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Chile breathes sigh of relief as miners are rescued

Getty Images

Chilean miner Carlos Barrios salutes as he emerges from the rescue capsule Wednesday. He was the 13th to be freed in the dramatic operation to bring up 33 men trapped 622 meters below ground. By late afternoon local time, 22 miners had been brought to the surface. **Articles on pages 14-15.**

U.S. facilitates Kabul contact with Taliban

BRUSSELS—U.S.-led international forces in Afghanistan have been helping to facilitate preliminary contacts in Kabul between President Hamid Karzai's government and Taliban representatives, a move that signals a shift by the U.S. to more active support of Afghan reconciliation efforts.

*By **Adam Entous** in Brussels and **Julian E. Barnes** in Washington*

The previously undisclosed Western assistance, described by a senior North Atlantic Treaty Organization official in Brussels and a second official, includes safe passage for certain Taliban leaders to Kabul for the talks. Previously, the U.S. military had said Mr. Karzai's reconciliation efforts were premature.

"We have indeed facilitated, to various degrees, the contacts between these senior Taliban members to the highest levels of the Afghan government," the senior NATO official told reporters traveling with Defense Secretary Robert Gates. They were both in Brussels to attend a meeting of the trans-Atlantic alliance.

"These are contacts that have taken place in Kabul. It would be extremely difficult for a senior Taliban member to get to Kabul without being killed or captured if ISAF were not witting, and ISAF is witting," the senior NATO official said, referring to the U.S.-led International Security Assistance Force.

The official declined to say who on the Taliban side was participating in the talks, and whether they represented top leaders such as Mullah Mohammed Omar, who is believed to be hiding in Pakistan. "These are in the very preliminary stages of discussions, so you would not yet characterize this by any means as a negotiation," the official said. But he described the Taliban participants as high level.

Attempts were unsuccessful late Wednesday to reach representatives of the Afghan-based Taliban.

It is unclear how many channels of communication have been opened between Mr. Karzai's government and the Taliban, and the senior NATO official provided few details except to say that the talks facilitated by Western forces took place in Kabul.

Earlier this month, Afghan officials, retired Pakistani security chiefs and former Taliban leaders held talks in Kabul to try to find ways to open peace talks with the insurgents. But those meetings, sponsored by the United Arab Emirates in Kabul's luxurious Serena Hotel, didn't involve insurgents. The Taliban's official position has long been to refuse all peace contacts as long as U.S.-led international forces remain in the country.

Officials said the UAE round was one of several

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When Is a bagel not really a bagel? When it's an obwarzanek krakowski.
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World Watch

A comprehensive rundown of news from around the world.
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Support for Iran's opposition can avoid a showdown with Tehran. Page 13

J.P. Morgan's mortgage review overshadows earnings jump

J.P. Morgan Chase & Co. widened its review of foreclosures to 41 states and 115,000 loan files, making it the latest U.S. bank to take a more comprehensive look at its documentation to ensure all information is accurate.

"We are going file by file, case by case," said Chief Financial Officer Doug Braunstein. "If we made mistakes, we fill fix them," he said.

Several other U.S. banks—including **Bank of America** Corp., **Wells Fargo** & Co. and **Ally Financial** Inc.'s GMAC Mortgage—are scrambling to review documents due to concerns about their use of what are known as "robo signers" who approve hundreds of foreclosure documents a day.

Meanwhile, J.P. Morgan set aside $1.3 billion of additional pretax litigation reserves in the quarter, "including those for mortgage-related matters." J.P. Morgan Chief Executive Jamie Dimon said the reserve wasn't related to the foreclosure documentation issue.

The new foreclosure moves overshadowed the bank's announcement of $4.4 billion in third-quarter earnings. The results were up 23% from the year-ago quarter, surpassing analysts' estimates, but largely because it set aside less money for bad loans.

Income in the investment bank was down 33% on weaker trading, and the bank disclosed it cut compensation to its investment-banking unit by 31% during the third quarter. The bank set aside just over $2 billion to pay staff in the business, which earned $1.3 billion in the quarter—the unit's lowest profit since 2008's crisis-laden fourth quarter.

Trading revenues were also expected to decline at Goldman Sachs Group Inc. and Morgan Stanley, putting pressure on compensation around the industry. Goldman reports Oct. 19 and Morgan Stanley reports Oct. 20.

Feeling important in its own right

[Agenda]

By Patience Wheatcroft

Being important may not always be a good thing. Next month the Financial Stability Board will put forward its proposals for dealing with those banks it judges to be "systemically important," or, in popular parlance, "too big to fail." These will almost certainly include heavier capital requirements beyond those laid down in Basel III.

Standard Chartered is not boasting but it suspects that it will be one of those institutions that the FSB judges to be systemically important. With shareholder equity of about £30 billion ($47.6 billion), a presence in more than 70 countries and profits of £3.12 billion in its last half year, it is a business whose collapse would have huge ramifications and which regulators might rightly judge would best be avoided.

Hence Chief Executive Peter Sands thinks it likely that very soon his bank could be facing demands to increase its capital ratios. Mr. Sands does not wish to see his expansion plans constrained by enforced extra conservatism, so he is acting now, with a pre-emptive rights issue. By raising an extra £3.2 billion now he will increase Standard Chartered's core Tier 1 capital to 11%. Basel III called for a minimum of 7% plus a counter-cyclical buffer of up to 2.5%.

Whether 11% will be enough to keep the regulators happy remains to be seen. The Swiss authorities are imposing much stricter demands on their banks, but then between them **UBS** and **Credit Suisse** are five times the size of the Swiss economy. That really does make them too big to be allowed to fail.

Mr. Sands does not believe that the Swiss will be the only ones to move harder and faster than the FSB. At the recent meeting of the Institute of International Finance in Washington, other bankers, including **Deutsche Bank**'s Chief Executive Josef Ackermann, were cautioning national regulators against trying to race ahead of Basel. Such pleading is unlikely to deflect regulators who, having failed to act in time to stop the crash, are now keen to demonstrate their skill at slamming stable doors and bolting them tight.

Bloomberg News

Peter Sands, chief executive of Standard Chartered.

Mr. Sands does not wish to see his expansion plans constrained by enforced extra conservatism.

Their demands, when they come, will force other institutions either to close to large amounts of business or tap the markets for more capital. For a business such as Standard Chartered, with a focus on the emerging markets and plentiful opportunities beckoning in China, India, Indonesia and the like, being forced to walk away from opportunities would be too painful to contemplate. Mr. Sands has therefore wisely decided to jump ahead of any fund-raising queue.

His major investor, Temasek, has already agreed to take up its full entitlement in the rights issue and others will surely follow. The company's growth record over recent years is one that shareholders will want to continue to back. And although Mr. Sands is adamant that he is not seeking a war chest to fund acquisitions, well, at least he will be in a position to add the odd bolt-on purchases if and when they become available.

Is the check in the post?

The U.K. government has taken the first step toward privatizing its postal service, launching legislation for the move, which will take place next year. But in order to make **Royal Mail** at all palatable to purchasers, the business has first to be relieved of its pension-fund deficit.

This is a whopping £10.3 billion ($16.3 billion), symptomatic of the public-sector pension problem that successive administrations have ducked. The taxpayer is already saddled with the debt so is no worse off for holding it directly rather than indirectly.

Royal Mail is just one of the state-owned organizations now likely to come under the hammer as the government embarks on a new wave of privatizations. Other likely candidates are the Royal Mint, which is the world's largest exporter of coins and medals, as well as being the provider of the U.K.'s currency, and gambling organization, the Tote.

While the government is keen to harvest what cash it can from these sales, or at least, unburden itself of some losses, there is also a hope that the sales might benefit productivity.

The unions that are protesting vigorously about the proposed sale of Royal Mail are the same unions that have so fiercely resisted the modernization that the organization has badly needed. In the planned sale, at least a tenth of the shares will be offered to Royal Mail staff and the hope is that employees who become shareholders might have a more positive attitude toward the business.

The network of Post Offices which is part of Royal Mail will not be included in the sale but may be turned into a mutual organization. This is a form of ownership that the coalition government is enthusiastic about and is exploring in other areas of the public sector. The **John Lewis Partnership**, a retailer with 67,000 staff, each of whom is a "partner," is offering advice to the government on a dozen "pathfinder" experiments in mutualization, where public-sector employees have been set up as self-governing organizations to provide services.

The thinking is that by allowing them the freedom to run their own operations, they will become more efficient and creative in the services they provide and the way in which they do so. The business model has certainly worked for John Lewis, one of the U.K.'s most successful retailers. Given the poor performance of many public-sector bodies, experimenting with the mutual model must be worth trying.

Lazard lands Kheraj

Ever since he signaled the end of his stay at **J.P. Morgan**, there has been speculation about where Naguib Kheraj might land next. As chief executive of **Lazard International**, and a deputy chairman of the firm, he appears to have found his ideal role.

What's News

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- **Standard Chartered plans** to raise $5.15 billion in a rights issue to boost its capital position as new global banking rules take effect, in a move that global peers could follow. **19, 32**
- **Porsche said** its net loss narrowed sharply in fiscal 2010 and it expects a return to profitability in 2011. **17**
- **A U.K. judge ruled against** Liverpool FC's owners, bringing the debt-ridden Premier League club closer to being sold to the owners of the Boston Red Sox. **20**
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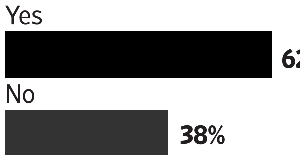

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NEWS

EU decides against deep-water drilling ban

By Guy Chazan

The European Union backed away from imposing a moratorium on deep-water oil drilling in European waters Wednesday, instead recommending new legislation to enforce tough new EU-wide safety standards for the offshore oil and gas industry.

Günther Oettinger, the EU's commissioner for energy, had called for a temporary ban on offshore drilling in sensitive areas until the causes of the Gulf of Mexico oil disaster had been fully investigated. But the idea was dismissed by the U.K., which argued its domestic oil and gas industry has one of the most robust safety and regulatory regimes in the world. The European Parliament also rejected the proposal in a vote last week. The U.S. lifted its own moratorium on deep-water drilling in the Gulf of Mexico on Tuesday.

Instead of a ban, the European Commission, the EU's executive arm, recommended on Wednesday a "single new piece of specific legislation for offshore oil and gas activities," including criteria for granting drilling permits and control of rigs.

"Safety is non-negotiable," Mr. Oettinger said. "We have to make sure that a disaster similar to the one in the Gulf of Mexico will never happen in European waters. This is why we propose that best practices already existing in Europe will become the standard throughout the European Union."

Under the measures being put forward, member states issuing drilling licenses would ensure that oil companies met key EU requirements, had contingency plans in place and the financial means available to pay for any environmental damage caused by accidents. In the event of a spill, companies would also be responsible for cleaning up damage to the natural habitat up to 200 nautical miles from the coast.

Such measures could have repercussions for the European oil industry. Most oil exploration is carried out in relatively shallow waters, but oil companies are increasingly moving into the deep offshore areas, such as the remote basins west of Shetland and in the Black Sea off the coast of Romania. There are nearly 900 offshore installations operating in the EU.

After the Deepwater Horizon rig exploded and sank in the Gulf of Mexico in April, killing 11 and triggering the worst offshore oil spill in U.S. history, the EU launched a safety review of all oil and gas operations in European waters.

While eschewing an outright call for a ban, the commission called on member states to consider suspending the licensing of new oil and gas operations until Europe's offshore safety regimes had been fully assessed. The EU's power to intervene in such matters is limited, since oil licenses are awarded by national governments. Even that softer formula provoked an angry response from Oil & Gas UK, the British oil industry's main trade body. Its head Malcolm Webb called the idea of a suspension "wholly unjustified."

Bloomberg News

Finance Minister Brian Lenihan has said subordinated bondholders should suffer losses to help pay for the bailout.

Anglo Irish creditors fight government plan

By Neil Shah

A group of **Anglo Irish Bank** Corp. creditors is fiercely resisting government efforts to have them help pay for the bank's bailout, complicating Ireland's already fractious banking-system rescue.

Investors holding roughly €500 million ($695.8 million) of Anglo Irish's riskiest bonds—about one-fifth of such debt—are challenging the government's position this week in meetings being run by investment bank Houlihan Lokey, according to a person involved in the efforts.

Another group of investors holding debt of nationalized **Irish Nationwide Building Society** is also trying to mobilize in order to secure a stronger bargaining position ahead of any negotiations with the government over losses. Irish Nationwide has €184 million in risky "subordinated" debt.

Bondholders are growing anxious that they will be forced to take losses on their holdings as part of the broad government bailout effort. They argue that the government has no legal standing to force bondholders to take a loss while the banks continue to operate as state-owned entities.

An acrimonious legal battle would be debt-ridden Ireland's latest black eye. Last month, its central bank said it could cost the government as much as €50 billion to bail out Irish banks, a bill that is driving Ireland's budget deficit to 32% of its gross domestic output this year, the highest for any member of the euro zone since the currency was launched in 1999.

To placate investors and ratings firms, Ireland will unveil a four-year budget plan next month showing how it will cut spending and raise taxes to reduce its deficit to the European Union limit of 3% by 2014.

Ireland's treatment of bond investors could set a precedent for future debt restructurings of bonds issued by nationalized banks. Dublin officials hope to reduce their bank-bailout costs by getting holders of Anglo Irish's subordinated bonds to voluntarily sell their €2.4 billion of debt back to Ireland at a hefty loss, resulting in a multibillion-euro gain for the government. However, a protracted stand-off with creditors could end up further tarnishing Ireland's reputation as a global capital magnet.

"This issue needs to be dealt with sooner rather than later," said Michael Cummins, a director at Dublin-based fixed-income firm Glas Securities. "There needs to be less speculation and headlines regarding subordinated and senior bank debt and more focus on the real economic challenge ahead."

But Anglo Irish's creditors likely face an uphill battle. Finance Minister Brian Lenihan has repeatedly said the bank's subordinated bondholders should suffer losses to help pay for the bailout. Anglo Irish's "senior" bond investors, who rank higher in a liquidation, will be honored in full, he has said.

Anglo Irish's subordinated bonds are trading at a fifth of their original value, suggesting investors' own hopes are low. A spokesman for Ireland's National Treasury Management Agency couldn't be reached.

Many observers expect Ireland to avoid having to force losses on investors by offering to buy back the subordinated bonds for a price slightly higher than their current market value, a move Anglo Irish also made in 2009.

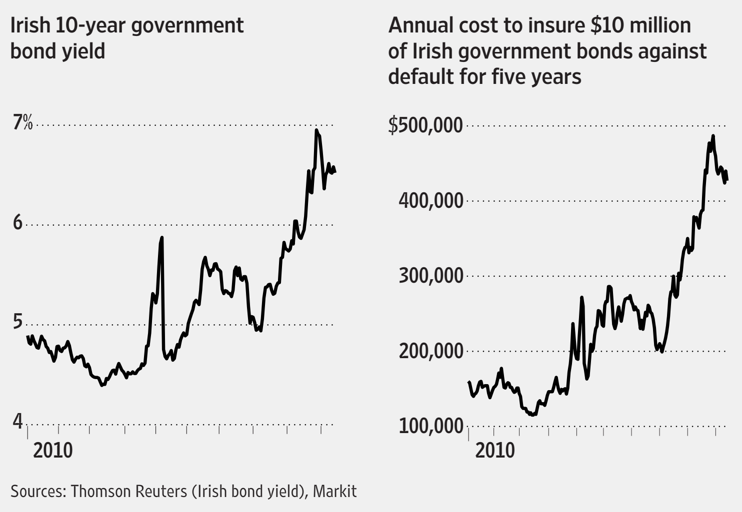
"People might make a public protest, but deep down surely they're not expecting to get 100% back either," said Cambiz Alikhani, partner at London-based asset manager Iveagh Ltd., who doesn't own any Irish bank bonds.

Ireland is also working on legislation that could force losses on investors if the buyback doesn't work out.

Analysts said how Ireland resolves the subordinated debt issue could have ripple effects for similar debt instruments issued by banks across the globe. "Whatever action is taken...will be seen by the markets and the ratings agencies as setting a precedent," Simon Adamson, a banking analyst at research firm CreditSights, said in a recent report.

Brief relief?

Ireland's bond yields have fallen recently, but more troubles could be looming.



Sources: Thomson Reuters (Irish bond yield), Markit

Ireland's Cowen seeks consensus

By Quentin Fottrell

DUBLIN—Irish Prime Minister Brian Cowen has written to the leaders of the main opposition parties seeking a meeting, with the objective of creating a cross-party consensus on the government's proposed four-year budgetary plan, his department said Wednesday.

A government spokeswoman, referring to Mr. Cowen's letter, said, "He believes that the pursuit of the national interest and common good must have priority at this time."

The government aims to cut the country's budget deficit to 3% of gross domestic product by 2014, as previously agreed with the European Union, from an expected 32% of GDP this year due to the cost of the country's bank rescue, estimated at €50 billion ($70 billion) in a worst-case scenario.

"We've received a letter, but we haven't had time to consider it yet," said a spokesman for the opposition Fine Gael party.

A spokesman for the Labour Party also said Mr. Cowen has invited party leaders to a meeting to discuss the budget, but said it is too early to form a response yet.

John Gormley, leader of the Green Party, junior coalition partner of Mr. Cowen's party, Fianna Fail, last week called for leaders of the main parties to meet before the government's four-year budgetary plan is due in early November.

Mr. Cowen has already ruled out establishing an all-party national government to deal with Ireland's economic crisis, but has said he had "no problem" with consultation between political parties.

However, opposition leaders have reacted with skepticism, in public at least, to the government's overtures. They are confident of a victory in the next election.

A general election is due in 2012, but many observers expect it early next year. The Fianna Fail-led coalition government is in third place behind Fine Gael and the Labour Party in recent public opinion polls.

Observers say the inspiration for this goes back to Ireland's last economic crisis in the 1980s. In 1987, when the government's debt stood at 112% of GDP, Alan Dukes, the then-leader of Fine Gael, decided to back Fianna Fail's budget cuts. Mr. Dukes's initiative became known as the Tallaght Strategy after the south Dublin suburb in which it was announced.

The government went on to make deep cuts to public-sector spending, paving the way for the economy's revival in the 1990s and its subsequent transformation into the "Celtic Tiger." However, Fianna Fail was narrowly returned to power in 1989 as part of a coalition. It then went on to govern for 17 of the following 21 years.

These days, some observers say opposition parties have much to lose and little to gain by entering talks and say they are wary of being tainted by agreeing to four years of brutal tax increases, along with pension and social-welfare cuts that could yet see the Irish public take to the streets in protest, as voters have done in Greece and Iceland.

The government spokeswoman said of Mr. Cowen's letter Wednesday: "He believes it would send a strong signal to our European Union colleagues and international markets that the main political parties here are at one in their determination to achieve that objective and to do so in line with the commitments that this government has made in the context of our membership of the euro zone."

Hungary sets new taxes to address deficit target

By Veronika Gulyas

BUDAPEST—Hungarian Prime Minister Viktor Orbán said the country will rely on temporary new taxes on telecommunications and energy companies and supermarkets as the government struggles to meet budget-deficit targets required by the European Union.

In a speech Wednesday, Mr. Orbán, who has pledged not to implement further austerity measures in his recession-hit country, outlined his administration's plans to shrink the budget gap enough to win the confidence of skeptical financial markets.

Investor willingness to fund Hungary's debts is critical because Mr. Orbán has said he won't seek a new loan package from the International Monetary Fund, which would have provided a safety net for the country's finances.

Details of the government budget are expected to be released Monday. But Mr. Orbán said levies on telecoms, energy and supermarket businesses would raise 161 billion forint, or about $818 million, annually through 2012. He said the taxes would be calculated based on companies' 2009 results.

The IMF and the European Union walked away from loan talks with Hungary in July in part because they worried Mr. Orbán's government was relying too much on temporary measures, including a large temporary tax on banks, to meet its budget targets instead of making longer-lasting changes to state spending programs.

As it moves to hold this year's budget deficit to 3.8% of gross domestic product and next year's gap to 3% of GDP, the government will also suspend government payments into private pension funds from November until the end of next year, Mr. Orbán said.

The details of the pension measure weren't immediately clear. It wasn't expected to affect pension payments, but is aimed at temporarily reducing the deficit-widening impact of a revamp of the country's pension system.

Hungary and other countries that are shifting to privatized pension funds have asked the EU to change the rules for how the costs of the revamp are accounted for in their budgets. The EU hasn't responded yet.

EUROPE NEWS

Delessard/Neco/Sipa

Georges Salomon perfected the ski binding and built a global brand.

A ski-binding pioneer

[Remembrances: Georges Salomon 1925-2010]

By Stephen Miller

Georges Salomon perfected the modern ski binding, saving countless leg and knee injuries and made Alpine skiing safe for beginners and racers alike.

After creating his toe-release and cable-heel binding systems, Mr. Salomon went on to expand Salomon into a global ski brand that produced boots, skis and skiwear, as well as golf clubs.

He died Oct. 5 at age 84 at his home on Lake Annecy in Haute-Savoie in France, not far from slopes in the French Alps.

Originally a schoolteacher, Mr. Salomon set up a workshop in Annecy with his father, a saw-blade manufacturer, and in 1947 they began producing sharp metal edges for a nascent postwar Alpine ski industry. Mr. Salomon developed machinery to automate blade production, the company's first important innovation.

In the early 1950s, he acquired a disused patent for a new kind of ski binding and worked on improvements. He introduced his first toe-release system in 1955, and a series of technical innovations followed, including "Le Lift," the first Salomon binding that replaced the traditional leather binding straps.

In 1962, he introduced the Allais safety binding, named for the French Alpine skiing champion of the 1930s. At the 1966 Alpine World Ski Championship in Portillo, Chile, French skiers with Salomon bindings dominated. By 1972, Salomon claimed the world market for ski bindings with more than a million sold annually.

The company ventured into skiwear and then boots, creating the rear-entry ski boot—which was in vogue in the mid-1980s among novice skiers who sought more comfortable gear. Professionals, however, rejected the boots' looser fit.

Mr. Salomon, predicting in the '80s the future lay in producing complete equipment packages, led Salomon to develop its own line of skis, introduced in 1990.

Mr. Salomon and his family sold Salomon to Adidas in 1997 in a deal valued at $1.5 billion. Many analysts attributed the high price to Salomon's earlier acquisition of Taylor Made, a golf-equipment maker that Adidas held on to when it sold Salomon to Finland-based Amer Sports in 2005.

Mr. Salomon and his family sold Salomon to sport giant Adidas in 1997 in a deal valued at $1.5 billion.

A recreational skier, Mr. Salomon tested and honed his products. His shock of white hair and easy manner invited comparisons to philosophers and ski bums, but his aggressive innovation belied such talk.

—*Email remembrances@wsj.com*

EUROPE NEWS

Agence France-Presse/Getty Images (2)

Ukrainian President Viktor Yanukovych, left, is investigating the government of former Premier Yulia Tymoshenko, right.

Ukraine government investigates its rivals

By Alan Cullison
And James Marson

KIEV—Ukraine's government will issue a raft of corruption allegations against the country's former prime minister Thursday—a move certain to step up tensions with her supporters who say the country's new president is creating an authoritarian state.

In a new twist in Ukraine politics, the government of President Viktor Yanukovych will use Western expertise in leveling charges against his rivals. Investigators will release a report researched and written by U.S. private detectives and attorneys who have lately been employed by the country's political elite.

The report takes aim at officials who served under former Prime Minister Yulia Tymoshenko, a charismatic populist heroine of Ukraine's 2004 Orange Revolution who was defeated in elections at the beginning of the year and has since seen a number of allies arrested or investigated for corruption or mismanagement.

Ms. Tymoshenko, a longtime archrival of Mr. Yanukovych, has called the investigations politically motivated.

Political analysts said the latest attack on Ms. Tymoshenko may backfire, since voters in Ukraine have in the past viewed corruption allegations as a public-relations tactic used to destroy opponents. Ms. Tymoshenko's political career got a boost in the 1990s when she was briefly jailed on corruption charges that were later dropped.

"This is not an attempt to fight corruption," said Oleh Rybachuk, a former chief of staff in Ukraine's presidential administration. "It is a strategy to destroy their lifelong opponent [Tymoshenko]. She's no angel, but this is a selective approach."

Mr. Yanukovych's chief of staff, Serhiy Lyovochkin, denied any political motivation in the investigation, which has so far cost more than $2 million, and which officials say aims at retrieving stolen funds to state coffers.

The firms that compiled the report—the law firms **Akin Gump Strauss Hauer & Feld**, and **Trout Cacheris**, and the investigative firm **Kroll** Inc.—worked for five months in London, Washington and Kiev on the report.

The investigators compiled 2,000 pages of exhibits to back up allegations, and two civil suits have already been filed in the U.S. and U.K. against companies that allegedly aided corrupt government officials in skimming public funds.

While the report doesn't link Ms. Tymoshenko to any alleged theft, it does accuse some high-level officials around her.

The report says Ms. Tymoshenko steered hundreds of millions of dollars of budget money to boost her popularity before presidential elections that swept her out of power this year, when she was defeated by Mr. Yanukovych, whose allies in Parliament then fired her.

Among the more serious charges, the report says Ms. Tymoshenko authorized the sale last year of about €320 million ($443 million) in carbon credits under the Kyoto Protocol framework, and used most of the proceeds to cover a shortfall in Ukraine's pension fund.

Although some has been returned to segregate accounts earmarked for environmental projects as directed by the Kyoto agreement, about €200 million hasn't.

The report also accused the Tymoshenko government of buying 1,000 imported vehicles for the Ministry of Health shortly before the elections, and using them mainly as a mobile advertising gimmick for her campaign.

The report also accuses Ms. Tymoshenko of diverting money from a state stabilization fund for banks and steering it into an unrelated program to provide funding for 6.4 million citizens to register and formally own their plots of land.

Hryhoriy Nemyria, former deputy prime minister and a top adviser to Ms. Tymoshenko, declined to comment on specific allegations, saying he hadn't had a chance to review them. But he denied any widespread corruption in her government, and called the report a smear campaign conducted under the guise of a professional investigation.

He noted that investigators looked only at the Tymoshenko government, without looking at Mr. Yanukovych's own role as prime minister from 2006 to 2007.

"These American firms are being used by a government widely accused of backsliding on democracy in a smear campaign to help cement their rule," he said.

The report accuses officials in Ms. Tymoshenko's government of enriching themselves by acting as intermediaries in government purchases of vehicles, medical products, vaccines and 22,000 tons of sugar needed to replenish the country's supplies this year after they were sold off in the summer of 2009.

Mark MacDougall, who headed the investigation for Akin Gump, said the investigation ranged far outside Ukraine to the state of Oregon, the U.K., Latvia, Israel and the Seychelles, where it found "the use of extensive classic offshore money laundering structures."

Investigators said the findings give a rare glimpse into some of the methods of government graft in a country where allegations are plentiful but proof is usually scarce. They allege that the cases were part of a wider pattern of malfeasance in Ms. Tymoshenko's government, and that its profile was part of an "effort to provide a survey or cross-section of suspect government transactions during the stated period of time."

"From the start, our job has been to establish the facts," Mr. MacDougall said. "Every material finding in the report is backed by hard evidence."

Kroll and Akin Gump have in recent years been retained by top businessmen and politicians in other high-profile matters in Ukraine. Kroll was in 2001 employed by a party backed by oligarch Viktor Pinchuk, son-in-law of Mr. Yanukovych's political patron, then-President Leonid Kuchma, to look into the killing of investigative journalist Georgiy Gongadze in 2000.

Akin Gump has in the past represented Rinat Akhmetov, Ukraine's richest man and a major backer of Mr. Yanukovych.

Ethnic violence flares in Kosovo

By Gordon Fairclough

MITROVICA, Kosovo—Assailants struck in the middle of the night, setting fire to a car belonging to one ethnic Serb politician who favors cooperation with Kosovo's Albanian-dominated national government and tossing a grenade at the home of another.

The attack last month in the town of Zvecan was part of a recent series of arsons and bombings that have swept across the north of this fledgling Balkan state, which declared independence from Serbia in 2008 after years of ethnic strife.

Many local Serbs—who make up the majority of the population in Kosovo's northern-most municipalities—don't recognize the authority of Kosovo's central government in Pristina and say they would prefer to remain part of Serbia.

As Kosovo and Serbia prepare for talks aimed at improving relations, tensions have climbed here in the ethnically split town of Mitrovica and other parts of the north, as both sides maneuver to strengthen their positions before discussions start.

On Wednesday, U.S. Secretary of State Hillary Clinton stopped in Pristina and met Kosovo's prime minister, Hashim Thaci. Mrs. Clinton, who visited Serbia Tuesday, called on both sides to "settle practical problems and overcome obstacles to being good neighbors."

Mr. Thaci said it is time for "a new phase" in which Serbia and Kosovo can "cooperate and look to the future."

Coming up with a solution that will bring peace to north Kosovo, which for the past decade has functioned largely as an extension of Serbia, will be critical to any lasting reconciliation between Pristina and Belgrade, diplomats say.

North Atlantic Treaty Organization peacekeeping troops and police officers deployed by the European Union have stepped up joint patrols with Kosovo police in the area and are using nightly checkpoints in an effort to intercept weapons and explosives.

Much of the recent violence is aimed at intimidating local Serbs willing to engage with Kosovo's leaders, EU and Kosovo officials say.

Hard-line nationalist Serbs "are sending very threatening messages to all Serbs who cooperate, who show a readiness to participate in Kosovo institutions," says Ylber Hysa, the Kosovo government's top official for the north.

Distrust between Albanians and Serbs runs deep. During the 1990s, as the former Yugoslavia disintegrated in warfare, Kosovo's Albanian majority suffered persecution at the hands of the Serbian government.

A bloody Serb crackdown on Albanian separatists led to a NATO air war against Serbia and international administration of Kosovo. Serbs suffered reprisal attacks. And in 2004, rioting across the country destroyed Serb property and forced many to flee their homes.

In recent years, however, progress has been made. Kosovo has pursued a policy of decentralization, allowing Serb communities to elect their own municipal leaders and giving them broad authority over education, health care and other government matters.

Mrs. Clinton met mayors from such Serb enclaves in a Kosovo that is 90% Albanian. She said Washington would support them and that the successes of Kosovo and its Serb minority are intertwined.

But the situation in Kosovo's northern municipalities—which are adjacent to Serbia and home to more than 40% of the country's Serbs—has long been different. In the Serb north side of Mitrovica, Serbian flags fly, signs are written in Cyrillic and the Serbian currency, the dinar, is legal tender.

Oliver Ivanovic, a local Kosovo Serb who serves as state secretary in Serbia's Ministry for Kosovo and Metohija, says the north needs "some kind of special status" that will "make us feel that we are freely connected with Serbia." Anything less, he says, won't work. "Emotions are too strong and too widespread," he says.

In talks with Kosovo, Belgrade can be expected to push for a great degree of autonomy and authority for Serb communities in the north, as well as provisions that grant a sort of extra-territorial status to Serb churches and monasteries across Kosovo. The EU put enormous pressure on Belgrade to enter into negotiations, effectively tying Serbia's membership in the EU to better ties with Kosovo.

In the past, some in Belgrade have called for Kosovo's partition so that the northern municipalities can rejoin Serbia, something rejected by Pristina.

Agence France-Presse/Getty Images

US Secretary of State Hillary Clinton poses in front of a statue of her husband, former President Bill Clinton, in Pristina on Wednesday.

U.S. NEWS

Higher ethanol levels allowed in gas

By Tennille Tracy

WASHINGTON—The U.S. Environmental Protection Agency on Wednesday approved an increase of ethanol levels in gasoline for model-year 2007 cars and newer.

In a widely anticipated move, the EPA said it would allow ethanol to make up 15% of fuel blends, up from the current 10%, for these vehicles.

The EPA also proposed a labeling program under which U.S. gasoline stations would state the level of ethanol included in the fuel and identify the types of vehicles for which the blend has been approved.

The decision has been criticized by auto makers, off-road equipment makers and the petroleum industry, which has urged the EPA to postpone a decision until more testing could be done.

While the groups have varying motives for opposing greater corn ethanol production, they—along with many environmentalists—generally say the government hasn't conducted sufficient testing to warrant higher concentrations of ethanol in motor fuels.

The EPA's clean-air director said the agency relied on solid testing to reach its conclusion.

"For EPA's part, we followed the law. We looked at the test results," said Gina McCarthy, the EPA's assistant administrator for air and radiation, in a conference call. She said it was "an appropriate decision for the agency to make under our jurisdiction under the Clean Air Act."

For cars made between 2001 and 2006, the agency is awaiting the outcome of additional research.

The EPA's decision comes as the Obama administration is under criticism by some Farm Belt lawmakers for what they say are overly burdensome regulations from the agency. In South Dakota, Republican Kristi Noem has called for EPA Administrator Lisa Jackson's resignation, citing the agency's inaction on the issue some 18 months after an ethanol industry trade group formally petitioned the agency for such a step.

The cause of boosting ethanol use in cars has been strongly championed by Growth Energy, an ethanol trade group led by Wesley Clark, the retired U.S. Army general and 2004 Democratic presidential candidate.

Gen. Clark's group petitioned the EPA last year to allow ethanol levels in gasoline blends to be as high as 15%. Without the increase, the group said, the U.S. wouldn't be able to meet a congressional mandate requiring some 36 billion gallons of renewable fuel to be blended into the domestic fuel supply by 2022.

—Stephen Power contributed to this article.

Republicans launch $50 million ad blitz

By Brody Mullins And Danny Yadron

An alliance of Republican groups is launching a $50 million advertising blitz this week in a final push to help the GOP win a majority in the House, representing the biggest spending blitz ever by such groups in a congressional election.

The coordinated effort, which the groups have dubbed the "House surge strategy," tops what the official Republican House election committee expects to spend on TV ads for the entire contest. It is aimed at the few dozen competitive races where Democratic candidates have significantly more money in the bank than their Republican opponents, eating into one of the Democrats' last financial advantages.

Democratic candidates, notably incumbents, have raised more cash than many of their Republicans rivals in this year's most competitive House races, according to a Wall Street Journal tally of Federal Election Commission data. In the 40 races deemed toss-ups by the Cook Political Report, a political handicapper, Democratic candidates had a combined $39.3 million of cash on hand as of June 30, the most-recent filing deadline. Republican candidates had $16.5 million in the bank.

Steven Law, who runs two of the Republican organizations, American Crossroads and its affiliate Crossroads GPS, said the effort was "aimed at putting Republicans over the top by evening out the financial disparities and dramatically expanding the field of battle."

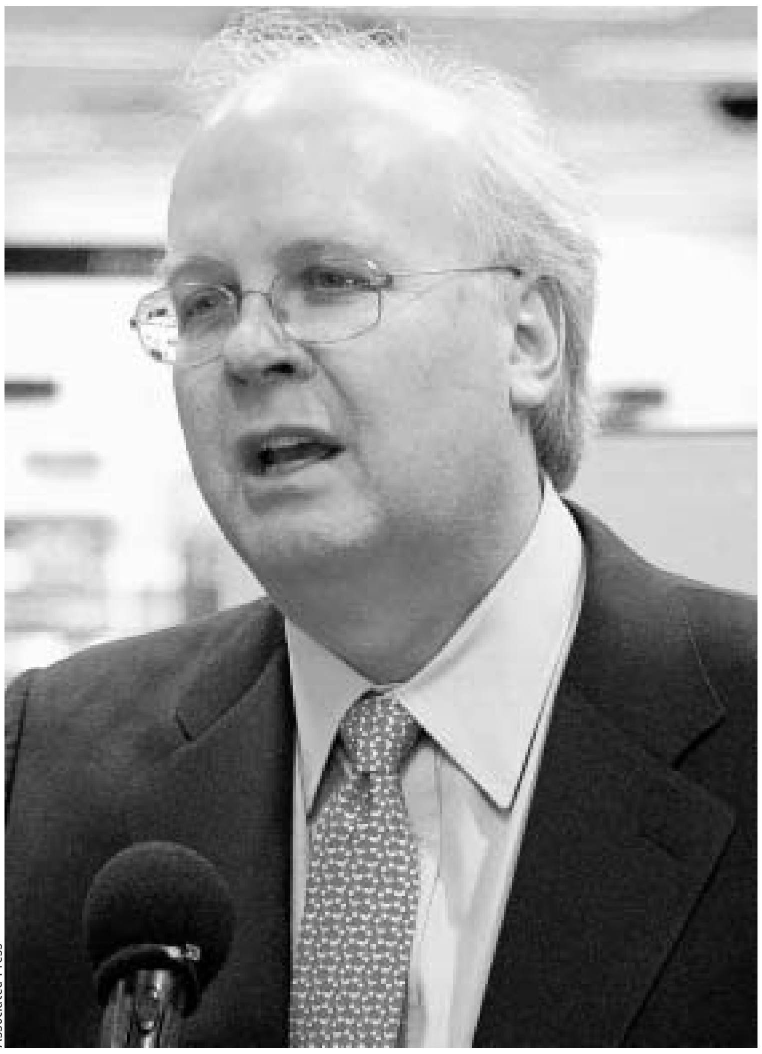
American Crossroads was set up with the help of former Republican White House advisers Karl Rove and Edward Gillespie.

The other two groups are the American Action Network, run by former Republican Sen. Norm Coleman of Minnesota, and the Commission on Hope, Growth and Opportunity, a relative newcomer to the scene founded by Republican campaign consultant Scott Reed.

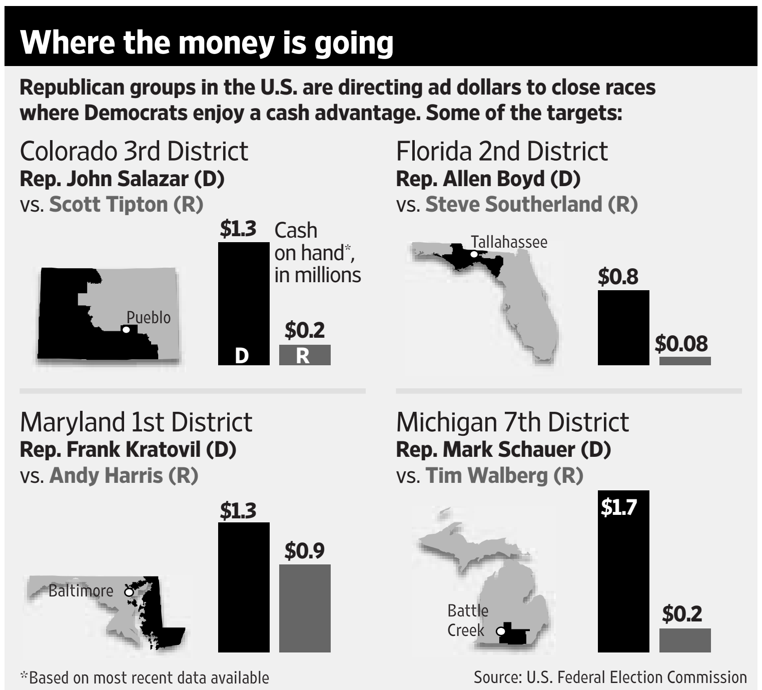
In the Denver suburbs, a $1.5 million ad purchase by the American Action Network will level the playing field for Republican Ryan Frazier, who is taking on two-term Democratic Rep. Ed Perlmutter. Mr. Frazier had only $252,000 on hand as of July 21, while Mr. Perlmutter had a war chest of $1.3 million,

"Conventional wisdom was that Democrats would have a sizable financial advantage in the 2010 elections—that will not be the case," said Rob Collins, president of the American Action Network.

The spending campaign underscores a phenomenon that emerged with force in the 2010 elections: Outside political groups, most of which don't have to disclose their donors, are rivaling the traditional dominance of political parties' official campaign committees. Many of these groups, including those launching the ad blitz, are less than a year old.


Associated Press

A group backed by Karl Rove is working on the 'House surge strategy.'.



"The scales have tipped from the political party to the outside political organizations," said former Rep. Bill Paxon of New York, who once led the National Republican Congressional Committee, the party's House campaign arm.

Evan Tracey, head of Campaign Media Analysis Group, which tracks campaign-ad spending, called the combination of ad outlays by the groups "historic" in its size, an assessment echoed by other campaign-finance experts and officials.

The record spending was made possible in part by a Supreme Court decision that allowed companies and unions to donate unlimited funds to such groups. It also allowed ads by such groups directly supporting or opposing candidates in the weeks before the election.

Spending by outside groups thus far has focused on Senate races. The new Republican effort marks the beginning of an effort to defeat House Democrats.

In southern New York, Democratic Rep. Maurice Hinchey has raised and spent more than his rival, Republican George Phillips. Mr. Hinchey had $267,106 left in his campaign account as of Aug. 25 and Mr. Phillips had $34,727, FEC records show.

American Crossroads plans to drop $300,000 in anti-Democratic ad buys on the race, giving Mr. Phillips more money to play with than his incumbent opponent, who is currently favored to win.

In South Bend, Ind., GOP groups are launching a coordinated effort on behalf of Republican state House leader Jackie Walorski, who has $700,000 less in the bank than her rival, two-term Democratic Rep. Joe Donnelly, who has $1 million.

The American Action Network will spend $240,000 on broadcast TV ads in South Bend, while American Crossroads and its affiliate will buy $150,000 of ads on Chicago-area cable, which shares its media market with northwest Indiana.

The spending is coordinated to avoid overlap. "It's fair to say that the targets are coordinated so that we are all not tripping over each other," said a Republican involved with the effort.

Meanwhile, Democrats have received $482 million, or 53%, of the $911 million donated to all congressional candidates and political parties from corporate political-action committees or individuals who work for companies, according to the nonpartisan Center for Responsive Politics. Democrats have also collected 93% of the $49 million donated by labor unions.

Gates says Congress should set gay policy

By Adam Entous

Defense Secretary Robert Gates said he would strongly prefer legislative action by Congress to repeal the policy that bans homosexuals from serving openly in the military, rather than to see the ban repealed immediately by court order.

Mr. Gates said extensive training and regulatory changes were needed to ensure that the "don't ask, don't tell policy" is repealed in an orderly way to minimize the impact on U.S. forces.

A federal judge in California issued an injunction on Tuesday to immediately stop enforcement of the 17-year-old policy, ordering the government to suspend and discontinue all pending discharge proceedings and investigations under way.

"I feel very strongly that this is an action that needs to be taken by the Congress, and that it is an action that requires careful preparation and a lot of training," Mr. Gates told

Mr. Gates wants any legislative changes to take effect after the Pentagon completes its own review.

reporters on his plane when asked his reaction to the decision by U.S. District Judge Virginia Phillips.

Legislation to repeal the policy stalled in Congress last month, but the White House and its Democratic allies plan to try again after the November congressional election. President Barack Obama has made repeal a priority.

Mr. Gates has voiced support for repealing "don't ask, don't tell" but wants any legislative changes to take effect after the Pentagon completes its own review later this year.

"We have a lot of revision of regulations that has to be done, in addition to the training," Mr. Gates said.

Mr. Gates said the Pentagon review, which includes surveys of service members and their spouses, should not be rushed.

"One of the results of the review will be what kind of other changes we need to make.... This is a very complex business. It has enormous consequences for our troops," Mr. Gates said.

Brian L. Frank for The Wall Street Journal

Software engineer Robby Obaya with his dog Ginger at the Zynga Game Network offices in San Francisco.

Technology start-ups buoy San Francisco

By Pui-Wing Tam
And Nick Wingfield

SAN FRANCISCO—San Francisco is enjoying a renaissance as a technology center as numerous Web and digital-media companies move in or expand in a burst of economic activity not seen since the dot-com boom of the 1990s.

While there has long been plenty of high-tech ferment 30 miles to the south in Silicon Valley, San Francisco itself has traditionally been the region's finance and cultural center rather than a tech magnet. Now, the city is seeing growth from start-ups such as the microblogging service **Twitter** Inc. and the social-gaming company **Zynga Game Network** Inc.

Late last month, Zynga announced a seven-year lease for a 270,000-square-foot space in the South of Market neighborhood, one of San Francisco's biggest commercial-rental deals in years.

At the same time, the city's design talent, cheaper office rents and mix of amenities are drawing an influx of smaller tech firms, such as the social-gaming start-up **Booyah** Inc. and help-desk software start-up **Zendesk** Inc.

"San Francisco is absolutely becoming ground zero for mobile and Web start-ups," said John Hering, chief executive officer of Lookout Mobile Security, a 35-person company that arrived from Los Angeles in January.

It isn't clear how sustainable San Francisco's tech boom is, especially since start-ups are by definition unproven. Many of the Web-based ones aren't yet generating revenue, much less profit. And most rely largely on the same venture capitalists, so if funding dried up, the impact would be widely felt.

During the dot-com boom, when San Francisco was sprouting Internet companies such as **Pets.com** Inc., the ferment spawned tech-filled enclaves before a tbust in 2000 and 2001 wiped out many of the companies. While the sector has shown fits and starts of revival since then, city officials and entrepreneurs said the current level of tech activity is among the most sustained in San Francisco in a decade.

"After the dot-com implosion, everyone had an alternative" for where to locate, said San Francisco Mayor Gavin Newsom. "Now, jobs are chasing people."

Mr. Newsom said Zynga's new lease is the first in a series of office-space deals with Web companies he expects to be announced in coming weeks. Overall, there are now some 500 tech companies in San Francisco, according to the city's Office of Economic and Workforce Development. The activity is crucial for San Francisco, which is projecting a budget shortfall of about $450 million for the 2011-12 fiscal year.

And with the city's unemployment rate at 9.7% in August, tech companies have fueled pockets of job growth, with a 50% increase in the number of software jobs and more than a 20% jump in Internet publisher jobs for the 18 months ended in late 2009, according to Ted Egan, chief economist in San Francisco's Controller's Office.

The influx is also buoying commercial real estate. Tech companies are seeking 1.3 million square feet of space—either to expand or set up shop here— and make up 30% of the current demand for office space, according to Colliers International. Investors are pouring money into the city's start-ups, with venture capitalists putting $528 million into San Francisco companies in the second quarter, more than triple the $164 million in the same period a year earlier, according to research firm VentureSource.

San Francisco now rivals Silicon Valley for hot start-ups, some investors say. "The growth rate of exciting companies is happening more in San Francisco than elsewhere," said George Zachary, a venture capitalist at Charles River Ventures in Menlo Park, Calif. Of the 16 companies he has recently given "seed" financing to, Mr. Zachary said, about 10 are located in the city.

The activity doesn't span all areas of tech; computer-hardware makers still gravitate to Silicon Valley, which has no equal for engineering talent, and start-ups that move north aren't as close to potential partners such as **Facebook** Inc. in Palo Alto.

For Fed, risks of goosing markets are worth taking

[Capital]

By David Wessel

The Federal Reserve is about to try to pump up stock and bond markets, depress the value of the U.S. dollar and generate a whiff of inflation.

That's not how Fed Chairman Ben Bernanke will describe it Friday when he elaborates on his latest plan for resuscitating the U.S. economy. But that's what happens when the Fed turns up its electronic printing presses, creates money and buys hundreds of billions in U.S. Treasury debt, as it is poised to do. That's how "quantitative easing," or QE, works.

Why is he doing this? Unemployment is way above the Fed's target; inflation is a bit below and perhaps falling further. When cutting *short-term* interest rates nearly to zero didn't revive the economy, the Fed bought $1.75 trillion in U.S. Treasurys and mortgages to reduce *long-term* interest rates. In the spring, it rested. It figured all that it had done plus the Obama fiscal stimulus had saved the economy from calamity. It hoped business and consumer spending would take over.

Now, the Fed is saying: We stopped prematurely. It reasons that if the government did more to juice the economy now, unemployment would fall, as would the risk of deflation, a debilitating decline in prices and wages. That diagnosis is important. As the German central banker Axel Weber argued this week: If a central bank thinks unemployment is "structural"—workers don't have the skills employers need or won't move to where the jobs are, or if consumers won't spend for fear of future tax increases or pension cuts—a central bank can and should do nothing. But after weekend meetings in Washington, Mr. Weber said: "My reading of U.S. colleagues' judgment is that when it comes to the strong increase in the unemployment rate, a large part...must be perceived as being [cyclical] rather than structural." And what is cyclical is susceptible to monetary stimulus, he said.

The Fed is reluctant to wheel out the howitzers again. It would prefer Congress and the president agreed to a short-term jolt of fiscal stimulus packaged with credible changes to spending and taxes to reduce future budget deficits. But, as former Fed Vice Chairman Donald Kohn put it recently, fiscal policy is "hamstrung." So the Fed is stepping in.

So how is this supposed to work? In any market, when someone with big bucks starts buying, the price goes up. If the Fed buys, say, another $500 billion of U.S. Treasurys, bond prices will go up and thus bond yields will fall. Economists estimate that would shave perhaps 0.13 to 0.20 percentage point off the yield on 10-year Treasurys, small but significant with yields now around 2.46%. Because other bond markets move with Treasurys, that means lower borrowing costs for big companies that can sell bonds. One problem: That won't do much to boost business spending, since companies are so flush with cash already.

It means lower mortgage rates, too. More problems: Home building isn't going to get us out of this torpor and many homeowners can't refinance; their houses are worth less than they paid for them.

So the Fed hopes to chase investors out of Treasurys into other, riskier securities. Like stocks. That seems plausible. Since Mr. Bernanke confirmed on Aug. 27 that the Fed was thinking about QE2, the Dow Jones Industrial Average has risen more than 10% and the yield on 10-year Treasurys has fallen. If markets thought the economy was getting better, stocks and bond yields would be up. The unusual combination is seen by the Fed as confirmation that QE2 might work as hoped. Higher stock prices, it figures, make households richer and business executives perkier. The Fed hopes they'll spend more as a result.

That's not the whole story. When the Fed prints more dollars, the price of dollars falls—in euros, yen, Brazilian reais. That's not the Fed's chief objective, but it's a fact. A cheaper dollar makes U.S. exports more attractive, and helps the U.S. export more while American shoppers are spending less. Two problems: One, no one else, especially the Chinese, is volunteering to let their currency rise against the dollar. Two, a cheaper dollar tends to mean higher oil prices. Still, the models on which the Fed relies suggest a weaker dollar is a net plus for U.S. growth.

OK, if this is such a good idea, why so much hesitancy and controversy? Because no one is sure it'll work, and everyone knows there'll be unwelcome, unintended consequences. The first round of QE was easier: The economy was collapsing.

Among the risks: One, the more bonds the Fed buys, the harder it'll be to sell them someday without shaking up the markets and the economy, a major worry for some at the Fed, less so for Mr. Bernanke.

Two, easy money leads investors to take excessive risks. The searing memory of the crisis may restrain some investors. Mr. Bernanke says the Fed failed to police the banks when it kept rates low for a long time in the 2000s. He vows to do better this time, scrutinizing both banks and others to spot imprudent bets early. That won't be easy.

Three, the Fed—so focused on unemployment and inflation—is paying too little attention to the possibility that it is sowing the seeds of future financial instability. The last round of easy money is blamed for a global credit binge and, by some, the housing bubble. What will this one yield?

Fourth, the Fed wouldn't mind a little more inflation; it doesn't want a lot. But inflation expectations are hard to calibrate precisely.

Mr. Bernanke and QE2 skeptics have the same list of benefits and risks, but weigh them differently. He thinks the risks are worth taking to avoid what might otherwise be years of stagnation, unemployment and deflation jitters.

WORLD NEWS

Chinese letter reflects rift on reform

BY JEREMY PAGE

SHENZHEN, China—A letter signed by nearly two dozen Chinese Communist Party elders blasting the government's clampdown on free expression is drawing attention to an intensifying discussion over political reform in the run-up to a major leadership conclave.

The signatories—including a former secretary to Mao Zedong—say the letter was inspired by Premier Wen Jiabao's surprise call for political reform in the southern city of Shenzhen in August, and is intended to encourage reformists in the party who want to gradually loosen its grip on society by allowing the media to report freely and by halting Internet censorship.

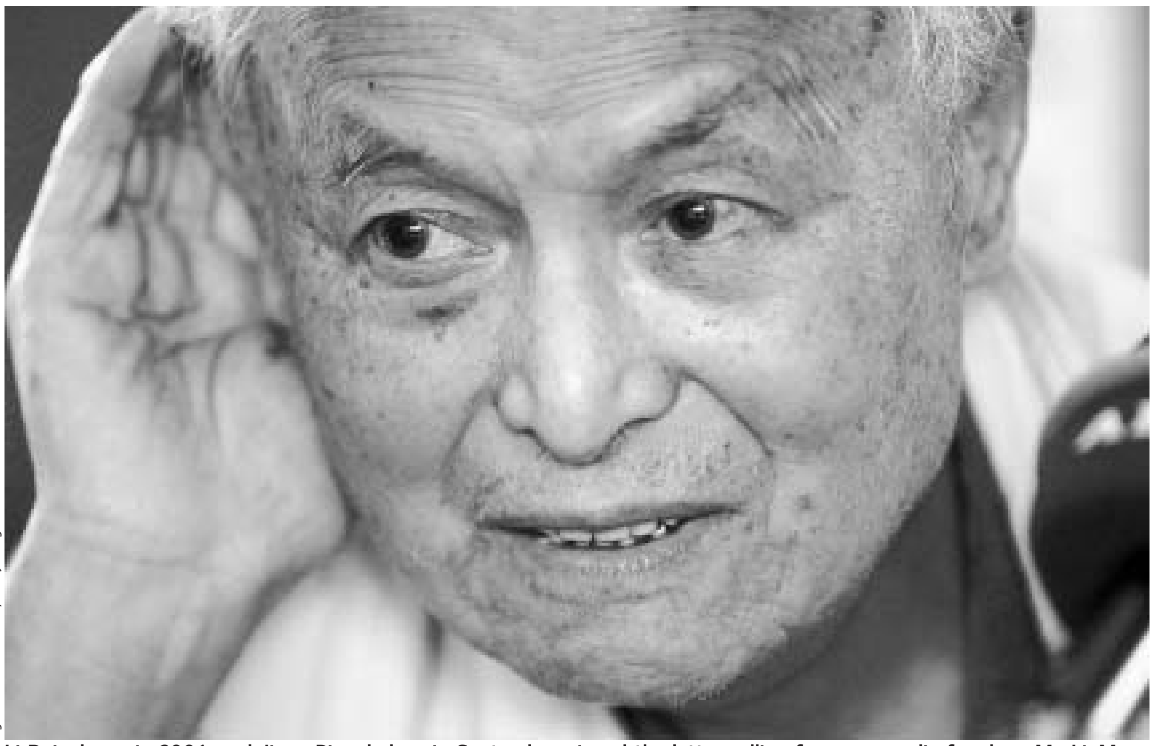
The letter was published online this week as the party's 371-member Central Committee prepared for a three-day meeting, starting Friday, which is expected to decide the direction of economic and political policies ahead of a leadership change in 2012.

It also comes as the party grapples to contain the fallout from the Nobel Peace Prize awarded last Friday to Liu Xiaobo, a Chinese dissident who was sentenced to 11 years in prison in December for writing a manifesto calling for freedom of expression and multiparty elections.

China's giant strides toward economic opening haven't been matched by any significant moves toward political liberalization. Indeed, many analysts see a new model developing in China: authoritarian state capitalism that delivers rapid growth and clamps down on political dissent in the name of social stability.

The media, meanwhile, remains largely muzzled in its efforts to act as a watchdog on government decision-making.

Yet by showing that senior Communist Party figures advocate political reforms, the letter challenges the Chinese government's official denunciation of Mr. Liu's prize as part of a conspiracy by Western countries to impose their values on China and undermine its rise. It suggests that some figures within the party are looking to Premier Wen, 68, as the figurehead of a reformist faction that wants competitive internal elections, and greater media freedom, to help fight corruption and address urgent social problems.



Agence France-Presse/Getty Images

Li Rui, above, in 2006, and Jiang Ping, below, in September, signed the letter calling for more media freedom. Mr. Li, Mao Zedong's former secretary, said, 'From Wen Jiabao's recent comments, it seems that he is advocating political reform.'

Conservatives, by contrast, warn that any such moves could lead to social unrest, and ultimately, the party's overthrow.

The way the letter was published—on the microblogging service of the Chinese website www.sina.com—also demonstrates the power of the Internet in China to advance political freedoms. In much the same way, Mr. Liu's wife, Liu Xia, used Twitter on Wednesday to protest the house arrest she has been under since her husband's award.

The elders' letter, which was signed Oct. 1 and first published Monday, although not circulated widely until Wednesday, demanded the abolition of the "invisible black hand" of censorship and respect for freedoms enshrined in China's 1982 constitution.

"Our goal is appealing to the reform faction among senior leaders to implement reform within the system," said Xiao Mo, former head of the Architecture Research Center of the Chinese National Academy of Arts.

He and other signatories said the letter wasn't connected to Mr. Liu, the 54-year-old former literature professor who was awarded the Nobel Peace Prize on Friday for his

Imaginechina

"long and nonviolent struggle for fundamental human rights in China."

But its release shortly after his prize highlights many of the same issues raised by the Nobel Committee and Mr. Liu.

"We have for 61 years 'served as master' in the name of the citizens of the People's Republic of China," the letter says. "But the freedom of speech and of the press we now enjoy is inferior even to that of Hong Kong before its return to Chinese

From the letter

■ Our core demand is that the system of censorship be dismantled in favor of a system of legal responsibility.

■ There are no more taboos concerning our Party's history. Chinese citizens have a right to know the errors of the ruling party.

■ The Internet is an important discussion platform for information in our society and the voice of citizens' views. ... Internet regulatory bodies must not arbitrarily delete online posts and online comments.

sovereignty, to that entrusted to the residents of a colony."

Among the signatories was Li Rui, Chairman Mao's former secretary and biographer, who is also a former member of the Central Committee and a onetime deputy head of the party's powerful Organization Department.

When asked what he expected the letter to achieve, Mr. Li, who is in his 90s, said: "It's hard to say what result will come of it in the end. From Wen Jiabao's recent comments, it seems that he is advocating political reform." Other signatories included Hu Jiwei, a former editor of the People's Daily, the official Communist Party mouthpiece, and Li Pu, a former deputy head of the official Xinhua news agency. Both are in their 90s.

The signatories are mostly known reformists, who have made similar appeals before, and their political influence is limited now because of their age.

But their letter is still likely to fuel public debate about political reform in China this year, as the party struggles to find a way to maintain economic growth at the same time as addressing an increasingly complex array of social problems.

An early sign of the debate came when Premier Wen wrote an unusual editorial in April praising Hu Yaobang, the reformist party chief who was ousted by conservatives in 1987, and whose death helped inspire the pro-democracy protests around Tiananmen Square in 1989.

Mr. Wen later surprised many observers with a speech in Shenzhen in August, in which he said: "Without the safeguard of political reform, the fruits of economic reform would be lost and the goal of modernization would not materialize."

His remarks were seen as an endorsement of political reforms that have been pioneered since 2005 in Shenzhen, including slashing a third of all government departments and relaxing restrictions on business associations, charities and other non-governmental organizations.

"We've achieved a lot through economic reform in the last 30 years, but we now have to do the same in the political, social and cultural spheres," said Tan Gang, deputy head of the party school in Shenzhen. "Premier Wen's speech was a big encouragement."

Other reforms under consideration in Shenzhen include allowing local media more freedom to monitor the government, and forming an anticorruption body along the lines of Hong Kong's Independent Commission Against Corruption.

Beyond Shenzhen, the speech was seen as a call to expand political reforms to the rest of the country in the same way economic reforms spread across China over the past three decades.

Crowds in Lebanon cheer Iranian leader's arrival

BY MARGARET COKER
AND CHARLES LEVINSON

BEIRUT—Iranian President Mahmoud Ahmadinejad offered Lebanon his country's strong support in fighting what he views as detrimental U.S. and Israeli influence in the Middle East, kicking off his first state visit to this Arab country with a provocative message that cuts to the heart of the political disputes threatening the fragile coalition government.

In a raucous evening rally organized by Shiite militant group and Iranian ally Hezbollah, the Iranian leader spoke of a balance of power in the region away from the U.S. and in favor of the Islamic Republic and its regional allies—what he refers to as "the resistance bloc" that includes Iran and Syria as well as the Palestinian group Hamas and Hezbollah, which the U.S. deems terrorist groups.

"Our world today stands on the verge of change, a change that is starting from our region," Mr. Ahmadinejad told a crowd of thousands of Hezbollah supporters and Shiite religious figures. "Lebanon is an example...for the unwavering resistance to the world's tyrants and a university for jihad."

Lebanon has long been a battleground for the region's powers. For years it has been seen as a bellwether for Iran's drive to expand the sphere of influence of Tehran and its revolutionary brand of Islam. This ideological battle underpins many of the disputes dividing Lebanon's two political blocs: the U.S.- and Saudi-backed government led by Prime Minister Saad Hariri, and the Hezbollah-led opposition.

A key dispute is whether Lebanon should continue its support for a United Nations tribunal investigating the 2005 murder of Mr. Hariri's father, former Prime Minister Rafik Hariri. Hezbollah is pressuring the government to denounce the tribunal's work amid rumors that members of Hezbollah are likely to be indicted for the assassination.

Ahead of Mr. Ahmadinejad's trip, the first to Lebanon for an Iranian head of state in seven years, the U.S. and Israel expressed concern that his visit could weaken Lebanon's fragile coalition government—with Sunni, Christian and Shiite members—to the detriment of U.S. allies in the small country.

"We reject any efforts to destabilize or inflame tensions within Lebanon," U.S. Secretary of State Hillary Clinton said Wednesday.

Mr. Ahmadinejad devoted significant time in his speech to discussing oft-repeated topics: the need for Islamic countries to build a unified front against Israel, particularly now, as the Palestinians attempt to negotiate the creation of an independent state; and the desire to strengthen an Islamic bloc of countries against what he views as a threatening West.

Israeli officials have kept a relatively low profile during his two-day visit to their northern neighbor. They fear that outspoken rhetoric could undermine denunciations of the visit from other Arab leaders, which, like Israel, see an expansionist Iran as a threat. Prime Minister Benjamin Netanyahu put out a statement accusing Iran of preventing peace between Israel and Lebanon.

Agence France-Presse/Getty Images

Iranian President Mahmoud Ahmadinejad, left, is greeted by Lebanese President Michel Sleiman upon his arrival in Beirut Wednesday.

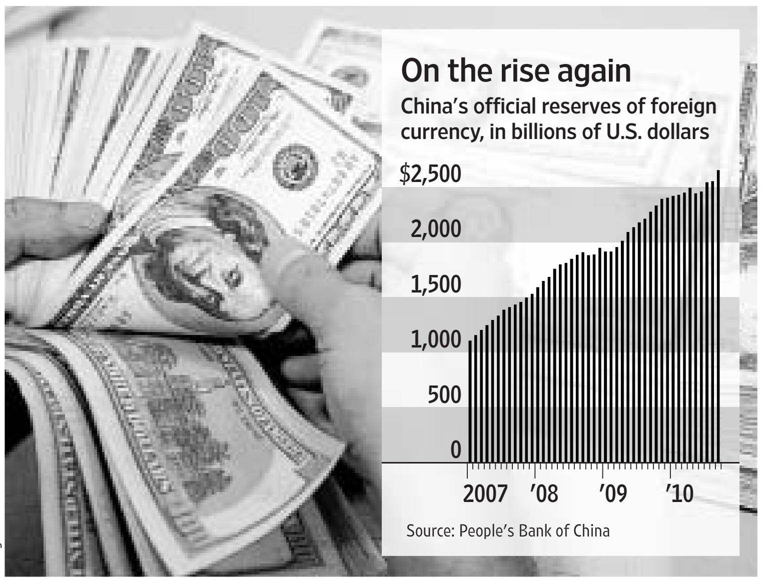
WORLD NEWS

China currency reserves surge

By Andrew Batson
And Aaron Back

BEIJING—China's foreign-exchange reserves swelled to $2.648 trillion at the end of September, in a record surge highlighting the extent of the nation's intervention in currency markets at a time of rising global tensions over exchange rates.

The reserves, already by far the largest such stash in the world, jumped by $194 billion in the third quarter, central-bank data issued Wednesday show, marking their biggest-ever quarterly gain. Economists said the increase in reserves was driven by both a rebound in China's trade surplus and the recent fall in the U.S. dollar, which increases the value of China's nondollar reserve holdings in dollar terms.



Imaginechina via Associated Press

A clerk counts dollar notes at a bank in Huaibei city, China, last month.

Agence France-Presse/Getty Images

Timothy Geithner, in an Oct. 1 photo, again spoke about the yuan. Tuesday.

China adds to its reserves whenever the central bank buys foreign currency and sells its own currency in the market. That makes the buildup of reserves one of the main public indicators of the government's policy of limiting the moves in its yuan currency. The latest jump in reserves—which follows China's pledge of increased exchange-rate flexibility in June—shows that there is still market pressure for the yuan to rise and that the central bank is still resisting that pressure, economists said.

"The huge increase last quarter will make it hard for China to argue that its policy interventions are not a major driver of global imbalances," said Mark Williams of Capital Economics in London.

International tensions over exchange rates were at the forefront of last weekend's meetings of the International Monetary Fund in Washington, and are expected to feature prominently at next month's summit of the Group of 20 major economies in Seoul. The prospect of looser U.S. monetary policy has recently helped to push the dollar down sharply against a range of currencies, from the euro and yen to the Australian dollar and Brazilian real, with the notable exception of the Chinese yuan.

The yuan has risen only about 2.3% against the dollar since June, most of that in the past month. Many U.S. politicians say China's currency is still undervalued, giving its exporters an unfair advantage. Other countries have also complained that China's tightly controlled exchange rate puts more of the burden of adjustment to a weaker dollar on their currencies and exporters, letting Chinese manufacturers off easy.

Japan has stressed that its recent intervention in the foreign-exchange market is different from countries that do not allow their currencies to fluctuate freely, such as China, which sets a daily reference rate for the yuan.

Japanese Prime Minister Naoto Kan on Wednesday said, "If a country keeps its own exchange rate artificially low, this is not in keeping with the G-20 agreement."

Japan took the foreign-exchange markets by surprise on Sept. 15 with a massive intervention to push the yen lower after it neared 15-year highs against the dollar.

On Tuesday, U.S. Treasury Secretary Timothy Geithner said the U.S. wants to make sure the yuan appreciates "at a gradual but still significant rate." A "substantially undervalued" yuan is unfair to other emerging economies that are letting their currencies move, Mr. Geithner said in a televised interview.

The latest reserve figure "certainly puts a target around the neck of China's exchange-rate policy in the newly declared currency wars," said Tom Orlik, an analyst at Stone & McCarthy Research Associates in Beijing.

For its part, China fears economic instability from currency swings, and officials have repeatedly said it will make only "gradual" changes in the exchange rate. In part that is to ensure local companies can adjust, and in part it is to deter waves of speculative capital coming into the country to bet on a stronger currency.

Those worries are shared by many other governments, especially in Asia, which has attracted investors seeking better returns amid uncertain economic prospects and low interest rates in much of the developed world. Such inflows have aggravated the upward pressure on currencies, and many countries have been looking for ways to fight back. Earlier this week, Thailand removed a tax break on foreign investment in its government bonds in hopes of stemming the baht's rise.

Chinese regulators have also repeatedly signaled concern over inflows of so-called hot money—or speculative capital. "Because of market conditions including the expectation of renminbi appreciation and a positive interest-rate gap with foreign currencies, this situation of net cross-border fund inflows is unlikely to change," the State Administration of Foreign Exchange said in a report Tuesday, using the official name for China's currency.

The latest data contain signs that such inflows may have picked up in the past couple of months. The $194 billion quarterly increase in reserves is sizable enough that it can't all be easily accounted for, meaning that other capital inflows could well have contributed.

Much of the increase came from improved export earnings: China's trade surplus for the three months to September totaled $65.64 billion, its highest quarterly surplus since the onset of the financial crisis in the fourth quarter of 2008, data also issued Wednesday show. The trade surplus did, however, fall to a five-month low of $16.88 billion during the single month of September, as commodity imports staged an unexpected rebound. Oil imports, for instance, hit a monthly record in volume terms.

Economists think swings in currency and financial markets in the third quarter may have added anywhere from $60 billion to $100 billion to the value of China's reserves, which are primarily held in U.S. government and other bonds. That is a reversal from the first half of the year, when the rising U.S. dollar was a drag on the reported value of the reserves.

—William Sposato in Tokyo contributed to this article.

Germany warns of trade war over yuan

By Andrea Thomas

BERLIN—Germany urged China to loosen controls on the yuan's exchange rate, warning that a trade war could result from countries competing to boost their exports by keeping their currencies weak.

German Economy Minister Rainer Brüderle said China needs to take action to defuse the risk of a damaging trade dispute with the U.S.

"We have to take care that the currency war doesn't become a trade war," Mr. Brüderle told German newspaper Handelsblatt. "China bears a lot of responsibility for ensuring that it doesn't come to an escalation," he said. The ministry confirmed his comments.

Mr. Brüderle's warning follows other recent criticism of China's exchange-rate policy by German policy makers including Chancellor Angela Merkel and Bundesbank President Axel Weber, and shows the growing concern in Europe's biggest economy that U.S.-China tensions could threaten the global trade flows on which Germany depends.

Germany's economic recovery has been driven in large part by exports to China and other fast-developing countries, and German policy makers view rising international tensions over exchange rates as potentially destabilizing. But German and European comments on China's exchange rate generally remain more muted than U.S. officials' criticisms of Beijing.

Many policy makers and economists on both sides of the Atlantic believe China keeps its currency artificially weak to help its exporters. But the issue is politically less prominent in Europe than in the U.S. In Germany, China's rapid industrialization and export prowess are seen as a boon, since German industry supplies large amounts of capital goods to China, as well as growing numbers of luxury cars to newly affluent Chinese.

Washington has been pushing China to let the yuan strengthen, but China has said that any movement will need to be gradual. Some U.S. officials believe Europe has been hiding behind the U.S. on the issue to avoid diplomatic tensions with Beijing.

However, European Union officials have become more critical of China lately. Last week, Luxembourg's Prime Minister Jean-Claude Juncker said after meeting Chinese Premier Wen Jiabao that "China's real effective exchange rate remains undervalued." European Central Bank President Jean-Claude Trichet and EU economics commissioner Olli Rehn, who also attended the meeting, echoed the point.

The three had urged Mr. Wen to allow an "orderly, significant and broad-based appreciation" of the yuan, the European officials said.

Mr. Wen later scolded the Europeans for pressing China on the issue.

Some European officials remain wary of criticizing China publicly over the yuan. EU trade commissioner Karel de Gucht said last week that he didn't believe pressure from outside would cause the Chinese to act; that pressure would come internally from worries about inflation, he said.

Business pressure on European governments over the currency has largely been muted until now. Executives say that is because many of Europe's biggest companies have large investments in China. Not only do exports from these factories benefit from a weak yuan, but companies also don't wish to upset the Chinese authorities.

—Stephen Fidler in Brussels and William Sposato in Tokyo contributed to this article.

U.S. helps facilitate Kabul talks with Taliban

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"strands" of outreach. ISAF has been facilitating the talks "for a few months, sporadically, with a few weeks to a month between each contact," an official said.

After the Serena talks were reported, Western officials confirmed that the Taliban officials participating were members of the Quetta Shura, the group's central decision-making body. But it was unclear if they had the sanction of Mr. Omar to participate, and it wasn't known whether they would be able to persuade large parts of the Taliban movement to adhere to any deal.

Military officials in Washington have cautioned in recent days not to expect dramatic results from recent talks. "What you are seeing here is a continuation of a process," said a military official.

Confirmation that the U.S. has helped facilitate Taliban participation will likely be received positively in Pakistan, where officials have called on Washington to play a more open role in reconciliation talks. "America is in the talks, but has not revealed itself," a senior Pakistani official said Tuesday. "The U.S. must reveal its face, or it [the war] will get worse. There has to be U.S. ownership of the reconciliation talks."

The Pakistani official said Islamabad doesn't need to run the talks but does need to show it is giving support. Pakistan has repeatedly pushed to be given a bigger role in reconciliation talks and has asked the U.S. to push the Afghan government to involve it more.

Mr. Karzai has demanded that the Taliban recognize the Afghan constitution and lay down arms. But some of his aides and other officials have suggested that the Afghan government would be willing to abandon such "red lines" in an attempt to kick-start substantive negotiations. In return, the Taliban would be expected to abandon demands for the immediate departure of all foreign forces as a precondition for talks, Afghan officials said.

The U.S. government has long insisted that insurgent acceptance of the Afghan constitution, which enshrines democratic freedoms and women's rights, is indispensable for any reconciliation. Other international officials and Afghan policy makers say that democratic mechanisms already exist for rewriting the constitution if necessary.

The senior NATO official speaking in Brussels suggested Mr. Karzai wasn't softening his position. "President Karzai's red lines are quite clear," the official said. "If agreement can be reached along those lines, then that would be a positive development for Afghanistan."

The Serena Hotel meetings—a follow-up to a session held in Abu Dhabi in June—haven't formally involved the 68-member peace council that Mr. Karzai appointed last month to try to open official talks with Taliban leadership headed by Mr. Omar. The Taliban have rejected that council, describing Mr. Karzai as an American stooge and saying the insurgency's military triumph over U.S.-led troops is within sight.

—Maria Abi-Habib in Kabul contributed to this article.