



**Why Liv Ullmann is returning to the stage after 20 years**

WEEKEND JOURNAL

**Geithner targets 'too slow' China over rate for yuan**

NEWS 4

# THE WALL STREET JOURNAL.

VOL. XXVIII NO. 161

EUROPE

Friday - Sunday, September 17 - 19, 2010

DOW JONES  
A NEWS CORPORATION COMPANY

europe.WSJ.com

Queen Elizabeth welcomes pope to U.K.



Queen Elizabeth II welcomes Pope Benedict XVI to the Palace of Holyroodhouse in Edinburgh on Thursday at the start of his four-day trip to the U.K., the first papal state visit to the country. Earlier, the pope condemned the sexual abuse scandal in the Catholic Church. **Related article on page 5**

## Sarkozy, EU step up fight over Gypsies

By CHARLES FORELLE

BRUSSELS—A war of words between the European Union and France over a French campaign to deport Gypsies spilled into a summit of EU leaders Thursday. French President Nicolas Sarkozy angrily denounced a top EU official who had alluded to Nazi horrors in her condemnation of the removals, and insisted they would continue.

The 27 EU leaders weren't scheduled to talk about Gypsies, also known as Roma in Europe. But controversy abhors a vacuum, and the summit's light schedule of nebulous foreign-policy discussion was quickly overtaken by an escalating international dispute that touches on the reach of Brussels' authority, the sanctity of European rights, the pursuit of law and order, and a very peeved French president.

Over a lunch initially dedicated to a progress report from an economic task force, Mr. Sarkozy and José Manuel Barroso, the president of the European Commission, the EU's executive arm, exchanged "very fierce" words, Bulgarian Premier Boyko Borisov told

reporters afterward. "Quite lively," said U.K. Prime Minister David Cameron.

Asked about the lunchtime contretemps, German Chancellor Angela Merkel said: "Lunch was good, as far as the food was concerned."

In late July, Mr. Sarkozy ordered his government to accelerate the dismantling of illegal camps across the country—many occupied by Gypsies—and sending their occupants back to their native countries, mostly Romania. The actions have drawn condemnation from human-rights groups, and the commission joined the fray Tuesday after news reports revealed a French interior ministry memorandum that directed regional governors to make Roma camps a "priority" for demolition.

EU Justice Commissioner Viviane Reding angrily said the commission would begin legal proceedings against Paris. EU law requires each of the 27 nations to allow the others' citizens to live within its borders, provided the immigrants can support themselves. Countries can deport those who fail to comply, but they can't select deportees on the basis of ethnicity.

And Mrs. Reding said one more thing Tuesday: "This is a situation I would have thought Europe would not have to witness again after the Second World War."

That put the French president over the edge. Mr. Sarkozy began a postsummit press briefing with a few perfunctory remarks about Europe's positions as the "premier commercial power in the world." Then he left his notes behind. "All of the leaders were shocked at Mrs. Reding's remarks," which raised "sinister memories" of World War II. "We don't talk like that among European partners," Mr. Sarkozy said.

Taking full advantage of the French language's rich vocabulary of affront, he referred to Mrs. Reding's comments as "hurtful," "deplorable," "shameful," "gravely injurious," "profoundly shocking," and "outrageous." They were, he added, "an injury, a wound, a humiliation." But Mr. Sarkozy wasn't finished.

Please turn to page 3

- South Korea free-trade deal wins approval..... 4
- Tariff cut gives Pakistan relief effort a boost..... 4

## Senate panel endorses Russia arms treaty

By ADAM ENTOUS

WASHINGTON—A key Senate committee backed a revamped nuclear arms-control treaty with Russia and its chairman voiced confidence that the accord, one of President Barack Obama's top foreign-policy objectives, will clear the full Senate this year.

The Foreign Relations Committee voted 14-to-4 to send a compromise resolution to ratify the so-called Start treaty to the full Senate for consideration. Three Republicans joined with the Democratic majority on the panel

to vote in favor.

"I personally believe we will have the votes to ratify this," Committee Chairman John Kerry, a Massachusetts Democrat, told reporters after the vote. "It augurs very well for the Senate debate." He said a full Senate vote isn't expected until after the Nov. 2 congressional election. "The stakes are enormous," he said.

Republican critics questioned how scheduled arms reductions will be verified. Some want Mr. Obama to commit to spending more money modernizing the U.S.'s remaining nuclear arsenal.

But Sen. Richard Lugar of Indiana, the leading Republican on the Foreign Relations Committee and a treaty supporter, helped craft compromise language to bring more of his fellow Republicans on board.

Officials said the real test will be the full Senate, where the treaty will need two-thirds support for passage. That means at least eight Republicans will need to join forces with Democrats.

Supporters say the congressional campaign season has been a complicating factor in the treaty debate because a number of Republi-

cans, who might normally endorse the deal, are reluctant to be seen handing Mr. Obama an election-eve policy victory. Mr. Kerry hopes some of those will come on board after the election season.

The administration's goal is to have the treaty in place by year-end. Officials say failure to pass the treaty would cost the U.S. "eyes and ears" inside the Russian Federation. Inspections of Russian bases stopped when the old Start treaty expired in December and won't resume until the new agreement takes effect.

Mr. Obama and Russian

President Dmitry Medvedev signed the treaty, the most significant arms-control pact between Washington and Moscow in almost two decades, in March.

It has been dubbed New Start, a reference both to the 1991 Strategic Arms Reduction Treaty it replaces and what both sides call a bid to reset the relationship between the world's two nuclear superpowers. It caps the number of deployed nuclear warheads at 1,550 apiece, a 30% reduction from the 2,200 limit agreed to in the Moscow Treaty of 2002.

### The Quirk



Modern day Phileas Fogg is planning a round-the-world blimp race. **Page 29**

### Editorial Opinion

The real problem with the yuan. **Page 12**

Bahrain BD 1.50 - Egypt \$175 (CV) Jordan JD 2 - Kuwait KD 1 - Oman OR 2 Qatar QR14 - Saudi Arabia SR 14

3.7 THE WALL STREET JOURNAL. 97792191986955



## PAGE TWO

# We're now stress-testing the planet

## [ Agenda ]

BY HOWARD COVINGTON

The chances of substantive political progress at the Cancún climate talks this year are slim, but at the more mundane level of trying better to understand the problem there are two interesting climate-related events closer to home. The Science Museum in London is finishing a new gallery called Atmosphere, which aims to explain climate science in a straightforward way to a confused public. It will be well worth a visit if only to see how complex this branch of science really is and to gauge the limits of our knowledge.

Meanwhile, at the Newton Institute in Cambridge, a group of the world's leading climate modelers are trying to push out the limits of knowledge by analyzing and reducing the uncertainties in climate models. The truth is that while we know a lot about the behavior of some of the main components of the climate system and we have a sense of how the whole fits together there is still a lot of scope for surprises—especially when we try to figure out what will actually happen as we stress the climate system with increased greenhouse gases.

Replace climate system by financial system in the last sentence and read mortgage-backed securities for greenhouse gases and you have something that might have been written by a central banker any time up to summer 2007. The results of that particular financial experiment are now in. The one on the climate system is very much running. What might we read across from one to the other?

Firstly, the Citigroup principle—if the music is playing, then carry on dancing—holds good. While there is plenty of money to be made from activities that create greenhouse gases it is hard to see this activity slowing meaningfully anytime soon. Secondly, there will probably be a



Bergs calved from Helheim glacier float in Sermilik Fjord, Greenland in 2009.

Northern Rock moment—some unmistakable public signal that, while not a disaster in itself, lets us know that trouble is surely on its way. An ice-free summer Arctic Ocean might serve this purpose. While fighting shy of exact predictions, the researchers in the field wouldn't be greatly surprised if this happened in the next decade or so.

Thirdly, a Bear Stearns event will eventually arrive—an upset in a major component of the system that tells us we are definitely in trouble. A plausible candidate could be a food crisis triggered by a repeat of this year's Russian wheat crop failure, but occurring several years running in more than one major crop growing area around the world as warmer conditions more frequently trigger floods and droughts. Alternatively, it could be an inundation of a coastal city made vulnerable by higher intensity storms as the oceans warm, helped on by rising sea levels should Greenland's glaciers accelerate their calving as the Arctic warms up.

When might we see this kind of adverse response to the stress test on the planet? The models are too imprecise to say—possibly when the atmosphere is another one degree Celsius or so hotter than today but even trying to work out when this will be means coming to grips with feedback

loops in the climate system that are still poorly understood. Current models suggest it might be a decade either side of mid-century.

The analogy can readily be extended. Ever-increasing house prices, with no collateral consequences, had to be assumed to justify large-scale subprime lending. Our current use of the climate system implicitly assumes that ever-increasing greenhouse-gas concentrations are equally consequence free. In both cases we can choose to argue that the obvious early-warning signs—increasing subprime delinquency on the one hand and increasing extreme weather frequency on the other—are statistical fluctuations rather than evidence of a trend.

It turned out that the financial models for mortgage-backed securities were overly optimistic. This was understandable since they were constructed by bankers in selling mode. It will be no great surprise if climate models suffer from the same defect, this time because of an understandable conservatism in assumptions about the operation of positive feedback loops where knowledge is not yet firm.

The Bear Stearns near-bankruptcy proved to be a tipping point. Through the operation of myriad interrelationships feeding back upon one another, credit

markets seized up and previously uncorrelated asset classes moved in unanticipated unison as their prices rapidly went south, leaving nowhere to hide. Researchers suspect that there may also be climate tipping points. At one of these points, climate feedbacks would operate together to produce what may be uncontrollable change. We can only guess where the tipping points lie, if they exist at all. But like Bear Stearns, we will surely know once we have passed one.

It took the biggest rescue in the history of capitalism to fix the financial system. The fix triggered a sovereign-debt crisis that still reverberates as we try to work out how the fixers will themselves be fixed. The planet's Bear Stearns event may trigger its own rescue through a combination of humanitarian action and geo-engineering that will presumably make the U.S.'s troubled asset-relief program look like a picnic.

What sort of rescue will be needed for the rescuers, and everyone else, from the unintended consequences of engineering the climate can only be guessed at.

The financial crisis was upon us remarkably swiftly. Mortgage-backed securities went from being the mainstay of investment banking profits to being toxic financial waste within half a decade. Momentum for a climate crisis will gather more slowly and it may take another half-century for greenhouse gases to go the same way. We will be waiting for the results of the stress test on the planet for some time yet. Like the stress tests on the banks, we may not appreciate the answers when we see them.

—Howard Covington was formerly chief executive of New Star Asset Management and a director of S.G. Warburg & Co. Ltd. He is a fellow of the Institute of Physics, chairman of the management committee of the Isaac Newton Institute for Mathematical Sciences and a trustee of the National Museum for Science and Industry.

## What's News

■ **European governments** approved a free-trade agreement with South Korea, the world's 12th-largest economy, in one of the biggest free-trade deals ever between two economies. 4

■ **U.K. retail sales fell** unexpectedly and sharply in August, reflecting consumers' concerns about government spending cuts and a reversal in the job market. 5

■ **The number of Americans** living in poverty increased to 14.3% last year from 13.2% in 2008, its highest level since 1994, data showed. 9

■ **Total's CEO said** he expects oil-exploration projects in the Gulf to take 20% longer due to tougher regulations after the BP spill. 17

■ **Fiat shareholders** approved a plan to break up Italy's biggest industrial group next year, freeing its core car business to focus on its alliance with Chrysler and possibly forge new ones. 18

## Inside



Ritz hotels bow to slump and add loyalty program. 27



English football's goal-scoring ability is heading south. 28

## ONLINE TODAY

### Most read in Europe



1. Zombie Buildings Haunt Spain
2. Bank of England's Mervyn King Tries to Sell Unions on Austerity
3. IRA Offshoot Threatens Banks
4. IBM CEO Thumps H-P
5. EU Proposals Target Derivatives

### europe.WSJ.com

FREE daily access for every reader  
First time users please register at:  
[wsj.com/accesstoday](http://wsj.com/accesstoday)  
Once registered, redeem future daily codes at:  
[wsj.com/accessrenew](http://wsj.com/accessrenew)  
Today's code is: EUROPE-RFJ-899

### Real Time Brussels

[blogs.wsj.com/brussels](http://blogs.wsj.com/brussels)

'No commissioner plays the Nazi card lightly, and Mrs. Reding is among the most media savvy.'

Charles Forelle on Viviane Reding's condemnation of Roma deportations



### Continuing coverage



Follow Pope Benedict XVI during his first papal visit to Britain at [wsj.com/uk](http://wsj.com/uk)

### Question of the day

Vote and discuss: How often do you attend religious services?

Vote online at [wsj.com/poll](http://wsj.com/poll)

### Previous results

Q: Do you agree with French lawmakers' move to ban the burqa and other full-body robes?

Yes

78%

No

22%

THE WALL STREET JOURNAL EUROPE  
(ISSN 0921-99)  
Commodity Quay, East Smithfield,  
London, E1W 1AZ

SUBSCRIPTIONS, inquiries and address changes to:  
Telephone: +44 (0) 20 3426 1234. Calling time from  
8 a.m. to 5 p.m. GMT. E-mail: [subs.wsje@dowjones.com](mailto:subs.wsje@dowjones.com).  
Website: [www.services.wsje.com](http://www.services.wsje.com)

ADVERTISING SALES worldwide through Dow Jones  
International. Frankfurt: 49 69 29725 390;  
London: 44 203 426 1111; Paris: 331 40 17 17 01.  
Printed in Belgium by Concentra Media N.V. Printed in  
Germany by Dogan Media Group / Hürriyet A.S. Branch  
Germany. Printed in Switzerland by Zehnder Print AG WIL.  
Printed in the United Kingdom by Newsfax International  
Ltd., London. Printed in Italy by Telesampa Centro Italia  
s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland  
by Midland Web Printing Ltd. Printed in Israel by The  
Jerusalem Post Group. Printed in Turkey by GLOBUS  
Dünya Basinevi.

Registered as a newspaper at the Post Office.  
Trademarks appearing herein are used under license from  
Dow Jones & Co. ©2010 Dow Jones & Company. All  
rights reserved. Editeur responsable: Patience Wheatcroft  
M-17936-2003.  
Registered address: Boulevard Brand Whitlock, 87, 1200  
Brussels, Belgium



NEWS

# Smokers fume as ban heads outdoors

*New York Mayor Bloomberg backs plan to extend prohibition from indoor workplaces to parks, beaches and plazas*

BY MICHAEL HOWARD SAUL  
AND CHRIS HERRING

For decades, one of the signature billboards in New York's Times Square was a man blowing smoke rings. He's lucky he's gone now, because soon that would likely cost him a \$50 fine.

As part of an expansion to the city's ban on smoking in indoor workplaces and park playgrounds, Mayor Michael Bloomberg and City Council Speaker Christine Quinn have lined up behind a plan prohibit smoking in parks, beaches, marinas boardwalks and pedestrian plazas.

With the mayor and the speaker united behind it, the measure is expected to pass, and that has many smokers angry and apprehensive.

"It's extreme," Benjamin Ratliff, a comedy club promoter who works in Times Square, said between drags on a cigarette. "This is something I'm addicted to—it's not something I can just stop doing that easily."

In addition to the pedestrian plaza at Times Square, the smoke-free zone would include Central Park, the Coney Island boardwalk and Herald Square, among many other famous locales.

"In passing it, we think it would help ensure that when New Yorkers and visitors to our city go to the parks and beaches for fresh air, there will actually be fresh air for them to breathe," said Mr.



Daniella Zalcmán for The Wall Street Journal (3); Antonio Bolfo for The Wall Street Journal (Ratliff)

These smokers at the Times Square pedestrian plaza could soon face a \$50 fine. From left, Sidhar Kaya, Benjamin Ratliff, Bridget Lohe and Lanz Joseph.

Bloomberg, a former smoker. He argued that second-hand smoke is dangerous, even outdoors.

While violators would be fined \$50, officials said they hoped most New Yorkers will enforce the ban on their own and "politely remind" smokers who are violating the law that they are in a smoke-free zone.

The legislation was slated to be introduced in the City Council on Thursday. If approved, it would take effect 90 days after the mayor signs

it into law.

"It's like a dictatorship," said Scott Sottile, a bus operator from Brooklyn, who was enjoying a cigarette with his lunch in Brooklyn's Columbus Park. "It's not like we're talking about smoking inside somewhere; this is outside," he said, gesturing at the sky above as a mariachi band played across the plaza from him. "It's just amazing to me."

He wasn't alone in his criticism. Walking along a path in Central

Park, architect Asen Borisov, who smokes half a pack of cigarettes daily, said he "would just stop coming to the park" altogether if the proposal passed.

"I already stopped going to the bars and restaurants," he said, "because half the pleasure for me was lighting up a cigarette when I finished my meal."

Violators could be issued summonses by the Police Department and Parks Department officials. But

Councilwoman Gale Brewer, the legislation's lead sponsor, said she thinks the enforcement will come largely from New Yorkers giving smokers gentle reminders.

People just need to say, "Excuse me, sir, but that's illegal. You really cannot smoke here," Ms. Brewer, a Democrat, recommended. "That's the way we would enforce it. That would be my vision. I'm here to say it's not revenue enhancing from my perspective. It's not punitive."

## Sarkozy, EU scrap at talks

*Continued from first page*

He said his government began dismantling camps because they posed a threat to public order and were havens for criminality, besides being shoddy and unfit for habitation. Still, he said, "we acted and will continue to act in strict accordance with European directives," including the antidiscrimination provisions. The memorandum naming Gypsies, he said, was replaced as soon as he learned of it.

"We will continue to dismantle illegal camps," he said. France dismantled some 500 camps in August, Mr. Sarkozy said, of which more than two-thirds housed not foreign Gypsies but "gens du voyage," people of French nationality who move about in caravans. (They aren't deported.)

The sniping even drew in the nor-

mally staid Jean-Claude Juncker, the prime minister of Luxembourg. Responding to reports that Mr. Sarkozy had said Luxembourg could take in Gypsies if Mrs. Reding liked them so much (Mrs. Reding is Luxembourgish), Mr. Juncker said the quip was "inappropriate," Agence France-Presse reported.

Mr. Barroso, the commission president, didn't take the bait—for the most part.

"It is unacceptable for there to be any kind of discrimination. We've had some things said that were out of order. The commission could itself complain about the use of rhetoric," he said at yet another news conference Thursday. "Let's put this behind us."

—Patrick McGroarty  
and Nicholas Winning  
contributed to this article.



European Pressphoto Agency

President Sarkozy, left, with Romanian President Traian Basescu on Thursday.

### BREITLING for BENTLEY

BENTLEY MOTORS CHRONOGRAPH

WWW.BREITLINGFORBENTLEY.COM



## NEWS

# Geithner takes heat on China

By BOB DAVIS

WASHINGTON—Facing hostile congressional questioning, Treasury Secretary Timothy Geithner took a middle ground by pressing China to significantly boost the value of its currency while fending off lawmakers who pressed for punitive steps he felt could be counterproductive.

“We’d like to see a sustained period of appreciation at a pace” that would largely erase the yuan’s undervaluation, Mr. Geithner told the Senate Banking Committee. While he didn’t name a specific target, he several times referred to the 20% appreciation of the yuan against the dollar from 2006 to 2008.

Mr. Geithner said the 1% jump in the yuan’s value over the past 10 days was “good and encouraging,” but said he wasn’t convinced that signaled a lasting move upward.

Thursday morning’s hearing in the Senate and afternoon session at the House Ways and Means Committee come at a politically sensitive moment. Chinese trade policies have become an issue in the November U.S. elections and the Obama administration is on the defensive because the Chinese currency has appreciated little since Beijing said in June it would allow greater “flexibility” in the exchange rate after tying the yuan tightly to the dollar since 2008.

Lawmakers from both political parties said at the Senate hearing that Chinese trade policies amount to an unfair trade subsidy that hurts American companies and needs to be halted. About 100 House lawmakers sent a letter recently to the House leadership asking for a vote on a bill that would allow the U.S. to impose tariffs and other penalties on countries that undervalue their currency.

In the Senate, New York Democrat Charles Schumer is leading a similar effort. He and other lawmakers blasted Mr. Geithner for not taking sufficient action.



Treasury Secretary Timothy Geithner takes his seat to testify before a Senate Banking, Housing and Urban Affairs Committee hearing largely focused on China’s exchange-rate policies in Washington on Thursday.

“China’s currency manipulation is like a boot on the throat of our recovery and this administration refuses to try to get China to remove that boot,” he told Mr. Geithner. Kentucky Republican Jim Bunning accused the secretary of having “violated the law” by releasing a report on currency manipulation several months late and having “ignored reality” by not labeling China a currency manipulator.

For more than a decade lawmakers have excoriated for being too soft on Beijing. But the congressional tongue-lashing can have an effect—largely through signaling to Beijing that punitive legislation is possible if it doesn’t adjust its policies. Indeed, Mr. Geithner tried to use the congressional ire to ramp up pressure on Beijing to act.

“It’s very important for people to know how strong the sentiment is,”

he said, and that it’s bipartisan.

An undervalued yuan makes Chinese exports less expensive than they otherwise would be and makes imports more expensive. That can work to the disadvantage of U.S. exporters that compete with China, including tool makers and wind power companies.

Mr. Geithner said Chinese currency policy has a “material effect” on the U.S. economy. He told lawmakers several times, though, that U.S. policies encouraging research and investment were more important to U.S. competitiveness than foreign trade measures.

Lawmakers pressed Mr. Geithner to take harsher action with Beijing or at least to provide advice on how U.S. trade laws could be toughened effectively. Senate Banking Committee Chairman Chris Dodd said while there wasn’t sufficient time left on

the legislative calendar to pass new punitive legislation, a bill backed by the administration would send a powerful signal to Beijing.

Walking a fine line, Mr. Geithner punted on those requests. He said any new legislation must be “consistent with international obligations”—meaning it couldn’t violate rules of the World Trade Organization and other international bodies—and “has to be effective in terms of producing more benefits than it does risks.”

He wouldn’t define risks. Administration officials have said privately that they don’t want to back Chinese leaders into a corner and produce an anti-U.S. backlash.

China’s Foreign Ministry Thursday reiterated Beijing’s position that yuan appreciation won’t resolve the U.S. trade deficit with China or high unemployment in the U.S.

# Tariff cut gives boost to Pakistan relief effort

By JOHN W. MILLER

BRUSSELS—European Union governments agreed to suspend some tariffs on imports from Pakistan in an effort to help it recover from this summer’s brutal flooding.

The cuts, however, will be less than hoped for by many activists, EU officials said, a sign that the recession is limiting what rich countries are willing to do to help those in need. Donor countries are meeting Sunday in New York to discuss ways of raising more money for reconstruction in Pakistan.

U.S. special envoy to Pakistan and Afghanistan Richard Holbrooke said Thursday that the world will be able to fund only a quarter of the tens of billions of dollars needed to rebuild Pakistan, according to the Associated Press.

Pakistan sustained economic damage of around \$15 billion, roughly 10% of its gross domestic product. Flood-relief aid committed to Pakistan so far amounts to \$1.1 billion. Pakistan will have to pay for much of the reconstruction, especially by improving its meager tax-collection record, Mr. Holbrooke said. “I don’t want to withhold money they need, but I think we have to be clear that the Congress is going to be reluctant to give money if the money is filling in a gap because people are not paying taxes,” he said.

With aid budgets limited, diplomats have turned to trade, where Pakistan has ample room to grow. With 170 million people, Pakistan is the sixth most populous nation on earth. Yet its exports totaled only \$13.1 billion last year, roughly the same as Ecuador, population 13.4 million.

The EU imported only \$4.6 billion in goods from Pakistan last year, ranking Pakistan 46th among all of the EU’s trading partners. Pakistani exports to the U.S. amounted to \$3.2 billion.

Pakistani textile firms, under pressure from Chinese competition, have taken the lead in lobbying for better market access in the U.S. and EU. They are finding some allies. The U.S. Chamber of Commerce wrote to Secretary of State Hillary Clinton and U.S. Trade Representative Ron Kirk last month to advise tariff cuts.

On Thursday, EU leaders offered a tangible concession. “The European Council underlines its firm commitment to grant exclusively to Pakistan increased market access to the EU through the immediate and time-limited reduction of duties on key imports,” they said in a statement. Pakistan will also be allowed to join a low-tariff scheme known as GSP-plus by 2014.

EU Trade Commissioner Karel De Gucht will administer the specific cuts. In the end, the cuts will be about \$400 million a year, EU officials said. The officials expect the commissioner to limit the cuts to around that amount to protect manufacturers in textile-producing nations such as Italy, Spain and France, which say they fear being drowned out by Pakistani imports.

—Tom Wright  
contributed to this article.

# EU approves Korea trade deal

By JOHN W. MILLER  
AND MATTHEW DALTON

BRUSSELS—European governments Thursday approved a free trade agreement with South Korea, the world’s 12th-largest economy. With bilateral trade at \$74.3 billion last year, it is one of the biggest free trade deals ever between two economies, rivaled only by Australia’s trade pacts with China and the U.S.

All 27 European Union members had to clear the treaty, which must still be ratified by the European and Korean parliaments. The biggest hurdle was getting the approval of Italian Prime Minister Silvio Berlusconi. His government had opposed the agreement on the grounds that inexpensive South Korean imports would unfairly challenge Fiat SpA in selling small cars.

Mr. Berlusconi changed his stance Thursday, as trade ministers met on the sidelines of an EU summit after other EU leaders guaranteed separate legislation mandating emergency tariffs in case South Korean imports overwhelm EU markets, and postponed the deal’s implementation to July 1, 2011. Starting then, tariffs will be phased out on 96% of European and 99% of South Korean goods within three years. All levies on industrial goods

will be eliminated within five years.

The deal is a coup for EU trade negotiators. The EU started talks with South Korea in 2007, the same year as the U.S. Fearing a protectionist backlash, however the administration of U.S. President Barack Obama hasn’t yet presented the U.S.-South Korea free trade agreement to Congress.

The paralysis in the U.S. is emblematic of what has been happening to trade talks across the world. The last attempt to restart the nine-year-old Doha Round of global talks, in December in Geneva, failed amid fears of fueling protectionism.

In all countries, “people are afraid” of another trade deal, U.S. Trade Representative Ron Kirk said in an interview during that Geneva summit. “Trade has provided a way for people to have fresh produce, cheap T-shirts, available electronics, but the pain of trade is very real.”

President Obama in July said he wanted the two countries to resolve differences by November, when he will visit South Korea for the Group of 20 economic leaders summit. EU ministers will monitor South Korea’s free-trade talks with the U.S., to ensure that any new benefits given to the U.S. should also be granted to the EU.

The EU, meanwhile, is working

## EU-Korea trade boost

The EU believes its new free-trade deal with South Korea can give European companies an edge over the U.S. in the race to grow exports to the world’s 12th biggest economy. In billions of dollars



on free-trade deals with India, Vietnam and Malaysia. The deal with South Korea is “the first generation of bilateral trade agreements which will bind Europe and Asia together in an ever-closer economic bond,” Belgian Foreign Minister Steven Vanackere told reporters.

According to EU estimates, the deal will generate an additional \$25 billion of additional exports for EU producers. It will likely be in the

high-technology industrial sectors where Europe is strong. Top EU exports to South Korea in 2009 were nuclear machinery and parts, \$8.6 billion, electronics, \$3.4 billion, and cars and trucks, \$2 billion.

Still, the European car industry is skeptical it will come out ahead. It has been fiercely critical of the rebates South Korea gives auto makers like Hyundai Motor Inc. on each car they export to offset tariffs paid on that car’s imported parts. Those rebates will continue but will be capped if there are “dramatic changes in foreign outsourcing.”

South Korea exported \$36.5 billion of cars to rest of the world last year while importing only \$5.5 billion. “There’s obviously something in the Korean market that makes it difficult to sell cars there,” says Ivan Hodac, secretary-general of the European Automobile Manufacturers’ Association. “Just because you eliminate the 8% duty doesn’t mean it will get easier.”

Trade analysts, however, said the EU will be the big winner. “It’s a typically mercantilist deal, where, as in most trade deals, the bigger economy has an advantage,” says Fredrik Erixon, director of the European Center for International Politics and Economy, a Brussels pro-market think tank.



## EUROPE NEWS

# Pope faults handling of abuse cases

BY STACY MEICHTRY

EDINBURGH, Scotland—Pope Benedict XVI on Thursday faulted the Roman Catholic hierarchy for not acting swiftly to stop sexual abuse by priests, as he traveled to the U.K.

The Vatican has billed the trip, the first-ever papal state visit to the U.K., as an occasion for the pope to reassert himself on the world stage and challenge Europe's drift from church teachings. After visiting Queen Elizabeth II in Edinburgh and presiding over a Mass in Glasgow, the pope flew to London on Thursday night.

Prior to arriving in Scotland, the pope responded to written questions from reporters aboard the papal flight, which arrived in Scotland Thursday morning.

When asked to respond to recent polls showing the scandal had shaken the faith of British Catholics, the pope said he was "shocked by the revelations" of abuse, which he described as a "perversion that is hard to understand."

"It's sad that church authorities were not sufficiently vigilant, fast and decisive to take the necessary measures. For all of this, we are in a moment of penitence," he said.

The comments were the first time the pope has directed criticism at the highest ranks of Roman Catholicism. He has chastised abusive priests, accepted the resignations of bishops who failed to report abuse, and tightened church laws on disciplining abusive priests. He hasn't delved into what some victims of abuse consider the root cause of the crisis: bishops and cardinals who cover up for abusive priests.

Critics of the pope have called on him to order bishops and other officials to immediately report allegations of sexual abuse to police. Vatican laws have no such requirement.



Pope Benedict XVI gives Holy Communion to pilgrims on stage at Bellahouston Park in Glasgow on Thursday.

Church officials are required to comply with civil laws in their respective countries, but many predominantly Catholic countries, such as Italy, don't have mandatory reporting laws.

The pope called on church authorities to ensure that abusive priests "are excluded from every form of contact with the young." He added that abusive priests suffered from a "sickness" and needed to be "protected from themselves." The pope didn't say how authorities should crack down.

Cases of sexual abuse by Catholic priests haven't been widespread in the U.K., where Catholics make up about 10% of the population. Neighbors with higher Catholic populations, such as Ireland and, more recently, Belgium, have been racked with allegations of decades-old

abuse that have only recently been reported by victims.

Victims from across Europe, North America and Australia have said they plan to converge on the U.K. to protest the pope's visit. Organizers say the pope is expected to meet with a group of about 10 victims, a move that has helped defuse criticism of the pope during prior trips. The Vatican has declined to comment on the potential meeting.

Groups advocating gay rights and atheism have also said they will also protest the visit. The pope said he was "not worried" about what kind of welcome he will receive on British soil. "A church that tries to be popular is on the wrong track," Pope Benedict said.

The pope, a native of Germany, met with Queen Elizabeth II at the Holyrood House, the royal family's

palace residence in Edinburgh, on Thursday. There, he invoked the Nazi persecution of European Jewry as a "lesson" of "atheist extremism."

"Let us never forget how the exclusion of God, religion and virtue from public life leads ultimately to a truncated vision of man," he said. The pope, who presided over an open-air Mass in Glasgow afterward, has made the renewal of Christian faith in Europe a cornerstone of his papacy.

On Sunday, the pope plans to beatify Cardinal John Henry Newman, a 19th-century theologian who converted to Catholicism. Cardinal Newman, like the pope, advocated a robust presence for religious leaders in the public square. Pope Benedict's call for renewal, however, has run aground over the past year as the public has turned its attention to the

sexual-abuse allegations.

Among the guests who attended the royal reception in Edinburgh was Cardinal Sean Brady, Ireland's top Catholic official, who has faced repeated calls to resign at home for failing to report two abuse cases to police.

Cardinal Brady, who carried out an internal church investigation of the abuse cases in the 1970s, apologized earlier this year for his handling of the cases, saying he would resign if asked to by the pope.

Some victims said the cardinal's presence at the royal reception belied the pope's criticism of church authorities. "If there was real remorse, action would be taken to discipline men like Sean Brady. ... The actions don't fit the words," said Marie Collins, 66, of Dublin, who was abused by a priest in 1960 while she was recovering from surgery in a children's hospital.

Pope Benedict has accepted the resignation of some bishops in Ireland and rejected others. None of the bishops was asked to resign, according to the Vatican.

Pope Benedict has faced scrutiny for his own handling of sexual-abuse cases as the former archbishop of Munich-Freising in Germany and as the Vatican's top official in charge of disciplining priests for more than two decades.

In one case disclosed in March by the Archdiocese of Munich-Freising, the pope approved the transfer of a priest known to church officials as a sex abuser to the archdiocese. The priest was convicted in 1986 for sexually abusing children in the archdiocese.

The pope's comments came as Germany's Jesuits announced a plan Thursday to pay the victims of sexual abuse in the order's schools "symbolic compensation" of at least €5,000 (\$6,500) each, the Associated Press reported.

## Sharp fall in U.K. retail sales

BY AINSLEY THOMSON  
AND ILONA BILLINGTON

LONDON—U.K. retail sales fell unexpectedly and sharply in August, reflecting consumers' concerns about government spending cuts and a reversal in the job market.

The volume of retail sales dropped 0.5% from July, the first decrease since January, and the annual rate of growth slowed to 0.4%, the government statistics office said. The agency observed a broad-based decline across both food and nonfood stores.

The result, together with other news Thursday of contracting order bookings among U.K. manufacturers, added to evidence that Britain's economic recovery is losing pace in the second half of the year.

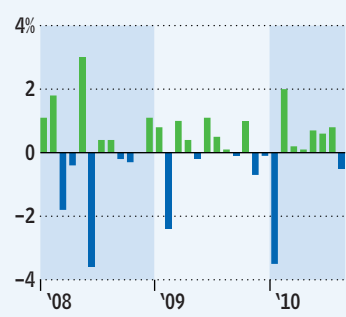
U.K. jobless totals in August went up again for the first time since January. House prices are also falling as demand for the growing number of properties up for sale remains sluggish and mortgage criteria remain tight, which also typically weighs on consumers' confidence.

The faltering recovery is in line with that of the 16-nation euro zone, where only Germany is bucking the trend with robust growth, led by exporters and consumers.

The European Union's Eurostat statistics agency reported earlier in

### Slow sales

U.K. retail sales, change from the previous month



Source: U.K. Office for National Statistics

the week that a slowing rise in industrial production in the region reflected fiscal-austerity plans in countries struggling to rein in budget deficits.

That euro-zone trend could drag down third-quarter growth in gross domestic product in the region. France recently became the first country to acknowledge it will have to lower its economic forecasts.

In the U.K., Prime Minister David Cameron's coalition government is planning to shrink the budget deficit with a combination of spending cuts and tax increases that would suck £113 billion out of the economy over five years. Most of these steps, in-

cluding a rise of 2.5 percentage points in the value-added tax on retail goods, won't take effect until January.

"While the prospect of next January's VAT rise should prompt some spending to be pulled forward into the end of this year, the outlook for spending next year still looks pretty bleak," said Vicky Redwood, senior U.K. economist for Capital Economics.

Economists traced the unexpectedly bad retail figures to concerns about job security and tax rises amid the government's austerity drive.

For now, the government still projects the economy will expand by 1.3% this year and by 2.6% in 2011.

The apparent cooling in the British economy clouds the outlook for the Bank of England, which until recently had been considering how and when to unwind its stimulus programs. BOE Governor Mervyn King this week suggested that the central bank could even add further support for the economy if growth slows more than expected.

Meanwhile U.K.-based retailers Kingfisher PLC, Kesa Electricals PLC and John Lewis Partnership PLC Thursday reported higher profits and sales, but warned the consumer environment in the U.K. and across Europe will remain tough for the rest of this year and into 2011.

## Gas pipeline is criticized

BY RICHARD BOUDREAU

MOSCOW—Ukraine's foreign minister said Thursday that one of Russia's most ambitious energy projects, the planned South Stream gas pipeline across the Black Sea to Europe, would be "wasteful, unnecessary and totally against the logic of modern economy."

The unusually pointed criticism underscored lingering tension between the two former Soviet neighbors over energy, despite a marked improvement in overall relations since the election of a Russia-

friendly government in Ukraine.

Foreign Minister Kostyantyn Hryshchenko also reaffirmed Ukraine's opposition to a takeover of its state energy firm, Naftogaz, by Russia's OAO Gazprom or a merger of the two as proposed by Moscow. Ukraine is seeking a discount on the natural gas it buys from Russia. Russian officials say lower prices could be achieved by merging the two energy companies.

Instead, Ukraine has proposed setting up a joint venture in which Gazprom and Naftogaz would have equal stakes.

F.P.JOURNE  
Invenit et Fecit

Entirely invented and manufactured in-house

NEW WEBSITE

FPJOURNE.COM



## EUROPE NEWS



Alexa Vachon for The Wall Street Journal

Farm manager Egon Rattei lost a tractor to thieves in April, part of what police call a wave of thieves taking vehicles from Germany to Poland.

## Cross-border thieves eye tractors and luxury cars

BY PATRICK MCGROARTY

FORST, Germany—Returning home from a midnight wild-boar hunt near his village along the Polish frontier in July, German farmer Matthias Rattei met an unexpected group of visitors: thieves trying to steal a €250,000 harvester and two tractors.

After several years of decline, thefts of luxury cars and heavy-duty equipment such as tractors and trucks are surging along Germany's eastern border. In 2009, vehicle thefts in four of the five German states near the eastern frontier with Poland and the Czech Republic rose to their highest levels since 2000. In Berlin, a 45-minute drive to the Polish border, thefts jumped more than 40%, representing more than €40 million (about \$50 million) in lost and damaged vehicles, insurance analysts say.

To many in this remote stretch of eastern Germany, the reason for the increase in vehicle larceny is clear: the elimination of border controls in 2007.

The lifting of the controls was widely seen as a milestone for European integration. It was particularly poignant in the relationship between Berlin and Warsaw. Large swaths of modern Poland previously belonged to Germany, and the border opening signaled that both were prepared to put aside animosities that long divided the two states.

As part of the so-called Schengen Agreement, travelers can pass borders freely across much of Europe. Yet for all of the benefits the change has brought, political and economic, German authorities say the move has unleashed a wave of thefts that is testing the limits of European Union law and overwhelming their resources.

Forces behind the crime — black market demand for high-quality cars and machinery in Russia, and depressed stretches of Poland with young men willing to break the law to secure them — are unlikely to change anytime soon, they say.

"It's not a short-term phenom-

on, and we shouldn't react in a short-term way," says Arne Feuring, the police chief in Brandenburg, a state of shrinking towns and flat farmland that surrounds Berlin and borders Poland.

Every night, criminals from Poland and further east slip into Germany, steal luxury Mercedes or farm combines, and sneak back, police officials say. The thieves deliver stolen vehicles to overseers who strip them of identifying features for resale in Ukraine or Russia, police say.

In July, German police scrambled a helicopter and four squad cars to retrieve the private Audi sedan of Interior Minister Thomas de Maizière—who oversees Germany's federal police force. The suspected car thief, a 33-year-old Pole, was heading toward the border when police forced him to pull over.

**To many in this remote stretch of eastern Germany, the reason for the increase in vehicle larceny is clear: the elimination of border controls in 2007.**

Organized Eastern European criminals have been stealing cars in western Europe since the 1990s, but German authorities say that along their open border the thieves have become increasingly brazen and pursue higher-ticket items, especially farm and construction machinery. The criminals communicate over short-wave radio and tote laptops to start computer-protected engines.

Mr. Feuring, the Brandenburg police chief, says countries with open borders will need to adjust their penal codes to handle criminals who can move between nations unimpeded. "It's not just a German problem, or a German-Polish problem," he says. "It's a European problem."

For now, German federal and state police have focused on improving cooperation with their Polish

counterparts. In a concrete former border checkpoint in the Polish town of Swiecko, teams of German and Polish police and customs officials face off across two rows of computer monitors 24 hours a day, handling 14,000 requests for cross-border assistance a year.

A focus is connecting German and Polish police officers during stolen vehicle operations. But they've failed to reduce thefts. They say the criminals are usually faster than the police.

"When you're on patrol 20 kilometers from the border and you determine that a car is stolen, and the driver hits the gas while you call the cooperative center, and then the center calls the Polish police—by then he's all the way to Ukraine," says Heiko Teggatz, a federal police officer based in Brandenburg who is active in one of Germany's major police unions.

Mr. Rattei's father, Egon, agrees; he manages a 5,500-acre crop, cattle and dairy farm nestled between Forst and the border. "They're highly organized, and very professional," says the elder Mr. Rattei, who lost a tractor to thieves in April.

German police were on hand to help him and his son in July, but it was good fortune and quick thinking that spared his farm equipment, he says.

After getting the call from his son that their farm equipment was heading toward the border, Mr. Rattei, who had been asleep, hopped in his car without changing out of his pajamas.

With the police and the Ratteis in hot pursuit, the tractor thieves ditched the moving equipment close to the border and disappeared into the woods. Polish authorities found no trace of them.

Earlier this month, someone broke into five of Mr. Rattei's tractors late at night but failed to get them started.

"Every night as I'm falling asleep, I think, 'Is something happening right now?'" he said. "It has a real impact on your psyche."

## EU's derivatives proposal carries risks of its own

[ Brussels Beat ]

By STEPHEN FIDLER



Proposals that emerged this week to improve regulation of European derivatives markets aim to push more and more financial transactions through central counterparties, or CCPs—clearing houses that act as a buyer in every sale of a financial instrument and a seller for every purchase.

It's a world-wide trend. By standing in the middle of every deal, CCPs are supposed to prevent the cascade of uncertainty that followed Lehman Brothers' demise two years ago this week.

That arose because financial institutions couldn't figure out their exposure to the failed firm—they simply didn't know how many of the myriad of pass-the-parcel transactions they were involved in ultimately depended on it.

But pushing CCPs to the center of the derivatives markets has brought to the fore another concern: that they themselves could become a source of risk to the financial system. "CCPs can go bust too," says Richard Portes, economics professor at the London Business School.

One way to address this risk is to ensure that CCPs, like major banks, have direct access to ready cash—liquidity from central banks.

Yet in making its proposals this week, the European Commission, which originally favored making access to central-bank liquidity a prerequisite for CCPs, backed away from the requirement.

An early draft of the proposed EU regulation, viewed by The Wall Street Journal, said CCPs "must have access to central bank liquidity."

The final proposal published this week said CCPs must have access to adequate liquidity, "which could result from access to central bank or to creditworthy and reliable commercial bank liquidity, or a combination of both."

Few people think commercial-bank credit lines are worth much to a problem institution at the center of a financial crisis. Such promises tend to melt away in the panic. For an institution in the center of a storm, the only sure guarantee of liquidity during a crisis is a central bank. So why did the commission change its mind?

According to people who have followed the process, the U.K. pushed strongly for the change over objections from Paris and Berlin, which argued forcefully for the central-bank requirement to remain. (The argument could well resurface as the 27 EU governments and the European Parliament seek to amend the proposals.)

The problem for the U.K. was that the requirement would have threatened the position of London as Europe's CCP hub because the U.K. uses the wrong currency. The

Bank of England can provide pounds but not the currencies in which most financial transactions will be denominated: the euro and the dollar.

For liquidity support in those currencies, a London-based CCP would need access to the European Central Bank and the Federal Reserve.

Theoretically, such support could be provided through swap lines via the Bank of England, but why should the ECB stick its neck out to underpin a CCP based outside the euro zone? "London didn't want the central-bank liquidity" requirement, says Mr. Portes.

Central-bank backstops sound like a good idea, but some experts see a downside: They dull incentives for CCPs to engage in state-of-the-art risk management.

CCPs have an excellent record in managing risk going back more than a century, through depression and world wars. Their financial stability has been protected, by bank credit lines, by their own capital and that of their owners, and by the collateral they require from clients, which can be adjusted to reflect the risks the clients are running.

"There are costs and benefits of having access to central bank lending. It can help prevent the CCP from being questioned during a crisis but it can also reduce some of the incentives for CCPs to be at the cutting edge of risk management," said Randall Kroszner, a professor of economics at Chicago University's Booth School and a former Fed governor.

Yet pushing CCPs to clear more, riskier and less-liquid financial instruments, as the commission is now demanding, means the chance of accidents increases. Clearing cash transactions that are settled within three days is one thing; dealing with derivatives that may be unwound in months or years is quite another, the experts say.

Risk could be further heightened by another requirement—also contained in the commission's proposals—that aims to improve competition by allowing investors to choose which CCP they use. At present, that choice is largely determined by the trading venue. The change would require CCPs to be interlinked, creating, as the industry calls it, interoperability.

However, connecting every CCP to every other risks recreating among the CCPs the cascade of uncertainty that occurred among banks and securities firms in 2008. As a result, while stating it as a long-term aim, the commission is moving cautiously on interoperability, suggesting the process will be closely monitored by financial supervisors before it is allowed to go ahead.

Interoperability, says Mr. Kroszner, is in principle the right way to go "but it's the practicalities of how this will operate which will determine whether you have reduced risk or increased the potential for systemic problems. If it's not done the right way, you're playing with fire."



# All the best things on screen start with great writing

Join the new Times and Sunday Times websites now and discover what happens when quality journalism meets the latest technology.

Just **£1 for your first 30 days.**

- Go quickly to the heart of issues with breaking news, incisive summaries and email alerts from our award-winning journalists
- Your favourite sections and writers brought vividly to life through unique features like the Review Booth and our stunning interactive graphics
- Enjoy daily lunchtime debates and live Q&As with key personalities – and join in if you want to
- Plus, this month watch out for exclusive arts coverage from celebrity contributor Rupert Everett

**Our two exciting new websites are yours for just £1 for the first 30 days. Join us.**

[thetimes.co.uk](http://thetimes.co.uk)

[thesundaytimes.co.uk](http://thesundaytimes.co.uk)

**THE TIMES**  
**THE SUNDAY TIMES**



Subscription is £1 for the first 30 days and £2 per week thereafter, billed at £8.66 per month. Subscription will automatically renew every month. Minimum age 18. Please see the websites' terms and conditions. Times+ membership is included within the subscription (excluding gift rewards).





## U.S. NEWS

# Democrats and GOP rethink strategies for November push

WASHINGTON—The two major parties began the general election sprint roiled by the fallout of a primary season marked by furiously anti-incumbent voters and major rifts over strategy.

By Peter Wallsten,  
Neil King Jr.  
And Laura Meckler

Republicans, widely expected to see big gains this November, were scrambling to mend their fences, between the party establishment and the candidates that challenged it during the primary season. Party leaders were stunned on Tuesday when tea-party favorite Christine O'Donnell won the Delaware Senate primary over longtime Rep. Mike Castle, the centrist Republican backed by party leaders.

Trying to unify the party, the head of the Republican Senate campaign committee, Sen. John Cornyn, made clear he supports Ms. O'Donnell and said he would send a contribution to her campaign. But party officials said there were no plans to invest in any significant way by funding TV ads to support her race.

Ms. O'Donnell's win fueled a growing debate about the GOP's November prospects. Some strategists argued that grass-roots activists, while motivated largely by anger at government spending and the Democrats' new health-care law, had touched off an ideological cleansing that could damage the party in November and beyond.

Ms. O'Donnell has taken heat for a series of revelations about her personal finances and positions that some Republicans argue are too rightward for the state, and her victory was seen by many in both parties as boosting Democrats' prospects in the race.

"You can't make forward progress without a majority," said Republican strategist Jim Barnett, who worked on the Castle race and managed an unsuccessful Senate primary bid by another centrist Republican backed by party leaders, former Rep. Rob Simmons of Connecticut. "Conservatives in the Senate will remain in the wilderness until and unless we can elect Republicans in all parts of the country."

But Sen. Jim DeMint (R., S.C.), a leader in the push for more conservative candidates, argued that the party was improving its chances by embracing ideas that most Americans cherish. "I don't think this is about purity at all," he said. "This is the right way to get to a big-tent Republican Party."

Meanwhile, in the House, 31 Democrats rebuffed their leadership this week on the expiring Bush-era tax cuts, signing a letter calling for temporary extension of all the breaks and signaling a possible impasse in Washington's bid to deal with the thorny political problem.

The letter provided the most dramatic sign yet of Democrat jitters over voting for the Obama administration's plan to extend current tax levels for middle-class earn-



David Ficke was among the crowd at a tea-party rally Sunday in St. Louis.

## Scoring primary season

### Winners

#### CLUB FOR GROWTH

The anti-tax, small government group saw seven of its endorsed candidates win GOP Senate nominations, likely increasing its clout within the party.

#### SEN. JIM DeMINT (R., S.C.)

Through his Senate Conservatives Fund, Mr. DeMint has supported a number of conservative insurgents who have prevailed over GOP establishment picks. That makes it likely that Mr. DeMint's influence will be enhanced when some of those candidates come to Washington.

#### REDSTATE.COM

Several of the victorious Republican nominees have been candidates backed by contributors to this conservative website, which has quickly become a clearinghouse for conservative political discussion and debate.

Photos: Associated Press

### Losers

#### PARTY SWITCHERS

Sen. Arlen Specter left the GOP; Rep. Parker Griffith turned Republican. Neither survived primaries in their new parties.

#### TARP SUPPORTERS

Of the 35 Senate Republicans who voted for the Troubled Asset Relief Program, 16 have either retired, announced they are retiring, lost their 2008 reelection or lost in 2010 primaries.

#### SEN. JOHN CORNYN (R., Texas)

The man heading the GOP Senate campaigns scored some major recruiting coups. But many of those candidates lost in their primaries.

#### LIBERAL DEMOCRATS

Challengers from the left haven't fared as well as those from the right. All of the Democrats who voted against health-care reform and are running again have kept their party nomination.

ers—families making less than \$250,000—while allowing taxes to rise for higher earners starting January.

House Democratic leaders had hoped to use the tax cuts as a rallying cry in the run-up to the election, casting Republicans who favor extending all the breaks as obstructionists and allies of the rich. Instead, the party now faces long odds in passing its tax plan before November.

The 31 Democrats, plus House Republicans, come close to forming a majority in that chamber.

"In my head, I know it's not good policy to raise taxes in a recession," said Rep. Michael McMahon (D., N.Y.), one of the members who signed this week's letter. "And in my

heart, I know it's bad politics to raise taxes at any time."

The disputes in both parties capped a long, tumultuous primary season that saw an unusually high number of incumbents lose to political newcomers, as the conservative tea-party movement exerted influence in a number of key races.

While virtually all polls suggest Democrats will feel the brunt of voter anger on Nov. 2, the GOP felt the heaviest impact of the tea-party movement in the primaries.

In all, the National Republican Senatorial Committee saw a total of eight of its chosen candidates fall to outsider insurgents, including two sitting senators.

—Naftali Bendavid  
contributed to this article.

## Tea party jolts the GOP, as Ronald Reagan did

[ Capital Journal ]

By GERALD F. SEIB



Exactly three decades ago, Ronald Reagan stormed to an election victory, and in the process reshaped the Republican Party. In came waves of Southerners and Midwest social conservatives who previously called themselves Democrats, and out went many Northeastern moderates and social liberals who suddenly felt out of place.

The movement produced a more conservative and ultimately successful Republican Party. It also inspired a serious independent presidential challenge in 1980 from one disaffected party moderate, Rep. John Anderson of Illinois, who won 7% of the vote in that year's election.

The tea-party movement, which is activating a new cadre of angry citizen-activists, could well be doing something similar to the Republican Party right now. This time, the outcome figures to be a party that isn't just more conservative, but also more populist. Again, the question of what happens to party moderates is a big one.

As that suggests, political parties aren't so much rigid hierarchies as living organisms, prone to changing shape over time. Sometimes these changes come from the top down; Bill Clinton, for example, was largely responsible for pulling the Democratic Party toward the center in the 1990s, a move that in itself was partly a reaction to the Republicans' Reagan Revolution of the 1980s.

Other times, changes occur from the bottom up. That's what seems to be happening to Republicans now. Out in the field, tea-party rebels are purging the ranks of what they derisively call RINOS—Republicans in Name Only.

Out is Gov. Charlie Crist of Florida, who now is pursuing his state's Senate seat as an independent. Out is Pennsylvania Sen. Arlen Specter, who earlier bolted for the Democratic Party (and found himself a man without a party when he lost the primary to retain his seat). Out is Utah Sen. Robert Bennett of Utah, who had always seemed plenty conservative enough for his party until ousted this year. Out is Delaware Rep. Mike Castle, a Republican officeholder for four decades before losing a primary this week.

Much as Mr. Reagan's revolution brought to prominence some previously little-known conservatives, the Republican party now is increasingly influenced by a crop of candidates unknown nationally (and sometimes within their own states) just a few months ago, and by a former governor named Palin.

One difference is that while Mr. Reagan made Republicans more conservative, the tea party is

making them more populist. Business interests will find, for example, that when they turn to the Republican Party to support free-trade agreements, the tea-party contingent isn't going to fall into line as Reagan conservatives did. And certainly this new wave of Republican leaders doesn't share the late president's positive view of immigration.

Today, as in 1980, it's centrists in both parties who have to figure out where this process leaves them: Do they have a home in the evolving political system? Just as the Republican candidates being washed out to sea this year tend to be the party's centrists, so too will many of the Democrats vanquished this year be party centrists who lose their seats in the Republican wave now forming.

Much will depend, of course, on which tea-party favorites actually win in the November general election, but a likely outcome of all this will be a Republican party more to the right, and a Democratic Party more to the left. "It's going to be a bipolar Congress," predicts Kenneth Duberstein, White House chief of staff for President Reagan.

Those who feel left out may well be Democrats who consider the Obama agenda is too liberal for their tastes, and Republicans who find the tea-party movement too conservative for theirs.

Those who feel left out may well be Democrats who consider the Obama agenda is too liberal, and Republicans who find the tea-party movement too conservative.

So what do they do? Like Mr. Anderson in 1980, some are trying to show that they can go it alone. That's what Mr. Crist is trying to do in Florida by running as independent, just as Connecticut Sen. Joseph Lieberman did when he was rejected by his Democratic Party in 2006 and successfully won re-election. But being on your own is a hard thing in American politics, where organization and money matter a lot.

Some of those who felt detached from both parties in the 1980s found a home—an uncomfortable and temporary one, as it turned out—with Ross Perot's movement in the 1990s. Over time, though, they drifted back to the two major parties.

Perhaps there will emerge a Republican leader who can knit together tea-party adherents and the party establishment. Perhaps Democrats can again tack to the center and pick up some who feel left behind. And yes, perhaps there will be a third party (New York Mayor Michael Bloomberg anyone?)

The only certainty is that the landscape won't look the same when the merry-go-round stops whirling.

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



## U.S. NEWS

# Army tests digital warriors' battle readiness

By NATHAN HODGE

WHITE SANDS MISSILE RANGE, N.M.—In a remote stretch of desert in southeastern New Mexico, the U.S. Army is experimenting with gadgetry that may play a key role in the battlefields of the not-too-distant future.

Beer-keg-shaped drones hover over a simulated battlefield, tracking targets of interest. Small, portable robots with an odd resemblance to the computer-animated hero of the movie "WALL-E" peer around corners, relaying sound and digital images. Sensors silently track enemy movements.

Some of these devices are already in service, but the Army wants to link them together on a secure mobile network that gives soldiers a detailed look at the battlefield in real time. The Army has outfitted a number of armored trucks with "network integration kits" that bundle together information from the different sensors, turning the vehicles into roving digital command posts.

Maj. Bill Venable, an Iraq War veteran and Army product manager, likened the new approach to "Web conferencing" on the battlefield. In the past, Maj. Venable said, he had to travel to a combat outpost to receive paper copies of operational orders, get the profile of an insurgent suspect or watch video feeds from a drone. With this new gear, soldiers could sift through military networks without heading back to base.

If all goes according to plan, some of this gadgetry may appear in Afghanistan as early as 2012. But first, the Army needs to see if the new equipment will actually be useful in combat.

That's the job of the Army Evaluation Task Force. Based at Fort Bliss, Texas, the unit is currently putting the equipment through its paces in a seven-week evaluation here. Col. Dan Pinnell, the task force commander, said his job was to provide the Army with a straight report card on the



Clockwise from top: Specialist Joshua Gabbard tests a Small Unmanned Ground Vehicle (SUGV), intended for reconnaissance operations in buildings or at vehicle checkpoints; soldiers prepare to fly a Class I Unmanned Aerial System for reconnaissance, surveillance and target acquisition, which can fly up to eight kilometers from the operator and then be handed off to a remote operator in closer range; the SUGV gets a closer look at a suspicious vehicle.

new gear. "My task is to evaluate capabilities—new doctrine, new hardware, new tactics and new organizations—in a realistic environment," he said.

The results of a similar exercise last year, Army officials acknowledge, were less than spectacular. The range of the new digital gear was extremely limited, with operations restricted to a five-kilometer radius, and much of the equipment wasn't tough enough to withstand battlefield conditions.

Observers say a larger issue remains—whether the service will con-



tinue funding the effort. The equipment being tested here is derived from a more ambitious modernization program called Future Combat Systems, which was cut short last year by Secretary of Defense Robert Gates, after the Army spent about \$18 billion on it.



from the program, Mr. Wood said, it "remains to be seen" whether current efforts might translate into a finished product.

So far, Pentagon leadership has approved low-rate production of the equipment, and placed a number of conditions on continued development. The Army is hoping for approval of additional sets of equipment later this year, but must pass a series of tests to show the Defense Department that it is resolving technological issues.

Paul Mehney, a spokesman for the Army's Program Executive Office-Integration, said the Army went into the 2009 tests using "pre-production" equipment and software. "We entered those tests knowing we were going to have fairly significant limitations on the equipment and how it would hold up."

Col. John Wendel, an Army program manager, said the Army and its main contractor for the program, Boeing Co., introduced dozens of fixes to the equipment since those tests. He said this year's evaluation of the equipment was much more demanding, reproducing more of the real-world conditions that soldiers face in Afghanistan, where the U.S. military is now focusing its efforts. For example, the test radius for the current equipment is more than 35 kilometers.

The Army is striving for maximum realism in this simulated battlefield. In a small mountain village on the missile range, soldiers dressed as the Afghan National Police dozed on cots in a small patrol station. Lt. Eric Muirhead played the role of village elder, wearing a skullcap and a white *shalwar kameez*, the loose trousers and tunic worn by Afghan men.

Lt. Muirhead said the scenario was supposed to reproduce the difficult, complex counterinsurgency fight in Afghanistan, where soldiers must identify key local leaders and stick to strict "rules of engagement" to avoid harming civilians.

## Poverty rate surges in U.S.

Incomes for the typical U.S. household fell slightly last year as substantial government aid and such self-help actions as families doubling up and young adults moving in with their parents muted the impact of the worst recession since the 1930s, the Census Bureau said Thursday.

By Conor Dougherty,  
Sara Murray  
And Ruth Mantell

The bureau's annual snapshot of American living standards also found that the fraction of Americans living in poverty rose to 14.3% from 13.2% in 2008, its highest level since 1994. A record 43.6 million Americans were living in poverty last year, the Census Bureau said.

The new data underscore the extent to which U.S. households relied on government benefits—and each other—to weather the recession. The numbers also show how living standards at the middle of the middle class have stalled. The report comes amid a vigorous election-year debate over how government policy can best help the poor and unemployed.

The median household income, the pretax income of households smack at the middle of the middle, fell 0.7% to \$49,777 in 2009. It is

down 4.2% from the prerecession year of 2007.

"It's going to be a long, hard slog back to what most Americans think of as normalcy or prosperous times," said Nicholas Eberstadt, a political economist at the right-leaning American Enterprise Institute.

Economists have been concerned about the persistently high unemployment rate, which rose 3.5 percentage points to 9.3% in 2009 from 5.8% in 2008, the largest increase since the Labor Department started keeping comparable average annual data in 1947.

"The deterioration in the labor market from 2008 to 2009 was the worst we've ever seen," said Heidi Shierholz, a labor economist with the Economic Policy Institute, a Washington think tank. "When you see a big deterioration in the labor market, poverty rises. The vast majority of people in this country depend on the labor market for their income."

The number of employed civilians fell to about 140 million in 2009 from 145 million in 2008, and the number of unemployed rose to 14 million from nine million, according to the Labor Department.

Many households continued to struggle despite economic growth in the second half of last year, said

Lawrence Katz, a Harvard University labor economist.

"Most of that growth in GDP [gross domestic product] has not been trickling down to the typical household," Mr. Katz said. "GDP largely showed up in profits but didn't show up in earnings of workers. Productivity went up, but those benefits didn't translate into rapidly growing wages."

Also Thursday, the Census Bureau reported that the number of Americans with health insurance fell to 253.6 million in 2009 from 255.1 million in 2008, the first year that the number of people with health insurance has decreased since 1987, when the government started collecting comparable data.

Edwin Park, co-director of health policy at the Center on Budget and Policy Priorities, a Washington think tank, had expected employer-sponsored coverage to erode. "The largest contributor would be fewer jobs. Job-based coverage is the primary way that workers get coverage."

WSJ.com

ONLINE TODAY: See additional analysis and data on U.S. income and poverty levels at [WSJ.com/Economy](http://WSJ.com/Economy).

## Being rich is riskier these days, study says

By MARK WHITEHOUSE

It's not as easy to be rich as it used to be.

In the past, America's most wealthy people barely felt the ups and downs of the economy. Over the past few decades, though, the roller-coaster ride has become more extreme for them than for any other income group, according to a new paper by two Northwestern University economists.

In the first year of the recession that began in 2007, the top 0.01% of earners in the U.S. saw their pretax income fall by an average of 12.7%, compared with 2.6% for all earners, according to an analysis of data from income-tax returns by economists Jonathan Parker and Annette Vissing-Jorgensen, in a paper presented Thursday at a Brookings Institution conference.

The richest also did better on the way up. In the four years leading up to the recession, their income rose at an annualized rate of 13.9%, compared with 1.8% for everyone.

Overall, since 1982, the income of the top 1% of earners has been about 2.4 times as volatile as the

average for everyone, the paper's authors find. That is a big change from the years 1947 to 1982, when the income of the top 1% fluctuated about 30% less than average. The authors found a similar picture when they looked at the income of the same families over time, at post-tax income and at the income of people in Canada.

The reason for rich peoples' bumpier ride, believe Mr. Parker and Ms. Vissing-Jorgensen, is likely related to the reason they have commanded an increasing share of the nation's income over the past few decades: Modern technology, such as satellite communications and electronic trading, have allowed people with the right skills and talents to plug in to the global economy like never before.

To be sure, the greater volatility doesn't mean poorer folks should feel sorry for the rich. On average, the people in the top 1% and 0.01% had pre-tax incomes of about \$900,000 and \$17 million, respectively, in 2008. So they were well able to absorb big losses.

"It's hard to think of that as being really hard," says Mr. Parker.



## WORLD NEWS

# Four Khmer Rouge leaders indicted

By PATRICK BARTA

A United Nations-backed tribunal in Cambodia indicted four senior members of the former Khmer Rouge regime, assuring that the country will keep grappling with its war-time past for at least another year.

The trial, which is expected to begin by mid-2011, is likely to be far more complex—and possibly more controversial—than the recently completed case against former Khmer Rouge prison commander Kaing Guek Eav, known as Duch, who was convicted of crimes against humanity in July. That case drew international attention because it was the first international-tribunal trial against a Khmer Rouge member after the collapse of the regime, which governed Cambodia from 1975 to 1979 and is blamed for 1.7 million deaths.

Many Cambodians criticized Duch's punishment—a 19-year jail sentence, after credit for time already served—as lenient, given his role in overseeing a prison where more than 12,000 people were tortured and killed. Both Mr. Kaing Guek Eav and his prosecutors have appealed.

The newest indictments target higher-level officials in the former Khmer Rouge government. Unlike

## Cambodia | Awaiting trial



**Nuon Chea**

Pol Pot's former deputy

Born: July 7, 1926  
Arrested: Sept. 19, 2007

Source: Extraordinary Chambers in the Courts of Cambodia



**Ieng Sary**

Former foreign minister

Born: Oct. 24, 1925  
Arrested: Nov. 14, 2007



**Ieng Thirith**

Former minister of social affairs

Born: 1932  
Arrested: Nov. 14, 2007



**Khieu Samphan**

Former Khmer Rouge head of state

Born: July 27, 1931  
Arrested: Nov. 19, 2007

Photos: Agence France-Presse/Getty Images (4)

Mr. Kaing Guek Eav, who acknowledged some role in crimes by the regime and expressed remorse, they have denied they were involved in the crimes.

The four leaders are Nuon Chea, a former acting prime minister who is considered one of the group's main ideologues; Ieng Sary, a former deputy prime minister and minister of foreign affairs; his wife Ieng Thirith, a Shakespeare scholar who was also a government minister; and Khieu Samphan, a former head of state.

All four were detained in 2007 and now face a raft of charges, including crimes against humanity, genocide and war crimes.

The second trial is considered to be more important than the first mainly because the accused were more senior than Mr. Kaing Guek Eav. It is hoped that investigations into their actions could yield considerably more information about the inner workings of the Khmer Rouge regime.

The radical Communist rebel group came to power in the after-

math of the Vietnam War and sought to create an agricultural utopia under the leadership of the late Pol Pot. The group forced residents of Cambodian cities to relocate to rural collectives, but many of the farms failed spectacularly, making it difficult for residents to survive. About a fifth of the country's population at the time died of starvation, illness or were killed.

The tribunal is controversial in Cambodia, however, in part because some former Khmer Rouge figures remain in government, including

Prime Minister Hun Sen, who served in the Khmer Rouge but later defected. Although he isn't under any suspicion of involvement in the atrocities, it is possible the tribunal's investigations could lead to officials or politicians.

Other residents have complained the process has taken too long, and cost too much money, without bringing many former leaders to justice.

Analysts had feared that the tribunal would lose momentum after the Duch trial and possibly choose not to pursue more indictments, or move so slowly that the four remaining leaders—who are in their late 70s and 80s—would die before trials could begin.

Human-rights experts and many Cambodian residents have argued it is necessary to complete at least one more trial, and possibly more, before Cambodia can fully bury its past.

The country is increasingly seen as an attractive investment destination, with significant potential to become a major source of agricultural commodities for China and other emerging markets. But Cambodia retains a reputation as a dangerous and unpredictable place, and many investors are watching the tribunal to determine if the country is fully returning to rule of law.

## Low expectations await Afghan legislative polls

KABUL—More Afghans are expected to stay away from the polls in Saturday's parliamentary election than in any vote since the Taliban's downfall, after a campaign marred by Taliban assassinations of candidates, intimidation of voters and fears of widespread fraud.

By Yaroslav Trofimov,  
Maria Abi-Habib  
and Matthew Rosenberg

International observers and diplomats project the turnout well below the 4.6 million voters, or about 30% of the registered electorate, that was posted in last year's presidential race. Some 6.4 million Afghans participated in the previous parliamentary elections in 2005.

The chief United Nations envoy in Afghanistan, Staffan de Mistura, said Thursday that he personally wouldn't be upset with a turnout of between 3.5 million and 4.5 million voters, while other observers and Western diplomats said that a turnout as low as three million would still be seen as acceptable by the international community.

"As far as security is concerned, we're finding ourselves in the worst period of 2010, and in the worst period of the recent years. It's the worst possible moment and the worst possible country in which to organize an election," Mr. de Mistura said.

The Taliban have repeatedly threatened to disrupt Saturday's vote with lethal attacks, even though some local insurgent commanders are tacitly backing candidates in parts of the country.

The election's outcome is important: the outgoing Afghan legisla-

ture rejected many of President Hamid Karzai's ministerial appointments and legislative changes, and emerged over the past year as an independent power center.

Though Mr. Karzai can circumvent the parliament's wishes with presidential decrees, he has been increasingly inconvenienced by having to deal with a hostile legislative branch.

"The president and his cabinet need a majority in this parliament," says Haroun Mir, the director of the Afghanistan Center for Research and Policy Studies, who frequently criticizes Mr. Karzai and is running for a seat from Kabul province.

It would be difficult for Mr. Karzai and his supporters to radically alter the parliament's shape, however. Nearly all the 249 incumbent lawmakers are running for re-election, and by some estimates as many as 85% of them are likely to secure a new mandate.

"It's anticipated that the incumbents will do very well," says Glenn Cowan, the principal of Democracy International Inc., a Maryland firm that is fielding 80 expatriate election observers across Afghanistan under a U.S. government grant. "They are viewed as a check on executive authority."

Because of the worsening violence, however, many of the successful candidates are likely to be former warlords and prominent businessmen who can afford to provide their own armed security.

In Afghanistan's weak political-party system, voters tend to choose individuals rather than follow party lines, and most candidates run as independents. Sixty-eight seats are reserved for women.

The campaign has been short on political debate, and mostly centered on candidates showing off their achievements and making promises of patronage to voters.

The Taliban have declared that they oppose the election as a foreign ploy to prolong Western military occupation. Yet, despite such declarations, some of local insurgent commanders have shown signs of taking sides in individual races, backing some candidates simply by allowing them to campaign in rebel-held areas, or by intimidating their opponents.

"In some areas, candidates have made deals and paid money or provided weapons to the Taliban, and that's why some groups of Taliban don't want to disrupt the election in those areas," says an insurgent commander in the eastern Kunar province.

Hajji Sakhi, a candidate running from Kunar, says he has approached the local Taliban commanders via tribal elders, asking them not to disrupt the vote, but hasn't received a reply. "The Taliban have asked candidates to help them release their prisoners if they get into the parliament," he says.

The U.N. envoy, Mr. de Mistura, says he welcomes the Taliban involvement in some races as a "movement in the right direction."

"It is always better to see any type of movement from bullets to ballots," he explains. "What we are watching with great attention is whether this [involvement in the election] translates into intimidation, harassment or physical threats" against rival candidates and their supporters.

The U.N., anticipating Taliban at-



Afghans pass an election poster in Herat, in western Afghanistan, on Thursday.

tacks over the weekend, has ordered a large part of its international staff to temporarily leave the country, and ordered others not directly involved in helping the election to stay indoors until Monday.

Aiming to minimize fraud, Afghan electoral authorities have closed down almost 1,000 of the country's 6,900 polling centers, most in Taliban-dominated areas where a free election was deemed impossible to guarantee.

Much of the ballot-stuffing in last year's presidential elections occurred in those areas, with voters too afraid to come out and vote—and corrupt election officials using the opportunity to stuff ballot boxes at empty polling stations. Most of the fraud last year was per-

petrated in behalf of Mr. Karzai, but some also occurred in favor of his opponents.

The decision to close polling stations has already sparked protests in several provinces, with local candidates and their supporters decrying it as unfair.

Even with this safeguard, endorsed by the international community, few expect Saturday's vote to be clean.

"There will be too much fraud. That you can say now," says Johann Kriegler, a South African judge who sits on Afghanistan's Electoral Complaints Commission, a watchdog that is empowered to throw out falsified results.

—Habib Totakhil  
contributed to this article.