

much brighter: GDP growing 1.1% this year and next and then 1.4% in 2012. By comparison, the U.K. looks more sprightly, with growth of 1.8%, 2.2% and 2.5% over the three years. Those figures were similar to forecasts issued by the U.K.'s Office for Budget Responsibility on Monday. It had previously forecast that the outcome for 2010 would be just 1.2% but has lifted the figure to concur with the EU forecast, slightly reducing its figures for the following two years to 2.3% and 2.6%.

The OBR concludes that the loss of public-sector jobs will not be as high as had previously been thought. The number cited at the time of the comprehensive spending review in October was 490,000 and now the OBR thinks it could be just 330,000 public-sector workers who lose their jobs over the four years of the coalition government's deficit-reduction program.

While that might seem to be good news, and would be for the public-sector workers involved, it may not be in the long-term interests of the economy. The economic crisis has provided the government with the opportunity to redress the balance between public sector and private, to reduce bureaucracy in favor of the wealth creators. While there may be benefits in spreading the redundancy costs over a longer

period, and allowing more natural wastage to lower the total, the determination to cut back government spending should not wane.

The original target was to reduce departmental spending by an average of 19%. The suggestion is that higher cuts to benefits may now leave leeway for more of the jobs to remain. But leaner government could be better government. The challenge is for the private sector to provide new jobs to take up the slack.

Evidence that the U.K. government is thinking of positive ways to do that came Monday in the shape of plans for corporate tax reform. There had already been a promise to look at the taxation of foreign earnings, an issue that has already driven some companies, such as WPP, the marketing group, to move its headquarters to more tax congenial regimes—in WPP's case, Ireland. Now the government is moving to more detailed discussion on this complicated issue, acknowledging a willingness to be more accommodating.

More unexpected though was the plan for a "patent box" approach to taxing profits on intellectual property. The idea is that companies that generate profits by manufacturing in the U.K. on the basis of intellectual property developed there will benefit from a low rate of tax on what falls within the "patent box." Too often companies may devise a product in the U.K. and then manufacture it elsewhere.

Drugs group GlaxoSmithKline has been an enthusiastic supporter of the idea and has already announced that the patent box would shape its investment plans. It is more than 40 years since GSK actually built a new factory in the U.K., while it has invested hugely in lower-tax areas such as Singapore.

Its response to the patent-box idea points to the beginnings of an answer to that familiar cry: "Where will the growth come from?" The answer is that low tax can help attract it.

What's News

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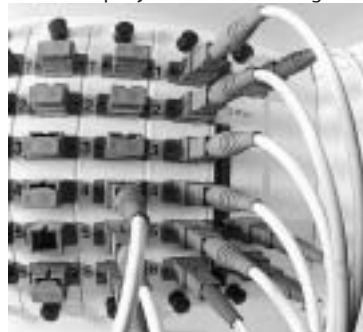
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Continuing coverage



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Monday's results

Q: Is Spain in a good position to weather the contagion storm?

Yes

54.6%

No

45.4%

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NEWS

Student protesters test U.K. leaders

BY CASSELL BRYAN-LOW
AND ALISTAIR MACDONALD

LONDON—Student protests in the U.K. over rising tuition fees are testing both the strength of Britain's new coalition government and the ability of police to contain social unrest in the country's looming period of deficit-battling austerity.

After successive weeks in which students mounted large protests in London and elsewhere—sometimes spiked with violence—police are girding for more demonstrations on Tuesday in opposition to plans to nearly triple university fees, a key plank in the government's deficit-cutting measures. A rally is scheduled in the capital's Trafalgar Square at noon with protesters then expected to march to the Houses of Parliament.

The issue is proving a key test of the strength of the coalition government led by the Conservative Party and Prime Minister David Cameron.

The coalition's junior partner, the Liberal Democrats, is under heavy pressure not to renege on a pre-election pledge not to raise university tuition. The Lib Dems face a December vote on the tuition increases, at a time when opinion polls are showing steep declines in support for the party and its leader, Nick Clegg.

The U.K. is just starting to see the fallout of the country's most sweeping budget cuts in many decades. On Monday, London's commuters struggled with the latest in



Demonstrators protesting plans for higher tuition smashed windows at Conservative Party offices in London on Nov. 10.

a string of strikes by public transport workers. And, firefighters in November planned a strike around Bonfire Night, an annual U.K. celebration that marked by fireworks and bonfires—though the strike was canceled at the last minute.

The student protests—which have already resulted in violent disturbances, criminal damage and dozens of arrests—are proving to be a trial for the police's ability to con-

tain public reaction to the cuts.

Britain's most senior police officer, Sir Paul Stephenson, last week warned of a new era of civil unrest. "The game has changed," said Sir Paul, speaking at a regular public meeting of the independent body that oversees the police.

Sir Paul added that the police adapted their strategy, having made what he described as mistakes during the Nov. 10 student protests that

led to a riot at the Conservative Party's headquarters in central London. Those lessons include sharply increasing the number of officers to police such events, as well as paying closer attention to social networking sites, where plans for protests are discussed.

Protest organizers have criticized police reaction as heavy-handed, including the tactic of "kettling," in which police contain a

large crowd by restricting or blocking exit routes. The strategy, which police call containment, came under scrutiny in the wake of the Group of 20 summit protests last year, in which one person died. Critics say the practice punishes law-abiding citizens as well as troublemakers, among other things.

Sir Paul, at the public meeting, defended using the tactic at last week's student protests, calling it appropriate under the circumstances. He commended officers for having handled protests well, including halting what was believed to be an attempt to occupy the Liberal Democrats' headquarters in London.

The tuition-fee issue is potentially the most damaging that many Liberal Democrat lawmakers will face in the near term.

Ahead of the May general election Liberal Democrats signed a National Union of Students' pledge opposing tuition fees. Many now regret this and lawmakers concede that some of the party's 57 members of Parliament will vote against the bill.

"There are people who agree with it, people who disagree and people who will abstain," said Gordon Birtwistle, a Liberal Democrat member of Parliament.

On Friday, a group of about 35 students surrounded Mr. Birtwistle's office in Burnley, North West England, to protest, in one of a number of direct actions that students have taken against Liberal Democrat lawmakers.

Americans still see bargains as fees rise

BY KIM HJELMGAARD

LONDON—When final-year economics undergraduate Robert Rogers transferred from Georgetown University to the London School of Economics, his annual tuition fees plummeted to around \$20,000 a year from around \$41,000.

"It didn't even occur to me to apply abroad when I was in high school," said Mr. Rogers, on a recent afternoon outside the LSE's Students' Union. "I certainly didn't hear of any of my [high-school] classmates applying to study abroad."

Mr. Rogers said that his reasons for moving to the LSE weren't financially motivated. But finances drive others to follow him. As tuition at U.S. colleges gets more expensive, some American high schoolers are looking to the U.K. to meet their educational needs.

It is almost heresy to say it right now here in the U.K., what with British students recently taking to the streets in protest at the government's proposal to raise tuition fees to no less than £6,000 a year (about \$9,350) for some domestic enrollees, but the fact remains that, by U.S. standards, universities across England, Scotland, Wales and Northern Ireland remain a "cheap" place to get an education.

Tuition fees in the U.K. vary from institution to institution, but the cost for an overseas undergraduate at University of St. Andrews, in Scotland, for the academic year 2009-2010 would be about \$19,000. And if you're lucky enough to be

able to claim "home" or "European Union" status, this figure would be just shy of \$3,000 a year—though it is set to triple or even quadruple from 2012 onward for some institutions south of the Scottish border under the British coalition government's aggressive overhauls to higher-education funding.

Every college that features in the top 20 of the U.S. News and World Report's most recent ranking of best U.S. colleges costs at least \$34,000 a year for tuition and fees. Most, in fact, are closer to \$40,000 a year, and quite a few top that level.

The downsides of going abroad include: plane tickets, time zones, foul weather and, in some cases, a tougher time getting a job back in a student's home country after graduation.

More than 3,000 normally U.S.-domiciled undergraduate-level students applied to U.K. schools in 2009, according to UCAS, the organization responsible for managing applications to higher-education programs in the U.K. And while only 1,330 were accepted, according to UCAS, the relatively modest numbers mask a rising trend.

There has been a 27% increase in undergraduate applications from U.S. students since 2006, while the total number of U.S. students studying for full degrees at British higher-education institutions as of 2009—across both the undergraduate and postgraduate levels—stands at just over 14,000, data from the U.K.'s Higher Education Statistics Agency show.

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EUROPE NEWS

Europe's plan to contain future financial crises hinges on a troubled country's solvency

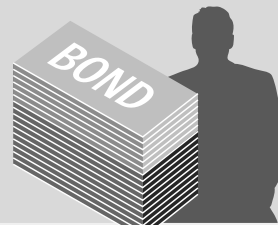
From 2013 on, a euro-zone country that finds itself burdened by unpayable debts...

...can apply for assistance from the 16 euro-zone governments and the International Monetary Fund

INSOLVENT

A country receives aid

Holders of sovereign debt are required to take losses



Representatives of the European Commission, the IMF and the European Central Bank decide whether the country is insolvent. Their assessment must be confirmed by finance ministers of the euro-zone nations.

SOLVENT

A country deemed to have a liquidity, rather than a solvency, problem, receives aid

No losses forced on sovereign debtholders.



EU bailout fund delays pain

BY CHARLES FORELLE
AND STEPHEN FIDLER

BRUSSELS—The European Union's proposed new bailout fund contemplates losses for government bondholders in the rescue of an insolvent country—but not anytime soon.

The new system, whose groundwork was approved Sunday night, wouldn't take effect until 2013, and would apply only to bonds issued after mid-2013.

In the meantime, Europe faces difficult questions about how to deal with existing debts of troubled countries and about how the transition to the new regime will take place.

Most crucially, the decision to delay any formal program of bondholder losses—known as “haircuts”—means the EU itself has implicitly committed to paying the bills of its weak states for years. That pledge will be sorely tested should the crisis expand beyond Greece and Ireland to larger countries that are more expensive to fix.

Europe “will do whatever it takes” to preserve stability, EU economy commissioner Olli Rehn said Monday.

It may take a lot. Greece got a bailout of €110 billion (\$145.67 billion), Ireland €67.5 billion; Portugal and Spain would together need €400 billion to see them through 2013, according to HSBC calculations.

And the next few years will be tough. The cost of carrying high

debt burdens—more than 150% of a year's economic output in the case of Greece—will land on public treasuries just as governments are cutting public services and raising taxes to squeeze more money out of their citizens to shrink their deficits.

The post-2013 deal “doesn't change the underlying sustainability of the debt” of problem countries, said Lorenzo Bernaldo de Quirós, a Madrid-based economist.

Markets appear unnerved. Despite the insistence of European leaders Sunday that no haircuts are even contemplated until 2013, two-year Irish, Greek, Portuguese and Spanish bonds remain expensive. Irish two-years traded Monday with yields above 7%—compared with less than 1% for rock-solid Germany.

Economists say the high yields signal that even debt issued before mid-2013 is at risk: The EU can say it won't force haircuts in a restructuring, but it can't rule out countries deciding that bailout funding comes at too high a price and defaulting of their own accord.

The rescue packages can't “prevent a restructuring of the debt of Greece nor of Ireland,” said Mr. Bernaldo de Quirós.

It is also unclear precisely what will happen when the new system arrives. Euro-zone governments say they will commit to including so-called collective action clauses in any bonds issued after mid-2013.

Those clauses, common in debt issued by poorer countries, make defaults more orderly by permitting a supermajority of creditors to agree to changing the terms of bonds for everyone, avoiding the difficulty of persuading every last holdout creditor.

The new bonds will also be subject to haircuts that could be imposed through these clauses if an insolvent country eventually has to borrow from the new bailout mechanism.

But since countries spread their borrowing out over decades, for the first few years after the switch, there wouldn't be enough post-2013 bonds outstanding for any haircutting under the new system to provide much financial relief to governments.

“People now know what will happen if you have a debt crisis in 2050. The more interesting thing is what happens if you have a debt crisis in the euro zone in 2015,” said Marco Annunziata, chief economist at UniCredit Group.

Mr. Annunziata and others argue that it isn't credible to insist that all bonds issued before 2013 are irrevocably safe from future haircuts. That, he says, is tantamount to promising potentially huge and long-lasting transfers from strong economies to pay off the debts of the weak.

If pre-2013 bonds are shielded, and a country runs into trouble in

2015, the options are few. Forcing losses on the small number of haircut-eligible bonds issued after the changeover wouldn't make much of a dent in the country's debt pile. So the EU would have to pony up fresh bailout funding to help the country get back on its feet and start paying down its debts.

Eventually, the country might be able to start borrowing again. But it would find its bonds a tough sell in the market. What's more, the EU is insisting that its post-2013 bailout funding be preferred credit that is repaid before ordinary bondholders, though after the International Monetary Fund. (The IMF's status as a preferred creditor is a matter of international custom; it isn't clear how the EU would enforce its claim of preference.)

Rodrigo Olivares-Caminal, a senior lecturer in financial law at the University of London, said a more likely solution to a near-term debt crisis is a so-called debt reprofiling, a voluntary exchange under which creditors—threatened with default by the country—agree to accept, for instance, their money at a later date.

Such an exchange would provide the opportunity to swiftly insert collective-action clauses into all of the country's debt and to make it haircut-eligible under the EU's system. “It could be much faster than you think,” Mr. Olivares-Caminal said.

Merkel sees euro as key for economy of Germany

Continued from first page
to Greece, Ireland and possibly other governments.

For example, Germany is taking on roughly €12 billion in credit exposure to the Irish government through the European Union and International Monetary Fund loans to Dublin, but is thereby shoring up around €118 billion of German banks' exposure to Ireland, according to Bundesbank data.

“The idea that we might not successfully defend the common European currency would have unimaginable economic, social, and also budgetary consequences for Germany,” Finance Minister Wolfgang Schäuble told reporters in Berlin on Monday.

Ms. Merkel's dilemma all year has been that the cold economic logic that underpins her government's commitment to the euro is hard to sell to German voters and lawmakers. Many ordinary Germans resent having to pay for the financial follies of other European countries, especially after years of cuts to entitlements at home.

The chancellor, whose ear is acutely tuned to German public perceptions, knows that nostalgia for the mark has grown this year.

When Ms. Merkel and her finance minister pushed the €750 billion bailout facility through Germany's parliament in May, they sold it as an emergency measure that would last only three years. In the meantime, they pledged, Berlin would impose much tougher rules on budgetary discipline on other euro members, to ensure that there would be no repeat of the Greek debt crisis.

In the face of stiff resistance from other euro-zone governments, however, Ms. Merkel backed away from her demand that euro-zone laggards face automatic sanctions last month.

On Oct. 18, Ms. Merkel stunned Europe and angered many in her own ruling coalition by agreeing to a quid-pro-quo with French President Nicolas Sarkozy.

Germany dropped its pressure for automatic sanctions. In return, France promised to support Germany's demand for a change to EU treaties, to enshrine the principle that bondholders, not just taxpayers, will pay a price if a euro member needs a bailout in future.

Germany's insistence on including bondholders spooked financial markets, pushing up the risk premiums on government bonds of Greece, Ireland and Portugal, and helping to push Ireland into a crisis, say many observers.

EU leaders including European Central Bank President Jean-Claude Trichet and Greece's Premier George Papandreou have slammed Ms. Merkel's proposal for making life even harder for euro-zone stragglers.

German officials deny sparking the past month's investor panic. But amid growing financial-market pressure on the euro and its weakest members, Ms. Merkel decided to push for a final agreement on its debt-restructuring idea. Berlin argued that clarity about Europe's future rules would help to reassure investors.

Euro-zone confidence continues to rise

BY PAUL HANNON

LONDON—Consumers and businesses across much of the euro zone continued to grow more confident about their prospects in November, despite the loss of faith among bond investors that culminated Sunday when Ireland became the euro-zone's second nation to need external financial help.

The European Commission Monday said its overall Economic Sentiment Indicator, or ESI, rose to 105.3 from 103.8 in October, the sixth straight monthly rise. The steady increase in the ESI above the average of 100 since it was first calculated in 1990 suggests the euro-zone economy will continue to grow in the

months ahead.

The largest improvement in confidence came in the services sector, with the commission's measure rising to 10.2 from 8.1. The headline measure of industrial confidence rose to 0.9 from zero in October, driven by another rise in total orders and export orders.

Encouragingly, both manufacturing companies and service providers expected to hire more workers in the coming months, suggesting that the euro zone's economic recovery could soon lead to a fall in the unemployment rate.

The prospect of a turnaround in the jobs market is already boosting consumer confidence, particularly in Germany. The commission's headline

measure for the euro zone rose to -9.4 from -10.9, ahead of expectations of a rise to -10.

In the U.K., which is outside the euro zone, the commission recorded a drop in consumer confidence, likely reflecting concerns about the impact of spending cuts announced by the government in late October. But the pickup in confidence wasn't universal, and the commission's measures for both the construction and retail sectors fell.

The recovery in confidence was strongest in Germany, where the ESI rose to 116.3 from 113.5.

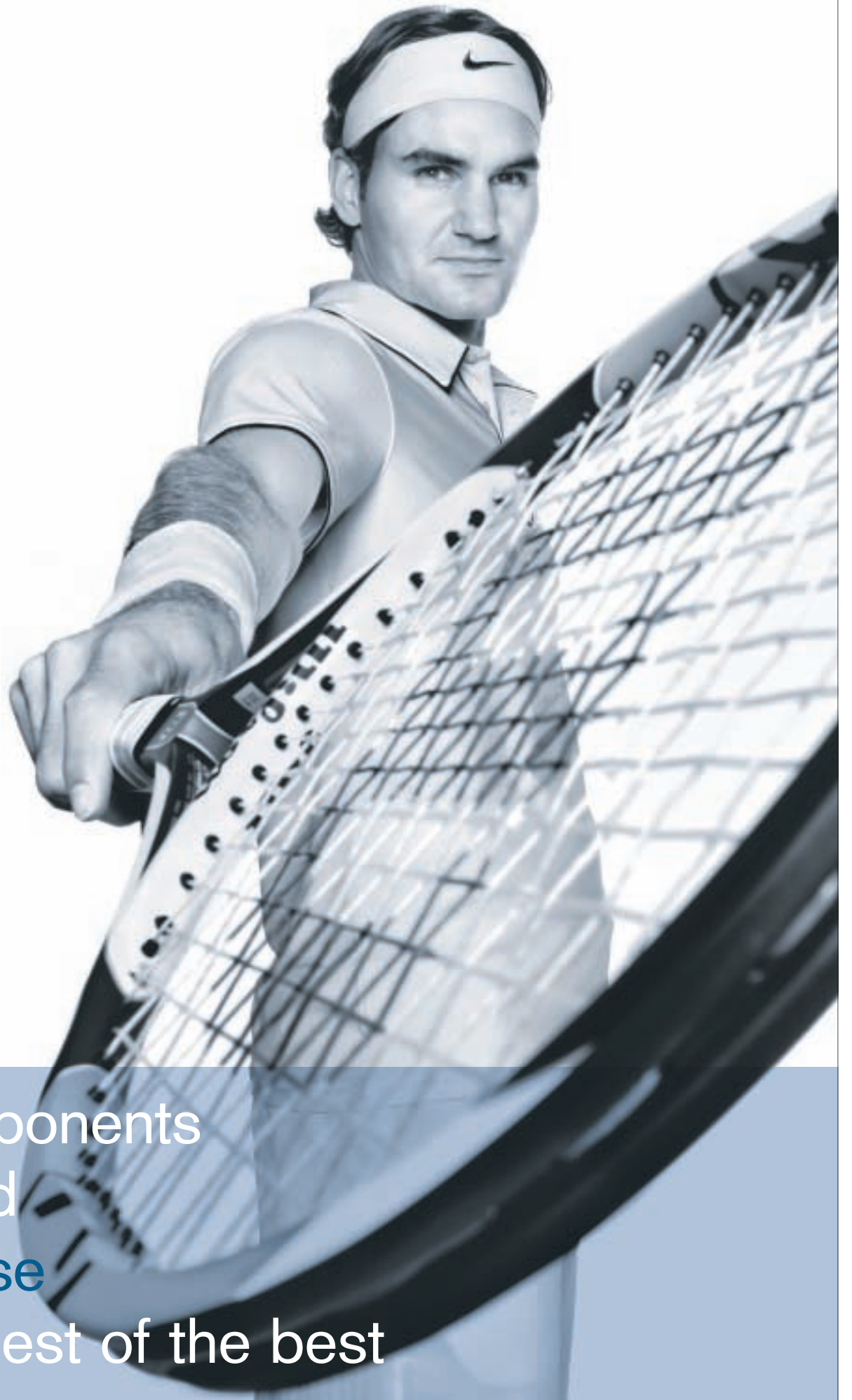
But confidence weakened in Portugal and Greece, two nations that have embarked on austerity programs in an effort to cut their large

debts.

“The trend emerging from today's sentiment indicators is one of increased divergence,” said Carsten Brzeski, an economist at ING Bank. “In fact, economic divergence remains the biggest problem for the euro zone for some time.”

The commission doesn't publish measures of confidence for Ireland, which Sunday followed Greece in agreeing a bailout package with the European Union and the International Monetary Fund.

A separate measure of the environment for manufacturers in the euro zone—the Business Climate Indicator—rose to 0.96 from 0.91, reaching its highest level since December 2007.



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THE WIKILEAKS FALLOUT

Pen portraits | How world leaders were described in the cables and how they replied



FRANCE
President Nicolas Sarkozy

What was said: "Has a thin-skinned and authoritarian style," is "touchy" and is an "emperor with no clothes."

Response: France's Budget Minister Francois Baroin said: "We are very supportive of the American administration in its efforts to avoid what not only damages countries' authority and the quality of their services, but also endangers men and women working to defend their country."



IRAN
President Mahmoud Ahmadinejad

What was said: Saudi King Abdullah said to have repeatedly urged America to attack Iran to "cut the off the head of the snake" to end its nuclear weapon program.

Response: President Ahmadinejad said: "These published documents lack legal credibility and value, and are a sinister act. We are all friends and brothers in the region and these documents will have no impact on the relationship between regional countries."



RUSSIA Prime Minister Vladimir Putin and President Dmitry Medvedev

What was said: Mr. Putin is described as an "alpha dog." Mr. Medvedev is described as playing "Robin" to Mr. Putin's "Batman."

Response: A Kremlin spokeswoman said: "Fictional Hollywood characters hardly deserve comment."



ITALY
Prime Minister Silvio Berlusconi

What was said: A cable describes Mr. Berlusconi as "feckless, vain and ineffective as a modern European leader" whose "frequent late nights and penchant for partying hard mean he does not get sufficient rest."

Response: Mr. Berlusconi laughed when told the content of the cables at a press conference, according to Italian newspapers.



Germany
Chancellor Angela Merkel

What was said: One envoy said Mrs. Merkel did not take risks and was "rarely creative."

Response: Foreign Minister Guido Westerwelle said: "A few gossipy comments about European politicians are not exactly welcome but they are not really important. But in other cases, people's lives could be put at risk," AFP reported.

Reuters (Sarkozy, Merkel); AFP/Getty Images (Ahmadinejad); AP (Putin, Medvedev); European Pressphoto Agency (Berlusconi)

Mideast leaders silent after Iran views are aired

BY MARGARET COKER

ABU DHABI—Middle Eastern governments were silent Monday about the trove of leaked U.S. intelligence made available over the weekend by WikiLeaks, which disclosed more-hawkish views by Arab leaders about Iran than they generally have voiced publicly, as well as some withering and indelicate comments about allied regional leaders themselves.

The U.S. diplomatic cables associated with the Middle East span a 30-year range, but the most recent missives focus on topics such as counterterrorism, military aid and Arab preoccupation with the rising influence of Iran's Persian, Shiite government in the region.

But it is the personal biases, frustrations and quirks expressed by Arab officials during closed-door meetings that makes for some of the most interesting—if embarrassing—reading, revealing personal feuds among the close-knit Arab leaders who take great pains to show a united public face.

In a Feb. 9, 2009, cable sent by U.S. Ambassador to Egypt, Margaret Scobey, to Secretary of State Hillary Clinton, Ms. Scobey writes that Egyptian President Hosni Mubarak "has a visceral hatred for the Islamic Republic, referring repeatedly to Iranians as 'liars.'"

The description of Mr. Mubarak's feelings isn't necessarily surprising, given that Iran broke diplomatic ties with Egypt in 1979 and that Egyptian officials speak negatively about Iran in public. But the cable goes on to characterize the view the Egyptian leader has toward two Arab countries that maintain good ties with Tehran. "He sees the Syrians and Qataris as sycophants to Tehran and liars themselves," the cable says of Mr. Mubarak.

Qatar is shown in the cables going to great lengths to reassure Washington that its loyalties are to America first, not to Iran. In a Dec.



Cables show Egyptian President Hosni Mubarak calling Iranians 'liars.'

20, 2009, cable summarizing a meeting between the visiting Deputy Secretary of Energy Daniel Poneman and Qatar's prime minister, Sheikh Hamad bin Jassim al-Thani, the member of Qatar's ruling family says that Washington shouldn't be "upset" about his nation's ties to Iran. "He characterized the relationship as one in which 'They lie to us, and we lie to them,'" according to the cable.

During a live televised news conference on Monday, Iran President Mahmoud Ahmadinejad dismissed the WikiLeaks documents, saying they wouldn't affect Iran's diplomatic relations with Arab countries.

"These published documents lack legal credibility and value, and are a sinister act. We are all friends and brothers in the region and these documents will have no impact on the relationship between regional countries," Mr. Ahmadinejad said.

Iraq and its top politicians also come under harsh criticism from leaders, according to the cables.

Arab governments have long been uneasy about the rise to power of Shiite political parties in Bagh-

dad, but some cables show frustration over a perceived lack of political leadership among Iraq's Sunni groups as well.

Abu Dhabi Crown Prince Mohammed bin Zayed al-Nahyan, who is also deputy supreme commander of the United Arab Emirates armed forces, is quoted as saying in a May 2005 cable that "there wasn't one worthwhile Sunni on the scene" in Iraq. The deputy ruler also singled out then-Iraqi Defense Minister Saadoun al-Dulaimi, a Sunni, as being "in it for himself," instead of having a desire to be a public servant, according to the cable.

A spokesperson for Iraq's Prime Minister Nouri al-Maliki, a conservative Shiite leader poised for a second term, whom Arab leaders cite as untrustworthy in several leaked cables, said Baghdad was still examining the WikiLeaks revelations and had no comment.

Iraq President Jalal Talabani is described in a November 2009 dispatch from Gary A. Grappo, former political counselor for the U.S. Embassy in Baghdad, as one of the Iraqi leaders with the closest ties to Tehran's clerical regime and Revolutionary Guards. Fakhri Karim, a senior aide to Mr. Talabani, called the document conclusions "fabrications."

Some of the cables contained some humor. During a March 2009 visit to Riyadh by John Brennan, President Barack Obama's chief counterterrorism adviser, King Abdullah bin Abdelaziz al-Saud proposes an unorthodox idea to help track detainees released from the U.S. detention facility at Guantanamo Bay: implant electronic chips.

"This was done with horses and falcons, the King said. Brennan replied, 'horses don't have good lawyers,' and that such a proposal would face legal hurdles in the U.S.," according to the cable.

—Farnaz Fassihi in Beirut and Ali A. Nabhan in Baghdad contributed to this article.

Leaks feed schism in Turkey's politics

BY MARC CHAMPION

Turkey's foreign minister on Monday shrugged off leaked State Department cables that described him as a dangerous Islamist with imperial delusions, but the leaks resonated strongly within Turkey where they fed into the country's divisive politics.

The weekend release of State Department cables by WikiLeaks revealed caustic U.S. assessments of foreign leaders in Turkey and many other countries. Analysts said that while the dispatches were embarrassing, neither side was likely to let them become a game-changer in their relations.

"Turkish-American relations will not be affected," Turkish foreign minister Ahmet Davutoglu told reporters in Washington on Monday after a meeting with U.S. Secretary of State. He said Mrs. Clinton had apologized for the leaks, according to CNN Turk, but added "it is correct to depict this as the 9/11 of di-

plomacy," the TV channel reported.

The leaks received wall-to-wall coverage in Turkey's media Monday. That, analysts say, was in part because of the sheer number of documents related to Turkey—close to 8,000 cables came from the U.S. Embassy in Ankara alone—and because of the way they played into Turkey's internal debate over the Islamic-leaning Justice and Development Party, or AKP, and its leaders.

Turkey's Finance Minister Mehmet Simsek on Monday denied a comment in a U.S. Embassy cable that in 2008 he urged foreign investors to sell stock in Turkey's largest media company, **Dogan Yayin Holding AS**, as it became locked in a tax battle with the government.

Mr. Simsek, a former Merrill Lynch banker with a strong links to the international investor community, said in a statement that the allegations were "baseless" and "fabricated."

—Joe Parkinson contributed to this article.

U.S. calls leaks an 'attack'

Continued from first page
tries allies and foes alike are likely to ask, 'Can the United States be trusted?'"

In London, Steve Field, a spokesman for British Prime Minister David Cameron, said "it's important that governments are able to operate on the basis of confidentiality of information." French Foreign Ministry spokesman Bernard Valero said "we strongly deplore the deliberate and irresponsible release of American diplomatic correspondence by the site WikiLeaks."

Pakistan's foreign ministry said it was an "irresponsible disclosure of sensitive official documents" while Iraq's foreign minister, Hoshiyar Zebari, called the document release "unhelpful and untimely."

The encrypted e-mails and other documents unearthed new revela-

tions about long-simmering nuclear trouble spots, detailing U.S., Israeli and Arab world fears of Iran's growing nuclear program, U.S. concerns about Pakistan's atomic arsenal and U.S. discussions about a united Korean peninsula as a long-term solution to North Korean aggression.

The leaks also cited American memos encouraging U.S. diplomats at the United Nations to collect data about the U.N. secretary-general and foreign diplomats. A State Department spokesman played down the diplomatic spying allegations, saying, "This is what diplomats, from our country and other countries, have done for hundreds of years."

The Sunday release of the documents was WikiLeaks' third in recent months, following caches of U.S. documents on the Afghanistan and Iraq wars.

THE WIKILEAKS FALLOUT

Cables show strain with China

BY JEREMY PAGE

BEIJING—Leaked U.S. diplomatic cables put China's relationship with Iran under renewed scrutiny by suggesting Beijing hadn't complied with U.S. requests to stop transfers to Tehran of technology and materials that could be used in its ballistic-missile and chemical-weapons programs.

China repeatedly failed to act on U.S. requests that it stop shipments of ballistic-missile components from North Korea to Iran on commercial flights via the Beijing airport in 2007, according to one of more than a quarter-million U.S. diplomatic cables made public Sunday.

Another of the cables gathered by the website WikiLeaks showed that U.S. Secretary of State Hillary Clinton asked China in February to act on intelligence that Iran was trying to buy gyroscopes and carbon fiber for its ballistic missiles from Chinese companies. Mrs. Clinton also expressed concern in May that Chinese companies were supplying Iran with precursors for chemical weapons, according to one cable.

Last year, Mrs. Clinton raised concern that a Chinese company was selling French thermal-imaging technology to Tehran that could be used against U.S. forces in the Gulf, yet another cable showed.

The cables reflect continuing U.S. concern that China isn't doing enough to prevent proliferation of materials and technology that could help Iranian weapons programs, in-



Kim Jong Il, left, and China's Hu Jintao met in August in northeastern China.

cluding some from North Korea.

China pledged in 2000 not to help any country develop ballistic missiles that can be used to deliver nuclear weapons. China also introduced stricter export controls in 2002 and in June backed U.N. sanctions that imposed a broader arms embargo on Iran.

But an analysis of the Iranian missile threat last month by Arms Control Today, which is published by the independent Arms Control Association in Washington, suggested U.S. pressure on Beijing has produced only mixed results.

The content of the leaks "shows either China's inability to enforce its own export laws, or a kind of malign

negligence," said Peter Crail, a research analyst at the ACA who covers North Korea. "There's a pattern of frustration on the part of the U.S. government." He said one factor could be China's continuing support for the North Korean regime, which earns hard currency from exports of missile technology, often sold through front companies in China.

The publication of the cables comes at a sensitive time in China-U.S. ties, as Beijing faces mounting pressure from Washington to rein in an increasingly belligerent North Korea ahead of President Hu Jintao's U.S. visit in January.

China's Foreign Ministry didn't respond to a request to comment

Monday. The U.S. State Department has called the leaks illegal.

Mrs. Clinton spoke about the leaks by telephone with her Chinese counterpart, Yang Jiechi, on Friday, the State Department said.

One cable from the U.S. Embassy in Beijing quoted an unidentified Chinese contact alleging in January that the Politburo, the powerful 25-person governing group in the Communist Party, ordered a cyberattack on Google Inc. as well as U.S. government computer systems.

A Google spokeswoman said: "We have conclusive evidence that the attack came from China." She declined to elaborate. China's government has repeatedly denied any involvement in any cyberattacks.

Another cable gave a detailed account of a conversation between a U.S. political officer and Li Guofu, an expert on the Middle East at the China Institute for International Studies, which is affiliated with the Foreign Ministry.

That cable said Mr. Li suggested that the U.S. negotiate a secret deal with Iran, allowing it limited uranium-enrichment operations in exchange for closer international supervision and a suspension of its support for Hamas and Hezbollah.

"Some of the talks between me and my diplomat friends are not supposed to be open for public," Prof. Li told The Wall Street Journal. He said he will be more careful in future talks with U.S. diplomats.

—Sue Feng
contributed to this article.

Kremlin says 'Batman' jibes are no big deal

BY RICHARD BOUDREAUX

MOSCOW—Russian officials played down the release of confidential U.S. diplomatic documents that portray Prime Minister Vladimir Putin as the dominant ruler in a "virtual mafia state."

Newly posted documents on the WikiLeaks website include a U.S. Embassy cable describing Mr. Putin as an "alpha dog" who calls the shots and President Dmitry Medvedev as a pale, hesitant figure who "plays Robin to Putin's Batman."

Foreign Minister Sergei Lavrov brushed off the assessments Monday, indicating that Russia didn't want their revelation to spoil the improved relations pursued by the Kremlin and the White House.

"It's certainly amusing reading, but in actual policy we prefer to be guided by the concrete actions of our partners," Mr. Lavrov told reporters in India, according to Russia's Interfax news agency. Natalya Timakova, a Kremlin spokeswoman, told Russian news agencies there was nothing new or worthy of comment in the documents. "Fictional Hollywood characters hardly deserve comment," she added.

The most-sensitive documents about Russia characterized the country and its leaders in ways that American officials would never do publicly but are nonetheless commonly voiced by commentators and analysts in Russia.

U.S. Sees Crimes in Leak

BY EVAN PEREZ
AND JEANNE WHALEN

Attorney General Eric Holder said the U.S. was looking to prosecute those responsible for the leak of U.S. diplomatic cables, but he drew a distinction between online whistleblower WikiLeaks and news organizations that published classified material.

"There's a predicate for us to believe that crimes have been committed here, and we are in the process of investigating those crimes," Mr. Holder told reporters.

He said the Federal Bureau of Investigation and the Defense Department were continuing their probe. But the investigation is complicated by the fact that key targets are overseas, officials say.

Over the weekend, sensitive U.S. diplomatic cables were published by U.S. and European news organizations, which sourced the material to WikiLeaks. The documents exposed years of U.S. foreign-policy maneuvering that could prove embarrassing to the U.S. and its allies, especially in the Islamic world.

Mr. Holder noted that news organizations that published the documents worked with the government to redact some of the material deemed most sensitive.

"I think one can compare the way in which various news organizations that have been involved in this have acted, as opposed to the way in which WikiLeaks has," he said. The news organizations, he said, acted in a "responsible manner."

It was the latest of a series of such publications of WikiLeaks-sourced documents, including the



Julian Assange, founder of WikiLeaks

July publication of more than 70,000 classified military reports on the Afghanistan and Iraq wars.

New batches of cables will be published on WikiLeaks' website in the next few days, WikiLeaks spokesman Kristinn Hrafnsson said Monday.

"I think we can see new releases tomorrow and gradual releases over the next days and weeks and possibly months," he said.

The U.S. has condemned the leak and urged WikiLeaks to return the documents, saying their publication could undermine cooperation between nations in fighting terrorism, nuclear proliferation and other problems.

Mr. Hrafnsson described Washington's position as an over-reaction, with "uncredible statements about individuals being put in danger, lives at risk, etc."

Authorities haven't named a suspect in the release of the latest cache of documents.

In July, the military charged Army intelligence analyst Pfc. Bradley Manning, 22 years old, with illegally taking secret State Department files and disseminating a classified video, later released by WikiLeaks, showing a U.S. military helicopter firing on people in Baghdad.

Pfc. Manning worked in intelligence operations in Baghdad. He was supposed to be examining intelligence relevant to Iraq, but defense officials said Pfc. Manning used his "Top Secret/SCI" clearance to tap into documents around the world.

Widening the probe is difficult because the WikiLeaks website is hosted outside the U.S. The site's founder, Julian Assange, is an Australian citizen and isn't within U.S. jurisdiction.

Federal officials have said Mr. Assange isn't considered a target of the probe. But the Pentagon has pushed for the leaks to be considered a theft of U.S. government property and wants to explore the possibility of charging Mr. Assange and others involved in disseminating the leaks, according to officials familiar with the matter.

The probe raises broader concerns for the news media. Current U.S. law focuses on the leaker of secret information, not the publisher of the material.

Government lawyers have debated whether WikiLeaks should be treated like a news organization, according to U.S. officials familiar with the matter.

Legal experts say a prosecution targeting WikiLeaks officials as publishers of the material would likely raise implications for conventional news organizations that publish secret government information.

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U.S. NEWS

Democrats get ready for tax-relief battle

By JANET HOOK

Congressional Democrats, under pressure from their liberal wing, are preparing to put up a fight over tax relief for wealthier Americans before they agree to any compromise with Republicans that could extend the Bush-era breaks.

With the lame-duck Congress reconvening, House Speaker Nancy Pelosi (D., Calif.) may hold a vote midweek on legislation that would extend the 2001 and 2003 tax cuts only for families with incomes less than \$250,000, while allowing the upper brackets to expire.

But Senate Democrats are still divided over their party's end-game strategy. Some Democrats are ready to accept a temporary extension of all tax cuts. But there is also growing interest among other Democrats in a compromise that would keep them in place only for families with income of as much as \$1 million. Administration officials have opposed making upper-income tax cuts permanent but are widely viewed as being willing to accept an extension of a year or two. Republicans are unified in opposition to allowing the Bush-era tax cuts to lapse for any income group.

The result could be a protracted series of votes in both chambers and a weeks-long debate before the compromise expected by many in Washington will be reached.

"The Democrats don't have a bargaining position—that's the problem," said Don Stewart, communications director for Senate GOP Leader Mitch McConnell (R., Ky.).

The White House Tuesday will host its first high-level bipartisan meeting on the issue. Expectations are dwindling about the meeting, which was initially billed as a long, summit-like session followed by a White House dinner for senior House and Senate leaders of both parties.

Tax policy is just one of many issues that Congress will be confronting this week, the beginning of the end of the contentious lame-duck session. Others include the expiring program of extended benefits for the



The lame-duck Congress meets in Washington this week to consider tax policy and other legislative issues, including expiring extended benefits for the long-term unemployed.

long-term unemployed, government funding and ratification of a nuclear-arms treaty with Russia.

The focal point on taxes will be breaking the impasse between Republicans who want all the Bush-era tax cuts to be made permanent and Democrats who, like Mr. Obama, want to make them permanent only for families with income under \$250,000. Although both sides are digging in now, Sen. Byron Dorgan (D., N.D.) said the compromise path was clear.

"What's likely to happen is there will be an extension of the tax cuts for everybody for a period of time," Mr. Dorgan said Sunday on CNN's "State of the Union."

Many liberal Democrats are reluctant to concede that ground without a fight. When Mr. Obama and his top advisers signaled willingness to give ground after the election, they were slammed by liberals who viewed it as a capitulation. "Let the millionaires fend for themselves for a change," said AFL-CIO president Richard Trumka before Thanksgiving.

Democrats have been trying to reinforce their commitment to the party's initial position of supporting only tax breaks for the middle class. "Democrats agree that there should be permanent extension to the middle-class tax cuts, that there shouldn't be a permanent extension of tax cuts for millionaires and billionaires," said White House press secretary Bill Burton.

By preparing to bring a middle-class tax-cut bill to the House floor, a Democratic leadership aide said, Ms. Pelosi was "daring Republicans" to vote against it. House GOP Leader John Boehner (R., Ohio) has already made plain he would take the dare.

Whatever happens in the House, the Senate will be the likely source of any potential compromise. Senate Majority Leader Harry Reid (D., Nev.) has promised two votes this month—on middle-class tax cuts and on Mr. McConnell's plan to make all the tax cuts permanent—before any compromise is forged.

—John McKinnon and Michael Crittenden contributed to this article.

Obama plans pay freeze

By JONATHAN WEISMAN

WASHINGTON—President Barack Obama on Monday proposed a two-year salary freeze for all federal civilian employees, ahead of negotiations with Congress on deficit cutting that are likely to dominate Washington next year.

The freeze, which would require congressional approval, would affect about two million workers and cover calendar years 2011 and 2012.

Mr. Obama made it clear his gesture was supposed to kick off negotiations on deficit cutting that would require political sacrifices on the part of Republicans and Democrats. He called on both parties to "set aside the politics of the moment to make progress for the long term."

"My hope is that starting today we can begin a bipartisan conversation about our future," the president

said in comments to reporters. "Everybody's going to have to cooperate."

Though in effect for two years, the proposed freeze would save \$28 billion over five years and more than \$60 billion over 10 years as the government pockets savings from a lower wage base for its civilian work force, said Jeffrey Zients, deputy White House budget director for management.

Workers were due to have a 1.4% pay raise in 2011. Federal wages generally rise each year in step with inflation, though Congress often makes adjustments.

Some conservatives have been attacking the federal work force as overpaid, but Mr. Obama didn't join in. He hailed those whose pay he would freeze as the men and women who protect the nation's borders and airports, guard federal prisons,

maintain national parks and make sure Social Security checks go out on time.

"Clearly this is a difficult decision," Mr. Zients said, lauding federal workers as dedicated civil servants. "The president is clearly asking them to make a sacrifice."

The White House had to make the announcement ahead of Tuesday's statutory deadline for White House notification to Congress of different pay rates for different localities where federal workers are employed.

Republicans, who will take control of the House next year, have been calling for such a freeze for months. Rep. Darrell Issa (R., Calif.), the senior Republican on the House Committee on Oversight and Government Reform, called the proposed pay freeze "necessary and, quite frankly, long overdue."

Talks on tax cuts set stage for the 2012 election cycle

[Capital Journal]

By GERALD F. SEIB



The first debate of the 2012 presidential election cycle will occur Tuesday, and taxes will be the subject.

That's not how President Barack Obama's meeting with Republican congressional leaders will be advertised, but that will be the reality when they sit down to discuss what to do with the Bush-era tax cuts, which expire at year's end if Congress and the president don't agree to extend some or all of them.

It's quite possible that, in the end, the tax cuts simply will be extended for everyone temporarily, punting the debate into next year and beyond. Meanwhile, there likely will be lots of maneuvers and test votes, all designed to probe the underlying question: What is the real balance of power in Washington in the wake of the midterm elections?

That power equation also will help shape the landscape for the 2012 presidential campaign. If there was any hope the tax debate could be separated from that seemingly distant presidential contest, it was extinguished when Senate Republican leader Mitch McConnell declared that his party's main political goal was to deny Mr. Obama a second term—and when the president seized upon that comment to portray the Republicans as more interested in politics than in governance.

So both sides will be test-driving their main themes for the next political cycle. Republicans will be arguing that they offer the low-tax, less-government path to real economic recovery, and that the Democrats want to strangle small-business growth by increasing taxes. Democrats will be trying out their argument that Republicans are out to protect the wealthy above all else, and that they remain addicted to Bush-era policies that caused economic calamity and ruinous budget deficits.

Substantively, the positions of the two sides are clear, and incompatible. Mr. Obama and the Democrats want to extend the tax cuts permanently for families making less than \$250,000 a year, and return to higher rates for all above that line. Republicans want to extend cuts permanently for all.

Both sides bring their own peculiar sets of strengths and vulnerabilities to this debate. The Republicans' strengths are most obvious, simply because they were demonstrated in this month's elections. Because the tax debate is being held in a lame-duck Congress, before the big batch of newly elected Republicans arrives early in 2011, GOP leaders have an incentive to resist compromise for now.

That could force all tax cuts to expire at year's end, allowing Republicans to accuse Mr. Obama of raising everybody's taxes. Then

they could re-open the conversation about extending the tax cuts next year, when their position has been fortified by the arrival of new members.

But that tactical maneuver also would expose Republicans to their greatest political vulnerability. Their risk is that the White House will make them look rigid, and charge that they are over-reading their election mandate, while the president is the one being reasonable.

Indeed, Mr. Obama's announcement Monday that he is freezing pay for federal workers for two years to deal with the deficit is one sign of how the White House intends to position him as a leader seeking sensible compromises to deal with economic distress. By contrast, the White House would portray a collapse of tax talks as a sign the GOP is playing games with the economy to seek political advantage.

Substantively, the positions of the Republicans and the Democrats are clear, and incompatible.

So, given that balance of power, what's the most likely outcome?

Here's a reasonable guess. There will be congressional votes on rival measures giving each side exactly what it wants, and they will fail. Democratic leaders will try to preserve most tax cuts while raising taxes on top earners, but, given that they didn't have the votes in the Senate for such a strategy before the election, they seem unlikely to have them now. Republicans, because they still face a Democrat-controlled Congress in the lame-duck session, won't have the votes to permanently extend all the tax cuts.

At that point Democrats will try an alternative of continuing tax cuts for all but the wealthiest Americans—say, for those with a family income above \$1 million rather than \$250,000. But liberal Democrats won't like the idea of extending cuts so far up the income scale, and conservative Democrats don't want to raise any taxes right now, so that approach might fail as well.

That would leave a temporary extension for all, perhaps for one or three years. (Democrats will resist extending for two years, which would reopen the whole issue squarely amid the 2012 campaign.) Then the question will be what Democrats might negotiate in return for agreeing to continue all tax cuts: an extension of long-term jobless benefits, for example, or a continuation of the "making work pay" tax credit for lower-income Americans the White House is pushing.

That would represent a truce in, but surely not the end of, a tax argument sure to continue through the presidential cycle.

Write to Gerald F. Seib at jerry.seib@wsj.com

WORLD NEWS

South Korea walks fine line

By EVAN RAMSTAD
AND GORDON FAIRCLOUGH

SEOUL—South Korean President Lee Myung-bak vowed Monday to strike back at any further attacks by North Korea on South Korean territory, but the South's military later canceled a drill that would have asserted its territorial rights over a maritime border the North disputes.

The military late Monday initially announced it would conduct an artillery drill on the same island attacked Nov. 23 by the North in an hourlong barrage that killed four South Koreans, destroyed more than 30 homes and damaged nearly every building in the island's main village, which was home to 1,400 people.

The new test was announced shortly after 7 p.m. Monday, then canceled about 90 minutes later without explanation. The test could have led to another confrontation with North Korea and, as a result, its cancellation underlined the constraints Seoul faces in dealing with Pyongyang's latest aggression.

North Korea cited a similar artillery drill on the island, called Yeonpyeong, as the reason it opened fire last week in what was the first attack on South Korean land by the North since the Korean War of the 1950s.

South Korea has conducted such tests for years. But North Korea's use of last week's test as justification to attack the island marked an escalation of a campaign that began in the late 1990s to force South Korea to redraw the inter-Korean maritime border off the countries' west coast.

In recent days, North Korea's statements shifted from emphasis on the test-firing to a broader condemnation of the sea border, unnerving South Koreans on four other islands in the border area and spurring speculation among defense analysts about Pyongyang's next move.

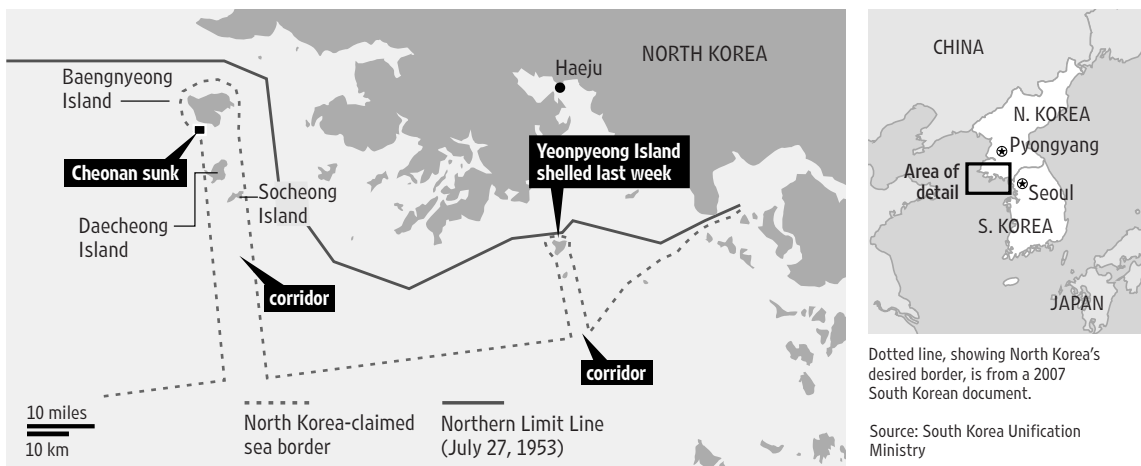
Statements in North Korean media since Friday justified the barrage as a means of preventing South Korea from making the line a "de facto border," without referring to the fact that the line has existed as such a border since it was drawn by the United Nations in 1953 after an armistice agreement ended hostilities.

"The 'northern limit line' adhered to by the south Korean authorities is an illegal ghost line," Roding Shinmun, North Korea's biggest newspaper, wrote Sunday in one of several articles in the North's media over the weekend that focused on the line.

North Korea objects to the line



South Korean President Lee Myung-bak talks with field commanders during a joint drill with U.S. forces Monday.



chiefly because it forces cargo and fishing vessels on its southwestern coast to take lengthy routes to international shipping lanes and open water. The narrowest passage is the area north of Yeonpyeong Island, which is separated from North Korea's mainland by just 10 kilometers, or about six miles.

Following the sinking of the South Korean warship Cheonan in March, North Korea issued a similar series of statements critical of the maritime border.

Defense analysts at the time speculated that North Korea might try an artillery attack on one of the five South Korea-controlled islands near the border, citing an exercise in January when it fired more than 400 rounds of artillery from various points on the North Korean coast that were aimed at one spot.

"It was a practice session for what they did last week," said Bruce Bechtol, a Korea defense specialist and professor at Angelo State Uni-

versity, in San Angelo, Texas. "This is part of a very deliberate, well-planned set of events designed to intimidate the South and bring the Northern Limit Line to the world's attention."

Many analysts say that getting the maritime border changed is a major goal of North Korean dictator Kim Jong Il—a chance to recover some of what is perceived in the North to have been lost when his father's invasion of South Korea in 1950 was turned back in the Korean War. Mr. Kim early last week visited a town on the coast near the disputed maritime border with military leaders.

On Monday, South Korean President Lee in a nationally televised speech called the North Korean attack an "inhumane crime" and noted that shells exploded just a few meters from the island's elementary school. "I am outraged by the ruthlessness of the North Korean regime, which is even indifferent to the lives

of little children," Mr. Lee said, though he didn't refer to Mr. Kim by name.

Public opinion polls show that a vast majority of South Koreans—as many as 80% in some surveys—are upset by what they perceive to be a weak response to the attack. In his speech, Mr. Lee defended the military and said North Korea would pay "a dear price without fail" if it attacks again.

On Sunday, South Korean military officials ordered all journalists, aid officials and other outsiders off the island, citing the prospect of another attack.

Mr. Lee vowed to "defend the five islands near the northern sea border with a watertight stance against any kind of provocation."

This past week, some residents of the other islands also left their homes to stay with friends and relatives on the mainland.

—Jaeyeon Woo
contributed to this article.

Nuclear scientists attacked in Tehran

Associated Press

TEHRAN—Assailants on motorcycles attached bombs to the cars of two nuclear scientists as they were driving to work in Tehran Monday, killing one and seriously wounding the other in separate attacks, state television reported.

The report didn't say whether the two university teachers were directly involved in the country's nuclear program.

State TV swiftly blamed Israel for the attacks. At least two other Iranian nuclear scientists have been killed in recent years in what Iran has alleged is part of a covert attempt by the West to damage its nuclear program. One of those two was killed in an attack similar to those on Monday.

The nuclear program is at the center of a bitter row between Iran on one side and the U.S. and its allies on the other.

A number of world powers suspect Iran is trying to make nuclear weapons, an allegation the government denies.

Tehran's refusal to limit some of its nuclear activities has brought on multiple rounds of United Nations sanctions against the country.

The assailants, who escaped, drove by their targets on motorcycles and attached the bombs as the cars were moving. The bombs exploded shortly thereafter, the state TV report said.

The attacks bore close similarities to another in January that killed a physics professor.

The man killed Monday was identified as Majid Shahriari, a member of the nuclear-engineering faculty at Shahid Beheshti University in Tehran. His wife, who was in the car with him, was wounded.

A second attack in Tehran seriously wounded nuclear physicist Fe-reidoun Abbasi. His wife was also in the car with him, and she was also wounded.

A pro-government website, mashregnews.ir, said Mr. Abbasi held a Ph.D. in nuclear physics and was a laser expert at Iran's Defense Ministry and one of few top Iranian specialists in nuclear-isotope separation.

The site said Mr. Abbasi has long been a member of the Revolutionary Guard, the country's most powerful military force. It said he was also a lecturer at Imam Hossein University, affiliated with the Guard.

Some Iranian media reported that Mr. Abbasi died after he was transferred to the hospital. But Iran's official IRNA news agency said he was in a stable condition.

The attacks bore close similarities to another in January that killed Masoud Ali Mohammadi, a senior physics professor at Tehran University.

He was killed when a bomb-rigged motorcycle exploded near his car as he was about to leave for work.

Afghan gunman kills 6 U.S. troops

By MATTHEW ROSENBERG

KABUL—A gunman in an Afghan Border Police uniform shot and killed six U.S. troops during a training mission in what appeared to be the deadliest in a series of shootings of allied personnel by Afghan forces.

The gunman was killed in a subsequent shootout with coalition forces. Afghan officials and the North Atlantic Treaty Organization task force here said they were investigating the incident, which occurred Monday in the eastern province of Nangarhar.

"Such attacks will not deter our cooperation with [NATO] to provide security in Afghanistan," said Zema-

rai Bashary, the spokesman for the Afghan Interior Ministry, which oversees the police.

NATO, in a statement, described the assailant as dressed in an Afghan Border Police uniform, leaving open the possibility the gunman wasn't with the border police but rather an infiltrator in disguise—a tactic the Taliban have previously used. Pentagon spokesman Col. David Lapan said the six killed were American service members.

Hours after the shooting, the Taliban took credit for the killings, saying the gunman had infiltrated the border police with the sole intent of killing foreign soldiers.

The Taliban's claim was impossi-

ble to immediately verify, and the militants have been known to take credit for events in which they played no direct role.

But if the gunman was from the border police, Monday's shooting would be the latest attack on coalition service members by Afghan security forces. Such events were relatively rare until recently.

A pair of U.S. Marines were allegedly killed by an Afghan soldier earlier this month in Helmand province. In July, an Afghan army sergeant killed two U.S. civilian trainers during an argument at a shooting range in northern Afghanistan before being gunned down himself. Earlier that month, an Afghan

soldier in the south killed three British soldiers.

The shootings have raised the prospect of Taliban sympathizers in the Afghan security forces. Coalition and Afghan officials say they don't believe the problem is widespread but acknowledge it is a possibility with a massive recruitment drive under way to expand the ranks of the Afghan army and police.

They also say an increase in joint operations between coalition and Afghan forces is bound to lead to arguments—and that a small percentage turn deadly.

—Maria Abi-Habib
and Habib Khan Totakhil
contributed to this article.

WORLD NEWS

Japanese lap up imports, foreign deals

BY YUKA HAYASHI
AND MIHO INADA

TOKYO—Pizza delivery, European suits and foreign beach condos: Thanks to a stronger yen, Japanese consumers are snapping them up at big discounts.

The yen's recent surge—the dollar closed Monday in Tokyo at 84.04 yen, stronger than its 15-year low of 79.75 yen—has lowered prices on imported items from avocados to Audis. To the delight of many consumers, the yen's gain also makes it easier for Japanese to travel abroad and invest in foreign assets, including real estate and mutual funds that target emerging-market stocks or U.S. high-yield bonds.

The bargains appear to be a silver lining in the dark cloud over Japan's economy. The yen's surge makes Japan's goods pricier worldwide, hurting the prospects for the country's export-driven economy. And even the cheap prices of imports are a mixed blessing: Falling prices on goods deepen the nation's stubborn deflation, keeping shoppers on the sidelines with expectations that prices will fall further and eroding corporate profits.

"In theory, a strong yen can enhance the consumer's purchasing power and prop up consumption and the economy as a whole," says Hiro-michi Shirakawa, a Credit Suisse economist. "But given that the economy relies nearly entirely on exports to realize growth right now, it's hard to paint this as a pretty story."

Many retailers entice customers with "strong-yen rebate" sales, offering discounts on imported goods. They hope to buttress sales hurt by lingering pessimism over job security, driven in part by Japanese exporters moving jobs overseas in response to the stronger yen.

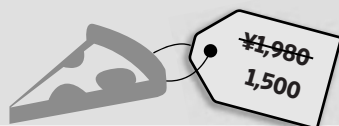
Department-store chain **Matsuzakaya** Co. recently held a sale featuring 2,000 imported leather bags and shoes at its central Tokyo store. On the last day of a weeklong sale this month, shoppers gathered around a wagon filled with purses costing 490 yen—roughly \$5.80—while others tried on Italian-made shoes. On top of 30% to 50% markdowns on the shoes and bags, the store was offering a discount depending on the previous day's exchange rate. If the dollar was at 81 yen, the discount was 10%; if it fell to 79 yen, the discount rose to 20%. Hiroko Isobe, a 48-year-old em-



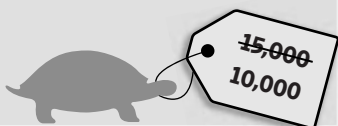
A customer buys Microsoft Corp.'s new Xbox 360 Kinect after the product's launch in Tokyo last week.

Cheap in Japan | The strong yen is pushing down prices for a range of items

MARGHERITA PIZZA FROM
SALVATORE CUOMO JAPAN



PET TURTLES
IMPORTED FROM INDONESIA



THREE-PERSON SOFA
IMPORTED FROM ITALY



COACH SIGNATURE FLAP
DUFFLE SHOULDER BAG



ELECTRIC TESLA ROADSTER
IMPORTED FROM U.S.



1,200-SQUARE-FOOT
MANUFACTURED HOUSE FROM U.S.



Source: WSJ Research

ployee of a financial firm, saw a newspaper ad for the sale and came to buy a pair of sneakers. She ended up with four pairs for just more than 5,000 yen in all, about \$60.

Supermarket operators **Ito-Yokado** Co. and **Aeon Retail** Co. are discounting imported groceries such as Australian beef and American broccoli. Pizza-delivery chain **Salvatore Cuomo Japan** Inc. offers its popular margherita pizza at 1,500 yen, compared with the usual 1,980

yen. The company says the yen's rise against the euro has cut the cost of Italian mozzarella and tomato sauce.

Even imported pets are getting a boost. "We can buy more animals now because each one is cheaper," says Koichiro Okuhira, president of Science Factory, an Osaka firm that imports rare animals it sells to people or leases to ad agencies.

Mr. Okuhira says business is booming in snakes, iguanas and, particularly, tortoises from Indone-

sia and the U.S. "They don't bark and can be raised in apartments with no-pet policies," he says. With a tortoise selling for 10,000 yen against an average 15,000 yen last year, he says the company is on track to sell 4,000 tortoises this year, twice as many as last year.

Global Property Inc. recently held a seminar in Tokyo on purchasing condominiums in Kuala Lumpur as an investment. The brokerage company also recommends condo-

miniums in Hawaii, citing sharp declines in the U.S. property market in addition to the strong yen. In the second quarter, when the yen began its latest rise, Japanese residents also became net buyers of real estate abroad after being net sellers for two years, figures from the Ministry of Finance show.

Many people are venturing abroad for vacations again. In the holiday month of August, the number of Japanese going overseas on package tours grew 7.5% from a year earlier to 475,000, according to the Japan Association of Travel Agents.

Kyoko Satake, a 52-year-old housewife, traveled to Hawaii in September for her niece's wedding. She bought a Marc Jacobs watch for her daughter, paying a little more than \$200, half what she would have paid in Japan. She thinks she saved even more by using her credit card to get a better exchange rate, because the yen kept appreciating.

Tsutomu Fujita, a 33-year-old photographer, has bought photography supplies online from New York retailer B&H Foto & Electronics Corp. "I can save a lot even after paying for shipping and import tariffs," says Mr. Fujita, who saves on costs by pooling orders with friends.

But he is seeing the other side of the yen's strength, too. He believes fewer soon-to-be-wed couples from Hong Kong are traveling to Japan to be photographed at famous tourist sites, crimping a longtime income stream. The yen value of dollar-based payments he receives from a foreign wire service has fallen nearly 30% in four years.

As his experience shows, the strong yen's benefits look small compared with the damage suffered by the economy by damped export earnings and deepening deflation. The consumer-price index in central Tokyo fell 0.5% from a year earlier in October. Leading the decline were furniture and household items, most imported from China and other Asian countries.

Mr. Shirakawa, the Credit Suisse economist, says that over the long term, the yen's rise could help strengthen the economy if people and companies increase overseas investment. But following steep drops in financial markets world-wide earlier this year, ordinary Japanese investors, like their peers elsewhere, remain risk-averse.

—*Makiko Segawa*
contributed to this article.

Islamists see losses in Egypt

BY CHARLES LEVINSON

CAIRO—Egypt's largest opposition group, the Muslim Brotherhood, said Monday it had failed to win a single seat in parliamentary elections, joining local and international rights groups in denouncing what they described as massive and systemic fraud.

No official results have been released. If the opposition's forecast—gathered from representatives observing the vote-counting process—is accurate, the government of President Hosni Mubarak will have pushed out a group that had made up one-fifth of Egypt's parliament.

"The evidence suggests that Egyptian officials made a concerted effort to prevent opposition candidates from exercising their rights during voting," said Joe Stork, dep-

uty director of Human Rights Watch Middle East division.

Egypt's High Election Commission dismissed the fraud allegations. It acknowledged a handful of irregularities in the voting, but said in a statement that those "did not undermine the electoral process as a whole."

The president's National Democratic Party has called the parliamentary vote a practice run for presidential elections late next year. It remains uncertain if Mr. Mubarak, 82 years old, will seek re-election.

Rights groups said poll monitors from opposition parties were systematically denied access to polling stations around the country, as the law requires.

Unlike in past elections, when Egypt's independent judiciary oversaw voting, a 2007 law significantly

restricted the oversight role of judges this time around.

The Muslim Brotherhood, which is banned but allowed to field candidates as independents, said that only 15 to 30 of its 130 candidates would proceed to a runoff to be held on Dec. 5. The rest of the group's candidates appeared to have lost outright.

The Brotherhood even lost in districts it won by huge margins in the 2005 elections.

The head of the Brotherhood's parliamentary bloc, Saad al-Katatni, for example, lost his seat in southern Egypt, after winning it with 74% of the vote five years ago.

As initial results poured in on Monday, there were scattered reports of violence around the country, as supporters of losing candidates rioted and clashed with police.

Pakistan graft watchdog says it was threatened

BY TOM WRIGHT

ISLAMABAD, Pakistan—Corruption watchdog Transparency International says it is facing intimidation in Pakistan because of its agreement with the U.S. to monitor increased aid flows to the country.

The U.S. Congress a year ago agreed to a five-year, \$7.5 billion civilian aid package for Pakistan, at least half of which will be funneled through Pakistan government ministries. The U.S. in September signed an agreement with Berlin-based Transparency International's Pakistan affiliate under which the group will set up a hotline through which people can report any misuse of U.S. assistance.

Syed Adil Gilani, chairman of Transparency International Pakistan, said he had received death threats from "high-level" government officials telling him to halt antigraft probes and plans for the hotline. He declined to name the source of the threats.

"They don't want TI Pakistan to monitor" U.S. aid flows into the country, he said.

Pakistani Interior Minister Rehman Malik didn't respond to requests for comment.

Transparency International's chairwoman, Huguette Labelle, wrote to Pakistan's chief justice Monday to ask for action to address any "possible state intimidation against TI Pakistan."