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France on higher terrorism alert



Associated Press

Soldiers patrol the Eiffel Tower in Paris, Monday, as France stepped up security against possible terrorist attacks, including one against the Paris transport network. French officials also said they were investigating a report that a female suicide bomber may be preparing to strike in Paris.

Banks' profits on mortgages spur criticism

By DAVID ENRICH AND SARA SCHAEFER MUÑOZ

LONDON—Rock-bottom interest rates in the U.K. are allowing the country's banks to transform their humdrum home-mortgage businesses into a lucrative cash cow, helping the banks return to profitability but fueling accusations of price gouging.

The difference between what U.K. banks are charging for home loans and what they pay to borrow money—known as their margin, or spread—has more than doubled from its previous average of barely 1%, according to bankers, analysts, mortgage brokers and other experts. That is despite the Bank of England's interest-rate cut to nearly zero in March 2009.

The shift has big implications for banks' bottom lines, customers' pocketbooks and potentially the U.K. economy. Critics accuse the banks of squeezing consumers, and the

situation is setting the stage for a showdown between banks and the government, since some of the banks are partly owned by taxpayers.

Until recently, margins on mortgage lending were slimmer in the U.K. than in almost any other major Western economy. Today, they are by far the fattest, according to a recent study by London-based Autonomous Research. U.K. consumer-research group Moneyfacts estimates that profit margins on U.K. mortgages have soared to an all-time high.

"Why should a U.K. borrower pay 3.4% for a variable-rate mortgage when a Swedish borrower pays 1.5%, despite the fact that the reference rates are similar?" asked Manus Costello, an analyst at Autonomous Research.

In a report released Monday, the Bank of England said the trend of banks imposing "a higher mark-up on new lending ... is consistent with

lenders rebuilding capital through retained earnings." Indeed, a return to healthy profits is widely seen as necessary for banks to show they are back on their feet following the financial crisis.

The biggest beneficiary of this trend is **Lloyds Banking Group PLC**, which is 41%-owned by the U.K. government due to a taxpayer-financed bailout. After posting a loss of £6.3 billion (\$9.84 billion) last year, Lloyds returned to profitability in the first half of 2010, largely propelled by its minting of money on mortgages.

Even though Lloyds is making fewer such loans than in past years, the business is generating more profits. That is because its margins on retail banking, which consists almost entirely of mortgage lending, swelled to 2.44% at

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■ Lloyds CEO Eric Daniels is stepping down 17

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THE WALL STREET JOURNAL.

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Serious play date: New breed of critics may create a fuss over a show. Page 29

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Zimbabwe's road to economic ruin. Page 13

Recession declared dead, but weakness haunts U.S.

The U.S. recession that wiped out 7.3 million jobs, cut 4.1% from economic output and cost Americans 21% of their net worth ended in June 2009, marking the longest

By Sara Murray, Michael S. Derby and Michael R. Crittenden

and deepest slump since the Great Depression. But even as the end to the recession was officially called, a new report highlighted the weaknesses still facing the U.S. economy.

The country's economy has struggled to find its feet since that low point and still faces stubbornly high unemploy-

ment and slow growth.

The recession ended 18 months after the economy began sliding into a downturn in December 2007, according to the National Bureau of Economic Research's Business Cycle Dating Committee, a group of academic economists that determines the widely accepted benchmarks for U.S. recessions.

The next-longest postwar slumps were those of the early 1970s and early 1980s, which both lasted 16 months.

The pronouncement comes as the economy shows signs it has avoided a slide back into another swoon. Stock-market investors have taken heart; the Dow Jones Industrial Av-

erage has rallied more than 7% this month, thanks to better-than-expected data on a number of fronts, including housing, manufacturing and unemployment. It rose 1.4% Monday to its highest close in four months.

The market's gains come after a bleak August, in which the Dow fell 4.3% as investors fretted that the economy would dip back into recession.

Still, the National Bureau of Economic Research warned that its call of an end to the recession didn't mean it had concluded "that economic conditions since that month have been favorable or that the economy has returned to

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A rush to the banking firewalls

[Agenda]

BY SIMON NIXON



U.K. banks have had a lot to be pleased about lately. First, there were the Basel III reforms, which turned out to be largely a damp squib compared to the tough talk of draconian new capital requirements that regulators were threatening at the start of the year. Although there are still details to be finalized, nobody believes any major European bank will have any difficulty complying with the rules when they finally take effect at the end of the decade.

Now there is growing optimism the U.K.'s Independent Commission for Banking will also stop short of recommending the splitting up of retail and investment banking. Instead, there is growing confidence that political and practical realities will lead it to focus on other, less radical solutions to the problem of too-big-to-fail banks and the risk faced by taxpayers from the implicit guarantee of risky investment banking activities.

The buzz word is banking circles now is "subsidiarization"—the idea that banks can address regulators' concerns by creating legal firewalls between their different businesses that stop short of full separation. Santander already operates a subsidiary structure along these lines: all its major units are separate legal entities, independently regulated and with responsibility for their own capital and funding. HSBC also largely follows this pattern. Since these have been two of the most successful banks in the world through the crisis, this models are understandably attracting increasing attention as a possible solution.

But is subsidiarization really the answer to the regulators' dilemma? Sure, a subsidiary structure can provide a great deal of comfort to regulators outside a



Bob Diamond in London on Sept. 7, the day he was named as Barclays' CEO.

bank's home market that their financial system will be insulated if the parent company goes down. A subsidiary structure would have enabled U.K. regulators to stop Lehman Brothers transferring large quantities of cash to the U.S. the night before it went into administration. Similarly, U.K. regulators would have been able to ring-fence the operations of Icelandic banks active in the U.K. before the crisis by forcing them to hold their own capital and liquidity. Instead, they collapsed with their parents, with disastrous consequences for the U.K. economy. Not surprisingly, regulators are keen on subsidiarization as part of their efforts to force banks to maintain so-called living wills to help ensure an orderly wind-up.

But it's not all clear subsidiarization provides the kind of firewall between different parts of a bank needed to protect taxpayers in the parent country. After all, HSBC operates a subsidiary structure, but that did not stop it funneling billions of dollars into its troubled U.S. unit, Household, rather than allowing it to go bust. At the time, HSBC argued persuasively that allowing

Household's bondholders to bear the losses from the unit's disastrous subprime lending would have calamitous consequences for its own credit rating. Santander argues that its decision to write down the value of its Argentinian unit to zero during that country's devaluation crisis early in the decade shows it was willing to cut a troubled subsidiary adrift. But ultimately, it never took this step—no bank could easily survive such a breach of trust.

But what if subsidiarization is the answer? What does this mean for the banks? Santander and HSBC clearly believe the model serves their shareholders well, the requirement to manage their own capital and liquidity providing management focus and discipline. But the risk is that banks forced to run themselves through separate legal entities will lose some of their ability to manage capital and liquidity efficiently, with resources trapped by local regulators rather than used where it can most profitably be deployed. That could mean banks are forced to operate with higher capital ratios and more expensive funding.

That is particularly worrying for a bank like Barclays, which could be forced to separate its investment banking and retail businesses. The U.K. bank, which is considering its options, doesn't think a split will necessarily lead to higher funding costs. It argues recent debate should mean the possibility of separation is already reflected in the price it is charged for its debt. It also notes that the risk that regulators might require the bank to reorganize its activities is cited as risk factor in all bond issue documents. But senior bank officials acknowledge they have no idea how a formal split that left bondholders exposed only to the investment banking balance sheet would affect its cost of funding, or how much extra capital would be required to satisfy bondholders.

But the debate over separation presents banks like Barclays—and its incoming CEO Bob Diamond—with a dilemma: if they admit that there are substantial synergies to be gained from conducting different types of banking business under one roof then regulators will rightly worry that retail deposits are indeed being used to cross-subsidize riskier investment banking activities. But if the bank can prove that operating a subsidiary structure will make no difference to capital and funding costs, then investors might ask why banks don't break themselves up anyway. What is the point of universal and global banks if they don't create any added value?

What is the point of universal and global banks if they don't create any added value? A business model based justified solely by reference to technological and management know-how or cross-selling opportunities is unlikely to be persuasive. Before long, banks would likely be under pressure from investors to break themselves up anyway. Far from being a comfortable middle way for regulators and banks, subsidiarization is likely to prove a blind alley. The commission should steer clear.

What's News

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NEWS

House without McQueen

By PAUL SONNE

LONDON—As the fashion elite filed into St. Paul's Cathedral on Monday to memorialize British designer Lee Alexander McQueen, the company he left behind is on the brink of making its first crucial trip down the women's catwalk without him.

The late Mr. McQueen, who built his label into one of the world's most daring fashion names, committed suicide last February. He was replaced four months ago by long-time deputy Sarah Burton, who took over as creative chief of the London-based Alexander McQueen label, a small but symbolic part of PPR SA's Gucci Group.

Now, as Ms. Burton gears up to unveil her first full women's wear collection in Paris on Oct. 5, the label faces a tough question: What does it mean to be Alexander McQueen without Alexander McQueen?

The strategic challenge highlights a longstanding problem in the fashion industry, where it's difficult to replace high-profile designers who become indivisible from their eponymous brands.

Mr. McQueen's shows were highly produced feats of shock and awe. His 1995 collection, "Highland Rape," which featured strutting nudity and ripped Tartan dresses, symbolized what he called the rape of Scotland by the British.

"I had no doubt, and nor did he, that he was an artist who just happened to work with clothing," said fashion columnist Suzy Menkes, addressing the memorial service.

Gucci Group must now make the label stand on its own, apart from the personality that made it. Whether that means continuing the tradition of such scandalous designs is unclear.

"The creation of modern beautifully crafted clothes was at the heart of Lee's vision. I intend to stay true to his legacy," Ms. Burton said in a statement released by Gucci Group in May, her only public comment on the matter.

Having worked under Mr. McQueen for 14 years, most recently as head of design for women's wear, she is well-placed to understand his vision. Like Mr. McQueen, she was born in Britain and trained at London's Central Saint Martins College of Art and Design. She joined his label before she graduated. But as a chief designer, she remains an unknown quantity. Gucci Group declined to make Ms. Burton available for an interview.

Gucci Group, which acquired a majority stake in Alexander McQueen in 2000, has said it is committed to keeping the McQueen business alive, but the fledgling label has lost money for years, breaking even for the first time in 2007, but then dipping back into the red with the downturn. Ms. Burton has to carve out an artistic vision that is her own; but she also must design clothes that can help lift the business out of its start-up phase.

That could be a strong point for the new chief designer: Much of her job at Alexander McQueen entailed boiling down the designer's catwalk creations into products that would be sellable on store shelves.

One possible avenue for the company is to focus on nurturing its secondary label, McQ, while signing licensing contracts in areas such as perfume.

When it comes to his appeal on the runway, "I don't think anyone will be able to keep up with Mc-

Queen," says fashion consultant Robert Burke, president and CEO of Robert Burke Associates. "I think it would probably be best to not try to compete with that." But he added: "Keeping consistency with the brand is really important. Any kind of major departure would not be good."

Though the McQueen label has benefited from recognition and publicity in the wake of Mr. McQueen's death, Antoine Belge, a luxury-goods analyst at HSBC, said the company should be wary of trying to grow the brand into a huge phenomenon.

"Gucci Group should try to make it a bit more sizeable whilst main-

taining its 'niche' positioning," Mr. Belge said.

Some labels have successfully replaced icons. One example is Calvin Klein: After the designer sold his fashion empire to private-equity firm Phillips-Van Heusen in 2003, his long-time protégé Francisco Costa took over creative duties and has received significant acclaim.

But it has often been more difficult. Gianni Versace SpA, for instance, suffered for years after its founder was murdered in Miami, until Donatella Versace managed to replace her brother as a guiding artistic force behind the label.



Big shoes to fill: Sarah Burton, long-time deputy of designer Alexander McQueen, who killed himself in February, takes over as the label's creative chief.

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EUROPE NEWS



Associated Press

Sweden's Prime Minister Fredrik Reinfeldt, whose coalition won Sunday's election, addresses media in Stockholm Monday

Swedish leader faces a bind after election

BY CHARLES DUXBURY
AND MARCUS WALKER

STOCKHOLM—Sweden's election on Sunday has left Prime Minister Fredrik Reinfeldt with a choice between trying to govern without a majority in parliament, or trying to persuade the opposition Green Party to support his center-right coalition.

Neither path appears easy, and if Mr. Reinfeldt can't make either work, Swedes may need to go to the polls again.

The cause of Mr. Reinfeldt's problem: the rise of a far-right, anti-immigration party, the Sweden Democrats, which won seats in Sweden's parliament for the first time and prevented the prime minister's four-party coalition, known as the Alliance, from winning an overall majority.

The Swedish leader has said he won't even consider cooperating with the Sweden Democrats, a party that is viewed as a xenophobic pariah by Sweden's mainstream politicians. The Sweden Democrats ran a campaign painting Muslim immigrants as a threat to the country's security and prosperity.

Such sentiment across Europe

has echoes in rising angst over Islamic influence in the U.S., though surveys suggest support for a diverse society is wider in the U.S. than in Europe, where radical parties are gaining influence amid hard economic times and fears that immigration of Muslims and other minorities could erode national identity.

"We have a responsibility in this parliamentary situation to look for broader support and that means we should start talks with the Greens and I hope for a good response from them," Mr. Reinfeldt said Sunday after the preliminary election result came in.

The latest projections suggest Mr. Reinfeldt's ruling Alliance coalition won 172 seats, just short of the 175 needed for an outright majority, while the left-leaning bloc of Greens and Social Democrats won 157 seats. The Green Party scored their best-ever result, taking 7.2% of the vote. The Sweden Democrats secured 5.7% of the vote, winning 20 seats.

Mr. Reinfeldt, the 45-year-old leader of the right-leaning Moderates party, has tried to turn Sweden in a more free-market direction since first taking office in 2006,

privatizing state assets and trimming welfare benefits and taxes. His policies have challenged Sweden's postwar attachment to generous welfare policies, incurring opposition from left-leaning parties.

The prime minister now wants to woo one of his left-leaning critics, the Green Party. Talks aren't expected to begin until after final election results are in, which could take until Wednesday. Already, however, the Greens are playing hard to get. Green leader Maria Wetterstrand appeared to dismiss the chances of her party forming a coalition with the center-right bloc when she spoke to state broadcaster SVT Sunday.

"That the Green Party would become a supporting party for a government which kicks people out from health insurance, which is not pushing any climate policy, which will build 10 new nuclear-power stations, that is not a set of policies which we can consider supporting," Ms. Wetterstrand said.

Her words suggest that the best Mr. Reinfeldt can hope for is an agreement from the Greens of support on an issue-by-issue basis rather than from within a formal coalition.

"The Greens are sitting with a trump card here," said Jonas Hinnfors, professor of political science at Gothenburg University. "They know the government will need a majority so they can be very firm with their demands," he said.

The Greens could press the government to reverse its decision to build more nuclear-power stations, a policy the Green Party vehemently opposes, says Mr. Hinnfors. They may also demand a halt to the planned privatization of more state-owned assets including stakes in **Nordea Bank AB** and telecom operator **TeliaSonera AB**.

Mr. Reinfeldt made clear on Sunday night that he intends to continue in government with or without the Greens. "The judgment of the Swedish people is that the Alliance should continue," he said.

Clegg tells party to be steadfast amid U.K. cuts

BY AINSLEY THOMSON

LIVERPOOL, England — Nick Clegg, U.K. deputy prime minister and leader of the Liberal Democrats, urged his party on Monday to "hold our nerve" as the British economy is rebuilt.

Speaking in Liverpool at the first party conference since the Liberal Democrats formed a coalition government with the Conservative Party in May, Mr. Clegg sought to reassure delegates worried that the party's identity has been eroded by being the junior partner.

"Hold our nerve and we will have changed British politics for good. Hold our nerve and we will have changed Britain for good," he said.

In an upbeat speech that sought to rouse delegates' faith in the party, Mr. Clegg told the audience to aim for 2015—the date of the next general election—when he said the party would reap the rewards for having helped rebuild Britain.

The conference is being watched for any signs of tension within the party, particularly from grass-roots members who say the party has lost its way since it joined the coalition. Liberal Democrat support has fallen significantly since the election, according to recent opinion polls.

In his address, Mr. Clegg defended his party's decision to enter the coalition government with the larger Conservative Party. "Imagine if we had turned away. How could we ever again have asked the voters to take us seriously?" he said.

Liberal Democrat delegates Monday sent a sharp message to their party leaders when they voted not to support the establishment of free schools and academies—one of the U.K. coalition government's major education policies. The delegates labeled the policy divisive and inefficient and urged people not to use the free schools, which are due to open next year.

Mr. Clegg took time to explain the reasoning for the Liberal Democrats' backing of the Conservatives' spending cuts, which are designed



Nick Clegg gestures during his speech.

to tackle the U.K.'s budget deficit. Austerity measures have caused unease among the traditionally left-leaning Liberal Democrats, with party critics suggesting the planned cuts will hurt poorer households.

"To those of you angry now about the difficult decisions needed to balance the budget, you'll be able to show that those decisions have set us on a better course with new growth and jobs that last," he said.

Mr. Clegg said October's Spending Review—where the details of the spending cuts will be announced—was about "balance and responsibility," not "slash and burn."

He said that if the deficit were reduced at a slower pace, as advocated by the opposition Labour Party, it would worsen rather than ease the pain of the spending cuts.

The government's austerity plans received a boost Monday when Moody's Investors Service Inc. retained its stable outlook on the U.K. Moody's said the triple-A rating should hold if cost-cutting plans remain on track.

In his speech, Mr. Clegg promised that the government would stick to longtime party principles.

—Laurence Norman
contributed to this article.

British lending to businesses falls

BY ILONA BILLINGTON

LONDON—Bank lending to U.K. businesses continued to fall in July from a year earlier, although by less than it did in June.

Total lending by banks and building societies fell by £2.5 billion (\$3.91 billion), a smaller drop than the £3.2 billion decline recorded the previous month, the Bank of England said Monday in its monthly report, Trends in Lending.

The annual rate of decline in lending to businesses eased to 5.7% from 7.9% in June, but the figures indicate that U.K. businesses don't want more credit or U.K. banks aren't able and willing to provide it.

The BOE said its own agents had reported that weak demand is at least part of the problem. "Contacts of the Bank's agents and most major U.K. lenders reported that demand for credit remained subdued," the BOE said. "The major U.K. lenders reported loan availability was broadly unchanged on the month."

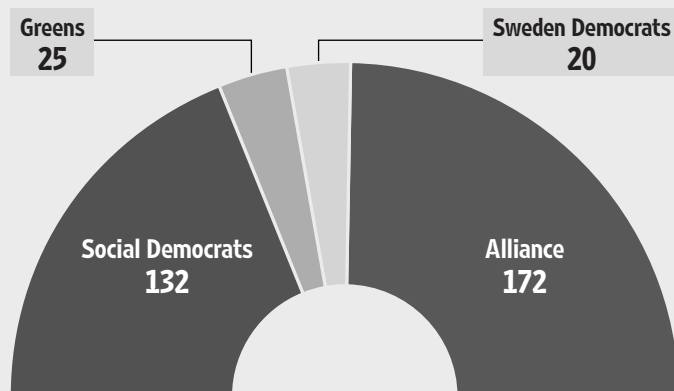
There is little sign of a notable pickup in lending ahead. "Net lending by the major U.K. lenders remained subdued in August, though [it] was slightly stronger than in recent months," the report said.

The BOE last month cut its growth forecasts for the U.K. economy, citing tight credit conditions as one reason for doing so.

Reaching out

Sweden's governing center-right alliance, short of a majority, hopes to woo the Greens

Projected number of seats in Swedish parliament following Sunday's election



Source: SVT

EUROPE NEWS

'No vacancy' for Irish leader's job

By QUENTIN FOTRELL

DUBLIN—Irish Finance Minister Brian Lenihan said Monday that there was “no vacancy” for Prime Minister Brian Cowen’s position after the leader’s widely criticized appearance on early-morning radio last week.

“The issue of the leadership doesn’t arise,” Mr. Lenihan said in a statement, adding, “there is no vacancy.” He was speaking after mounting speculation that Mr. Cowen’s leadership was under threat because of unhappiness within the government about his performance.

Mr. Lenihan denied rumors that backbenchers had approached him to take over. “No, backbenchers have been very respectful of me. And nobody has suggested to me that I should make a move. To the best of my knowledge, there is no move.”

Political analysts have also suggested that Justice Minister Dermot Ahern and Foreign Affairs Minister Micheal Martin were other possible frontrunners for the job as leader of the ruling right-of-center Fianna Fail party.

Last Friday, Mr. Cowen pledged to be “more cautious” in his social life after a poor performance in an early-morning radio interview sparked criticism from the public and opposition, and generated headlines around the world.

“I’ll be a bit more cautious in terms of that aspect of how I conduct my social life,” the prime minister, known as the Taoiseach, said.



Prime Minister Brian Cowen, shown in Brussels last week, has apologized for his performance in a radio interview.

“I take responsibility for my end of things and I’ll make sure they don’t happen again.”

Last Tuesday, Mr. Cowen spoke on state broadcaster RTE Radio on the second day of Fianna Fail’s parliamentary party conference in Galway. Mr. Cowen, who had been up until 2:30 a.m. local time, spoke less than five-and-a-half hours later on

RTE’s flagship news program Morning Ireland sounding tired, hoarse, groggy, sometimes slurring his words and, on occasion, momentarily mixing up answers to some of the questions.

The prime minister denied being hung over or drunk. He apologized shortly after when it became clear that the story had gone viral on the

Internet.

“It wasn’t my best performance and I would like to apologize for that,” he said at the time, admitting that he was under pressure to address his poor radio performance.

Before the prime minister issued his apology, Mr. Martin said, “We clearly have to learn lessons from the entire event and now move on.”

Dutch budget to skip over pressing issues

By MAARTEN VAN TARTWIJK AND ROBIN VAN DAALEN

AMSTERDAM—The Netherlands’ caretaker government on Tuesday is to present a 2011 budget that will sidestep many of the country’s pressing fiscal issues because talks to form a new government are still without a result.

The delay in reforms underscores the country’s political fragmentation since the previous government fell in February, with concerns rising from a looming pension crisis. The June elections resulted in a fragmented political landscape with no majority of parties able to find enough in common to form a coalition government.

The stalemate has left power in the hands of a caretaker government—consisting of the conservative Christian Democrats and left-leaning Christian Party—that has been unable to tackle the impact of the aging population on the budget.

The caretaker government on Tuesday is expected to announce about €3.2 billion (\$4.17 billion) in budget cuts for the period up to 2015, a modest reduction in comparison with the major cutbacks elsewhere in Europe.

The budget itself will be of “little importance,” said Sylvester Eijffinger, a professor of financial economics at Tilburg University. “The new government will have to come up with a real package.”

ECB steps up bond buys

By BRIAN BLACKSTONE

FRANKFURT—The European Central Bank has increased its purchases of government bonds amid rising concerns in financial markets about the ability of Greece, Ireland and Portugal to repay their debts.

The ECB initiated the bond-buying program in May, the height of Europe’s fiscal crisis, purchasing the debt of troubled countries in the 16-nation euro zone. The program was the central bank’s two-fold bid to build confidence—first, public confidence in the ability of those countries to meet their obligations and second, investors’ confidence that the central bank could always step in to keep markets liquid.

Critics worried that the program—a first for the ECB—would raise doubts about the central bank’s independence from politics.

The objective of the bond purchases, ECB President Jean-Claude Trichet said last month, is “to help restoring a functioning of our monetary policy transmission.”

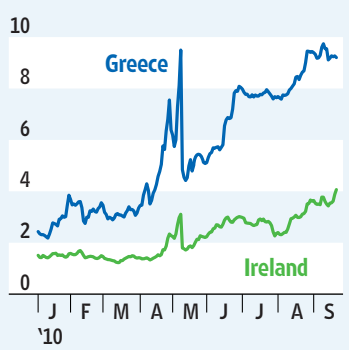
Bond buys by the ECB, though higher in recent weeks than during much of the summer, are still a fraction of what they were when the program started.

Although the ECB has spent more than €61 billion (\$79.58 billion) since May on government bonds, borrowing costs haven’t declined for struggling countries on Europe’s fringe. Yield spreads between government debt in Greece, Ireland and Portugal and their safer German equivalents are hitting or approaching highs, making it harder for the countries to finance debts.

The ECB said it spent €323 million on government bonds last

Growing apart

Spread between 10-year government bonds and comparable German bonds, in percentage points



Source: Thomson Reuters

week, up from €237 million the previous week and its highest level since mid-August. The bank doesn’t offer breakdowns of its purchases by country or maturity.

When the program started, the ECB was much more aggressive, buying more than €16 billion in bonds the first week alone. Those amounts dwindled as debt markets stabilized over the summer and the euro-zone economy showed signs of rebounding. By early August, the ECB was buying only about €10 million a week in bonds, leading to speculation at the time that the program would end soon.

But investor concerns over euro-zone governments’ high debts have flared anew. Southern Europe and Ireland face years of weak growth as their economies restructure. Commercial banks in those countries remain heavily dependent on the ECB for funding.

The latest increase in debt purchases “is an illustration that the sovereign-debt crisis is surfacing again, but it’s not as severe as May,” says Carsten Brzeski, economist at ING Bank in Brussels.

On Monday, yields spreads between Irish and German 10-year bonds—a key measure of investors’ perception of the risk associated with Irish bonds—exceeded four percentage points, a record, and more than double the spread that existed on May 10 when the ECB started buying government debt.

Portuguese yield spreads also hit a record Monday, at more than four percentage points above safer German equivalents. That spread was just 1.89 percentage points on May 10, a sign, some analysts said, that the ECB hasn’t been able to affect market sentiment. Greek spreads are near highs at more than nine percentage points above German government bonds.

The ECB’s bond purchases “are not serving much of a purpose in their current size,” says Marco Annunziata, chief economist at lender UniCredit in London.

Ireland and Portugal face key tests of investor confidence this week. Ireland plans to auction €1 billion to €1.5 billion in bonds Tuesday. Portugal is due to tap the debt markets Wednesday with a €750 million to €1 billion offering.

Higher financing costs compound the difficulty of bringing budget deficits under control. Ireland’s central-bank head, Patrick Honohan, warned Monday that although Dublin has taken “prompt and painful steps” to trim its deficit, the economy and interest rates “have evolved in a less-favorable way.”

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U.S. NEWS



Bloomberg News

Rep. Paul Ryan (R., Wis.), a leading conservative voice, says the GOP must show it's 'serious about limited government.'

Republicans to highlight parties' policy divisions

BY NEIL KING JR.
AND JANET ADAMY

Eyeing a potential congressional win in November, House Republicans are planning to chip away at the White House's legislative agenda—in particular the health-care law—by depriving the programs of cash.

The emerging plan has been devised in part to highlight the policy differences between the two main parties, especially over legislative achievements of the Obama administration that have proven unpopular with voters.

Republican leaders acknowledge many of these salvos will fail. At best, the party will gain a majority in the House and a razor-thin hold in the Senate in November's elections—short of what is needed to overcome a presidential veto. Analysts give the GOP a better shot at taking the House than the Senate.

But Republican lawmakers see the anticipated drama as foreshadowing the bigger brawl of the 2012 presidential elections and a clash of visions with President Barack Obama. A vote in the House to repeal the health-care overhaul would be among the GOP's top priorities.

Republican leaders are also devising legislative maneuvers that might have a bigger impact, using appropriations bills and other tactics to try to undermine the administration's overhaul of health care and financial regulations and its plans to regulate greenhouse gases. GOP leaders also hope to trim spending, return unspent stimulus funds and restore sweeping tax cuts.

Business groups have compiled lists of impeding regulations they hope to see stopped under a GOP House majority.

"We need to establish the proverbial lines in the sand and show we are serious about limited government," said Wisconsin's Rep. Paul Ryan, a leading conservative who is in line to chair the House budget committee if Republicans take control.

Democrats accuse the Republi-

cans of wanting to return to the same policies that sparked the financial crisis and helped put the country into recession. Mr. Obama has labeled Republicans as wanting to "cut more taxes for millionaires and cut more rules for corporations."

The White House concedes that Congress's withholding funds would be a threat to the health-care law, but argues such a strategy could backfire with consumers, particularly if it threatened to nix popular provisions, such as allowing children to stay on their parents' insurance plans until they turn 26.

"What the Republicans will be faced with is really taking those benefits away," said Kathleen Sebelius, secretary of Health and Human Services. "They will have to face their constituents who have their children enrolled on a family plan and say, 'That can't happen anymore.'"

The Republican plan is still in flux. Much hinges on what happens in the final throes of the current Congress, especially in the fight over the Bush-era tax cuts. And a new crop of lawmakers will inject unpredictability into the ranks.

Some lawmakers, Mr. Ryan among them, fear factions within the party remain wedded to their free-spending ways under President George W. Bush. Others worry that renegades could push too far. Several GOP lawmakers and tea-party candidates have suggested imposing a government shutdown if Democrats block the overhaul efforts, a strategy party leaders reject.

Still, the Republican plans are more modest than those advanced in the party's 1994 "Contract with America," which included a balanced-budget amendment and promises to overhaul welfare, court sentencing and tort law.

In a nod to that contract, Minority Leader John Boehner and other top Republicans plan to unveil more initiatives in coming weeks. One will be a requirement, pushed by tea-party activists, that all legislation cite its constitutional authority.

"This is all about the art of the doable," said Rep. Jeb Hensarling of Texas, one of eight Republicans on the White House's debt commission. "Is saving the country from bankruptcy a matter of doing or undoing? I think it's a mixture of both."

At its core, the GOP plan will focus on spending and whittling away the health-care law, the Democrats' landmark achievement, which extends insurance to 32 million Americans. House Republicans say a full repeal would pick up a few Democratic votes, but acknowledge the effort would fail in the Senate.

Instead, they plan other means to chip away at it, by trying to choke off appropriations funding for key pieces, since House approval is required to pass such spending.

Republican congressional aides and advisers say their focus would include blocking funding to hire new Internal Revenue Service agents, who are needed to enforce the law's tax increases. They also would consider barring spending for a new board that approves Medicare payment cuts, as well as on research that compares the effectiveness of medical procedures.

Other potential targets include funds to pay for a long-term care insurance program and money to help states set up insurance exchanges where consumers will be able to use tax credits beginning in 2014.

"By having the capacity to block funding for it, you get to very much shape how it turns out," said Douglas Holtz-Eakin, a director of the Congressional Budget Office under Mr. Bush.

Republicans would also bring to a vote measures that attack the law's least popular parts, including the requirement that most Americans carry health insurance.

Much of the \$938 billion bill is effectively on a glide path, a fact that works against the Republican plan, and many provisions don't begin until 2014. That's when lower earners will start getting tax credits to offset the cost of insurance and states will expand their Medicaid programs for the poor.

GOP candidates in Ohio defy populist rage on trade

[Capital Journal]

By GERALD F. SEIB



It's never a bad idea to watch Ohio—the classic big, industrialized swing state—in an important political year, and that's especially true this year.

In particular, keep an eye on Ohio's big Senate and governor's races, for there an important proposition is being put to the test—the proposition that supporting free trade is a losing message amid hard economic times, especially in the industrialized heartland.

Right now, both Republican contenders in those races—Rob Portman for the Senate and John Kasich for governor—are coming under fire for their past support of free trade. The fact that both enjoy big poll leads right now suggests the attacks have had limited effect so far.

A key question in the campaign stretch run, both for Ohio and for policy making in Washington after the election, is whether that remains the case.

Both Mr. Portman and Mr. Kasich are establishment figures who have managed to surge ahead in this season of anti-establishment fervor. Both have long been prominent figures in the state's GOP, and both are former House members. Mr. Portman also served in two cabinet-level jobs for a Republican administration in Washington, as trade representative and budget director for President George W. Bush.

Those are the kinds of insider resumes that could prove fatal in this year of the outside insurgent, and Democrats are certainly trying to drive home that thought. In the Senate race, for example, an ad being run by Democratic Lt. Gov. Lee Fisher, the Democrat running against Mr. Portman for an open Senate seat, marches quickly through the Republican's Washington record, flashes a picture of him standing alongside former Vice President Dick Cheney and intones at the close: "Washington insider Rob Portman. He's not what Ohio needs."

Yet a variety of public polls show both Republicans with significant leads at the moment. The Realclearpolitics.com average of the most current statewide polls shows Mr. Portman with a lead of more than 11 points over Mr. Fisher, while Mr. Kasich has an advantage of just under 11 points in his race to unseat incumbent Democratic Gov. Ted Strickland.

So both Republicans seem to be surviving the anti-establishment rage. The more compelling question is whether they are more vulnerable to an anti-free-trade message in an industrialized state with an unemployment rate of 10.3%.

Certainly both are being hit, and hard, over their past support of free-trade agreements. In the Senate race, the Democrats' Mr. Fisher has made a frontal assault on Mr. Portman based on trade. The ad that calls Mr. Portman a



Senate hopeful Rob Portman

Washington insider also uses his work as U.S. trade representative to charge that he backed trade deals that directly hurt Ohio workers.

"As George Bush's top trade official, Portman backed deals that shipped tens of thousands of Ohio jobs overseas," the ad declares. It bores in on trade with China, saying the U.S. trade gap with China widened by \$31 billion on Mr. Portman's watch in the trade office.

Similarly, in the governor's race, Mr. Strickland's campaign started out hitting Mr. Kasich hardest on his work for the failed Lehman Brothers investment firm, but lately it has shifted to going after his support for trade deals.

In a recent talk with supporters, replayed in a video on his campaign website, Mr. Strickland jabs Mr. Kasich for supporting both the North American Free Trade Agreement and liberalized trade with China, and stressed his own contrary views:

"When I was in congress we voted on NAFTA," Mr. Strickland says. "I voted no, he voted yes. When I was in Congress there was a vote on whether or not to grant China most-favored-nation trade status. I voted no, he voted yes."

In the same vein, Mr. Strickland is running an ad attacking Mr. Kasich on trade by using this line: "Kasich's trade deals cost Ohio thousands of jobs."

Meantime, the governor is running positive ads touting programs he has started to help generate jobs in Ohio, including one showing a businessman in an alternative-energy firm lauding him for creating "Ohio jobs."

Similar trade debates are starting to creep into Ohio House races. That represents a challenge for Republicans, not just in battling Democrats but in their efforts to keep the allegiance of tea-party activists, many of whom aren't big free-trade fans either.

Still, Ed Gillespie, former Republican national chairman, thinks GOP candidates can survive attacks on their trade views by stressing that shrinking trade translates into a shrinking jobs base. "I think the public sees that Obamanomics isn't working, whether it's taxes or trade or debt or a lack of trade expansion," he says.

One of the striking aspects of deep recession is that more protectionist sentiment hasn't cropped up. Ohio is testing whether that remains the case.

U.S. NEWS

State law tests death penalty

BY NATHAN KOPPEL

Kenneth Bernard Rouse was sentenced to death after a jury found him guilty in 1992 of fatally stabbing 63-year-old Hazel Colleen Broadway. Police found her body in a North Carolina convenience store, the knife still in her neck.

Nearly two decades later, Mr. Rouse, now 47, sits on North Carolina's death row, after filing unsuccessful appeals.

But a new, controversial state law might change that. Last year, North Carolina enacted what's known as the Racial Justice Act, requiring judges to let any inmate off death row if the judge finds that race was a "significant factor" in the death sentence.

About 95% of the state's death-row population, or 152 inmates including Mr. Rouse, filed bias claims by the August deadline, according to the North Carolina attorney general's office. The law also allows future capital-murder defendants to claim racial bias. Convicts whose petitions were successful would instead face life sentences, with no chance of parole.

North Carolina's new law is among the most hotly debated responses to recent criticism of the death penalty. Many states have rethought the sentence amid new genetic evidence that has freed some inmates.

Maryland has suspended its use of the death penalty while it reviews whether lethal injection causes undue pain; Texas last year passed a law to improve legal representation in death-penalty appeals. New Jersey and New Mexico in recent years abolished the death penalty.

But North Carolina has undertaken the most far-reaching effort to date to examine the amorphous question of whether race played an improper role in decisions to seek or impose death sentences.

It likely will be several months before any of the claims are considered by the courts, attorneys said.

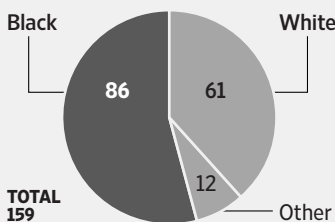
"There are so many variables



Kenneth Bernard Rouse, in an undated photo, has challenged his death sentence under a state law examining the role of race in such cases.

Race factor

Racial makeup of North Carolina's death row population



Note: As of June 21
Source: North Carolina Dept. of Correction
Photo: Associated Press

that can legitimately affect a prosecutor's decision to seek the death penalty, including the seriousness of an offense," said Christopher Slobogin, a death-penalty expert at Vanderbilt University Law School. "This will be a messy enterprise."

Other states could follow North Carolina's lead. Legislation is pending in Pennsylvania to allow death sentences to be challenged on the grounds of racial bias. A similar bill was introduced this year in California, though it was defeated because of concerns it would cost too much to administer, said a spokeswoman for Democratic California state senator Gilbert Cedillo, who introduced it.

Death-penalty critics and civil-rights advocates in North Carolina had pushed for several years to pass legislation aimed at examining the role of race in death-penalty cases. The Rouse case involves unusually specific evidence of alleged bias, and it was cited by advocates of the Racial Justice Act as an example of how discrimination can affect jurors' decision making, according to lawyers involved in the debate over the law.

In his petition, Mr. Rouse highlighted that he is black, his victim white and he was convicted by an all-white jury. Mr. Rouse also presented what he claimed was more specific

evidence of alleged bias. After the verdict in his case, a member of his legal team interviewed a juror, who allegedly used a racial epithet in describing blacks and said, "Black men rape white women so that they can brag to their friends about having done so," Mr. Rouse's bias petition claimed.

"If the Racial Justice Act covers anything, it covers Kenneth Rouse," said his attorney, Gordon Widenhouse.

Andrew Gregson, a lawyer in the district attorney's office that prosecuted Mr. Rouse, declined to comment on the case.

No particular case served as catalyst for the final legislation, according to people involved in the process. "We had quite a few people in the state who were concerned about the large number of people on death row who are African-American," said state Democratic senator Floyd McKissick Jr., who sponsored the legislation.

The legislation drew heated debate, narrowly passing the Democratic-controlled legislature. No Republican voted for it. "We are just giving murderers an additional tool to delay justice," Justin Burr, a Republican state legislator said.

Some Republicans in the fall election season have continued to

criticize their Democratic opponents for voting in favor of the legislation, although now the debate over bias legislation has been subsumed by a bigger controversy, attorneys said. The North Carolina attorney general's office last month released a report that the state's crime lab had routinely failed to disclose evidence possibly favorable to defendants, including in death-penalty cases.

Prosecutors also resisted the law, saying that it calls for a costly and unnecessary wholesale review of cases. "I feel very confident that race has not played a role in imposing the death penalty," said Peg Dorer, director of the North Carolina Conference of District Attorneys.

Of particular concern to prosecutors and other opponents is that the new law allows murder defendants to try to prove bias through broad statistical evidence, such as data showing that North Carolina prosecutors, on a county-wide or statewide basis, have sought the death penalty more frequently against black defendants or in cases involving a white victim. "You shouldn't try a case on statistics," said Sarah Stevens, a North Carolina Republican legislator. "Statistics can be manipulated."

Mr. Rouse's bias petition cited two recent studies from the Michigan State University College of Law. One study found that in more than 1,500 cases between 1990 and 2009, North Carolina defendants of all races were more than twice as likely to be sentenced to death if at least one of their alleged victims was white.

Another study concluded that in the cases of the 159 people currently on death row in the state, prosecutors removed blacks from juries at more than twice the rate that they struck prospective nonblack jurors.

Most inmates filing bias claims have cited the Michigan State study, according to Gerda Stein, a spokeswoman for the Center for Death Penalty Litigation, which represents about 40 inmates who have filed claims.

End called to recession, but weakness still lingers

Continued from first page operating at normal capacity."

The group said its determination did mean that "any future downturn of the economy would be a new recession and not a continuation of the recession that began in December 2007."

While there are several shorthand definitions used by market participants to mark turns in the business cycle, the economists' group relies on a more complex formula. It frequently waits some time before making its determinations, as it seeks to use the most definitive data available.

Separately, the Organization for Economic Cooperation and Development said in a report Monday that still-high U.S. unemployment was unlikely to return to precrisis levels for at least three years, one of a number of challenges Washington policy makers face as they seek to encourage a sluggish recovery.

The OECD said the recent economic downturn could result in a permanently higher level of unemployment. While previous U.S. recessions didn't cause any long-term structural damage to the economy, "it is possible this recession will trigger these effects," it said.

"It could be early 2013, at best, before the [unemployment] rate returns to its prerecession level," the report said.

The report said U.S. policy makers should continue efforts to support the job market. It said the Obama administration's stimulus efforts and the Federal Reserve's efforts to keep credit flowing "successfully turned the economy around."

Still, it said, domestic U.S. demand is likely to be dampened for the next few years as consumers save to replace net worth lost during the downturn and to bring down their debt levels.

The Fed, the OECD suggested, should continue to encourage the recovery but would soon have to begin raising interest rates.

"Since the movement of interest rates from extremely expansionary levels to neutral levels and the gradual shrinkage of the Federal Reserve's balance sheet will take some time, initial increases need to begin well before the economy once again approaches full capacity," the report said.

In addition to analyzing the U.S. efforts to respond to the recession, the OECD report also weighed in on Washington's high federal deficit. The Obama administration's plan to balance the federal budget by 2015 "is ambitious, but appropriately gradual and should therefore be implemented in full," the report said.

While that proposal is a start, the OECD said, policy makers are likely to have to take additional steps in the second half of the decade to continue to improve the nation's fiscal condition.

Additionally, the report noted that U.S. tax levels are low compared with other countries, and that modest increases, while politically unpopular, "would still keep the overall tax burden at a relatively moderate level and not impose excessive costs."

Capital takes tax on bags in stride

BY SARA MURRAY AND SUDEEP REDDY

WASHINGTON—Nine months after Washington's city government imposed a five-cent tax on disposable shopping bags at food stores, the fee has spurred a big change in behavior with little evident griping.

Recyclable bags have become a ubiquitous accessory, and stores are reporting a sharp drop in the use of plastic and paper bags.

"I am somewhat surprised by the extent to which people changed their behavior," said Christophe A.G. Tulou, acting director of the city Department of the Environment. "What we've done is created a market mechanism that gives people an incentive" not to use the bags.

When it took effect Jan. 1, the bag tax met with some consumer resistance. It also created confusion because it applies to not only grocery and liquor stores, but any store that sells food or alcohol.

The owners of Chocolate Moose, a downtown gift store that also sells candy, weren't keen on the tax at first. Co-owner Marcia Levi said it didn't seem fair to penalize a cus-



A 5-cent fee on bags has gone smoothly in Washington, D.C. Above, a customer buys a bag to carry purchases at the Chocolate Moose gift store.

tom who took a bag with jewelry or greeting cards. But things have changed. "I think it's the best thing that's ever happened," Ms. Levi said.

A large paper gift bag, emblazoned with Chocolate Moose's logo, costs the store about 50 cents apiece; plastic bags cost about 30 cents. Now, 75% of customers turn down the bag—for which they would have to pay only five cents—and either whip out a reus-

able sack or carry purchases without a bag, she said.

Ms. Levi has changed her own habits. "If I go into Whole Foods and don't have my bags...you really want to dig a hole and crawl into it," she said.

The fee has prompted many consumers to carry reusable bags, even though the fee is usually a small fraction of the purchase. Mary Richardson keeps five recyclable bags in

her car, something she didn't do before. "People didn't think about it before," said Ms. Richardson. "I have no problem with it," she said.

The city doesn't have a precise way to measure the tax's impact. Prior to the law, residents used about 270 million disposable bags a year, according to the city; the city estimated that would decline by 50% in the first year after the tax was imposed. A staff member for the councilman who sponsored the bill said an informal survey of grocery stores and pharmacies estimated a drop of 60% or more.

The levy goes to a fund to clean up Washington's Anacostia River.

Gary Cha, who owns several Yes! Organic Market grocery stores in the city, said that bag use at his stores has dropped at least 75%. Mr. Cha's one complaint was that officials didn't do a better job of explaining the fee largely went to the city and river cleanup, not to retailers. The first few months were tense for cashiers who dealt with customers "thinking that we are the greedy people charging," Mr. Cha said.

—Michael M. Phillips contributed to this article.

WORLD NEWS

Tajik attack stokes regional concern

A brazen attack by Islamist militants who killed at least 23 Tajikistan soldiers on Sunday is stoking concerns that the war in Afghanistan is spilling across the border into former Soviet Central Asia, destabilizing the already fragile governments there and endangering key coalition supply routes.

By Yaroslav Trofimov
in Kabul
and Alan Cullison
in Moscow

Tajikistan, an impoverished former Soviet republic that was ravaged by a civil war between a secular regime and the Islamist opposition in the 1990s, is particularly vulnerable. Tajikistan shares a long, porous border with northern Afghan provinces that have become Taliban strongholds over the past year, and has experienced a spate of smaller attacks in recent months.

Combined with ethnic unrest in neighboring Kyrgyzstan, the emergence of Islamist rebels in Tajikistan imperils the stability of the entire Central Asian region—including its most populous country, Uzbekistan, whose repressive government has so far been able to keep Islamist militancy in check. The U.S. military in Afghanistan receives most of its fuel and about 30% of its ground supplies through Uzbekistan, Kyrgyzstan and Tajikistan.

"If there is a major upsurge of insurgency in Tajikistan, both the Russians and the Americans are going to be scared," said Paul Quinn-Judge, Central Asia projects director for the International Crisis Group, a conflict-resolution organization. "It's not what the Americans need with Afghanistan going the way it is. And the Russians are very nervous about the way insurgency could metastasize through Central Asia in their direction."

On Sunday, a Tajikistan military column was ambushed in a mountain gorge in the Rasht district some 50 kilometers, or about 30 miles, from the Afghan border, said Faridun Makhmadaliev, head of the Tajikistan defense ministry press service. In addition to the 23 killed



An elderly man stares through a bus window in Dushanbe, Tajikistan, on Sunday, below posters of prison escapees.

servicemen, several others sustained serious injuries, Mr. Makhmadaliev said. He declined to confirm Tajikistan media reports that many other soldiers had been captured by the rebels. Tajikistan military reinforcements were pursuing the attackers, he said.

The heavy losses in Rasht show the insurgents are highly experienced, skilled fighters, more than a match for Tajikistan's weak army, said Semyon Bagdasarov, a member of the international-affairs committee of the Russian parliament and an expert on the region. "There's a very high probability that this will lead to a revival of the civil war in Tajikistan," he said. "Either we stop this, or what happens in Central Asia will be even worse than Afghanistan." Russia maintains a large military base and some 7,000 troops in Tajikistan.

The Tajikistan government blamed Sunday's attack on the "terrorist group" of Mullah Abdullo Rahimov, an Islamist rebel commander

during the 1990s civil war who—unlike most other opposition leaders—rejected the peace agreement that ended that conflict in 1997 and fled to Afghanistan. Mr. Rahimov returned from Afghanistan last year, heading a force of some 100 militants that included Tajiks, Uzbeks, Pakistanis and Chechens, according to Tajik media reports and government officials.

While the 1997 peace agreement called for power-sharing between President Emomali Rakhmon and the rebels, the government has been steadily pushing the former insurgents out of positions of influence, fueling discontent. Still, Hojja Akbar Turajonzoda, a spiritual leader of the rebels during the 1990s war, condemned Sunday's killings in Rasht as "a horrible crime," Tajikistan's Asia-Plus news agency reported.

In the weeks before Sunday's attack, Tajikistan militants orchestrated the jailbreak of several Islamist radicals from a prison in the

nation's capital city, Dushanbe, sent a suicide bomber to attack a regional police station, and bombed a Dushanbe disco. The Rasht valley was a stronghold of the Islamist opposition through the civil war.

The recent movement of Central Asian militants to the northern Afghan provinces—where they can blend in among Afghanistan's ethnic Uzbeks, Tajiks and Turkmen—is one of the reasons for the spike in insurgent activities in that part of the country, U.S. officials said.

In more remote districts of the north along the Tajikistan and Uzbekistan borders, Taliban-affiliated insurgents have been allowed to operate with impunity because the U.S.-led coalition concentrated its resources on the traditional Taliban heartland in the ethnic Pashtun areas of southern and eastern Afghanistan, such as Kandahar and Helmand.

While U.S. Special Operations Forces have staged an aggressive campaign to wipe out insurgent

leaders in Afghanistan's north, some U.S. officials said this has only served to drive the militants into safe havens in the sparsely patrolled marshy borderlands along the Panj River, which separates Tajikistan and Afghanistan.

The U.S. hardly used the Central Asian supply route until two years ago, and turned to the northern alternative only after allied convoys started coming under regular attack while passing through Pakistan in late 2008. Uzbekistan is currently the most important Central Asian conduit for supplies into Afghanistan, and the Uzbek state railway company recently built a spur over the border that is extending to the vicinity of the northern Afghan city of Mazar-i-Sharif.

The Taliban spokesman in Afghanistan, Zabihullah Mujahed, denied any involvement in the Tajikistan ambush. "The policy of the Islamic Emirate of Afghanistan is not to interfere in neighboring countries," he said in an interview. "This is Tajikistan's domestic issue."

But Waheed Muzhda, a Kabul-based political analyst who served in the Taliban foreign ministry before 2001 and maintains contacts with Taliban leaders, said Taliban-affiliated rebels are intensifying their operations in Central Asia because they seek to disrupt the U.S.-led coalition's logistics routes.

"They want to put pressure on the Tajik regime now that [North Atlantic Treaty Organization] forces supply through Tajikistan to Afghanistan," he said. "Tajikistan has a weak government and its people are tired of it. If these groups establish themselves there, they will try to spread their ideology to the entire Central Asia."

The group behind Sunday's attack, Mr. Muzhda said, was linked with the Islamic Movement of Uzbekistan, an al Qaeda-affiliated organization that includes ethnic Tajiks in addition to Uzbeks and other Central Asian nationalities.

—Habib Totakhil in Kabul
and Gregory L. White
and Richard Boudreaux
in Moscow
contributed to this article.

U.S. shifts focus in tackling Afghan graft

WASHINGTON—The U.S. is planning a concerted campaign against lower-level corruption in Afghanistan thought to be directly feeding the insurgency and is ceding more control to Afghans of the higher-level investigations that soured relations with President Hamid Karzai.

By Adam Entous,
Julian E. Barnes
and Siobhan Gorman

The Obama administration has made the battle against government corruption a key part of its Afghanistan war strategy for the past year, arguing that graft and fraud within Mr. Karzai's inner circle fuel public support for the Taliban. Now some top officials say corruption further down the food chain has a bigger impact on the insurgency's strength.

The shift could help the administration manage its difficult partnership with Mr. Karzai. U.S.-backed corruption investigations—and Mr. Karzai's rejection of them as infringements on Afghan sover-

eignty—have raised tensions between Washington and Kabul.

Officials said the evolving approach is more practical: the focus on lower-level corruption would have an impact on more Afghans. Much of the new focus will be on cases in which local power brokers and corrupt police shake down villagers, or when security contractors pay insurgents for safe passage.

To combat higher-level corruption, the U.S. will now work more privately to get Mr. Karzai to sideline corrupt figures and to let investigators operate free of interference, officials said.

One matter that could see the effects of the changing U.S. approach is the **Kabul Bank** case, an investigation into allegations of financial improprieties at Afghanistan's largest bank, which has ties to the Karzai administration. The U.S. is likely to push reform more than prosecution, but has made clear the Afghans will take the lead—in the bank case and in other high-level probes—in deciding how to proceed.



Hamid Karzai after voting Saturday

Critics said the Obama administration is backing off the fight against high-level corruption because it lacks the political will to confront Mr. Karzai and risks sending inconsistent messages that undercut U.S. standing.

U.S. officials say they won't turn a blind eye to corruption. "It isn't one way or the other," a military official said. The U.S. will continue to

encourage Mr. Karzai to clean house, but will try to be more discreet about it, officials said.

A military official said Mr. Karzai's reaction to the arrest of one of his top aides this summer, which he hadn't been told about beforehand, has led the U.S. to conclude that it needs to "be a little bit more transparent" with Mr. Karzai. That would mean providing advance notice of actions that are about to be taken and, where possible, ensuring that Mr. Karzai is on board with the pending move.

U.S. officials insist that this in no way amounts to a retreat from rooting out high-level wrongdoing. They say it means such corruption will be addressed more quietly so as not to embarrass Mr. Karzai, and that administration officials are assessing what kinds of corruption have more of an impact on fueling the insurgency. If they deem that a high-level corruption case is fueling the insurgency, it will be a priority.

The debate over corruption is tacit acknowledgment that the ad-

ministration's approach to combating corruption in the central government wasn't working.

The shift comes at a critical time. The White House is set to review its counterinsurgency strategy in December; Defense Secretary Robert Gates wants to begin to transition authority in some districts to the Afghans this winter; and President Barack Obama has said that troops will start to gradually withdraw starting in July 2011.

Before that review, many U.S. and NATO officials see slow progress combating corruption and improving local governance as the weakest link in the strategy. One senior U.S. military official said there was a growing realization that these deficiencies of governance were diluting the effectiveness of that strategy.

"It is important for us to focus on what areas of corruption are the most germane," said a senior defense official. "We are not in the business of creating a corruption-free Afghanistan."

WORLD NEWS

Crisis hurt poverty plan

By JOE LAURIA

UNITED NATIONS—The world financial meltdown of 2008 has kept as many as 70 million more people in extreme poverty, reversing gains made by governments to halve the total number of impoverished by 2015, the presidents of the World Bank and the International Monetary Fund said Monday.

They said the credit crisis in developed countries combined with a sharp rise in oil and food prices to slam the world's poorest people.

Dominique Strauss-Kahn, the IMF's managing director, told world leaders on the opening day of a three-day development summit at the United Nations that he spoke with "urgency" because "before the crisis we saw strong growth...in developing countries. But because of the crisis...we have lost years of

progress and the momentum has been derailed."

Mr. Strauss-Kahn estimated that because of the crisis, about 70 million fewer people "will have escaped from the chains of poverty by 2020."

World Bank President Robert Zoellick said the bank "estimates that 64 million more people are living in extreme poverty in 2010, and some 40 million more people went hungry last year because of the food, fuel and financial crises."

The meeting of 140 heads of state and government is assessing progress toward the implementation of eight development goals by 2015 agreed upon a 2000 U.N. summit.

In five years, the crisis may cause 1.2 million more children under the age of 5 to die and could keep 350,000 more students from completing grade school, Mr. Zoellick said.

In 1981, 52% of people in developing countries lived in extreme poverty, defined by the World Bank as living on less than \$1.25 a day, but by 2005, that percentage had been cut by more than half, Mr. Zoellick said.

"Efforts by developing countries were paying off right up until the crisis, with poverty falling sharply in East Asia, Latin America, and Eastern and Central Europe," he said.

"The triple blow of the food, fuel and financial crises since 2008 has slowed down and even reversed progress towards the [development goals] in many countries around the world," he said.

Mr. Zoellick said the World Bank would invest an additional \$750 million toward basic education in poor countries, which antipoverty group Oxfam on Monday called "a drop in the ocean."



IMF chief Dominique Strauss-Kahn addresses the U.N. summit on Monday.

Australia's new leader seeks more global role

By RACHEL PANNETT

CANBERRA, Australia—Prime Minister Julia Gillard said Monday that she will attend a string of world leaders' meetings, in a sign the new Australian leader seeks to carve out a role on the international stage.

Ms. Gillard last week named Kevin Rudd, whom she ousted as premier in June after a power struggle within the Labor Party, as foreign minister, as she seeks to heal political divisions. The appointment raised the prospect that Mr. Rudd, a Mandarin-speaking former diplomat, would be seen as Australia's leader on foreign shores.

Mr. Rudd embarked on his first foreign visit—to flood-stricken Pakistan and the U.S.—just days after taking up the foreign affairs role. Mr. Rudd met with U.S. Secretary of State Hillary Clinton in Washington during the weekend and is attending meetings of the United Nations General Assembly in New York this week.

Ms. Gillard said during the election campaign that she was something of a novice on foreign policy, and has been seen as focused on domestic concerns.

Monday's travel program appeared designed to establish Ms. Gillard's position on the world stage.

In early October, Ms. Gillard will lead Australia's delegation to the Asia-Europe Meeting in Brussels. She will attend the East Asia Summit in Hanoi at the end of the month and the Association of Southeast Asian Nations-Australia leaders' summit.

In mid-November, she will attend meetings of Group of 20 leaders in Seoul, followed by a meeting of Asia-Pacific Economic Cooperation leaders in Japan.

The recent decision by Asean to expand the East Asia Summit to include the U.S. and Russia "advances Australia's interest in creating strengthened regional arrangements to better address regional economic, political and security challenges," Ms. Gillard said.

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WORLD NEWS

Manila drama report casts blame

By JAMES HOOKWAY

Philippine President Benigno Aquino III said more than a dozen people, including several journalists, could be held liable for contributing to a calamitous hostage-taking in the Philippine capital last month that killed eight tourists from Hong Kong.

An initial government report into the standoff, meanwhile, shed fresh light on the chaotic circumstances that led to the bloodshed, and cast blame on on-site commanders and local government officials as well as reporters who allegedly distracted the sacked policeman who abducted the tour group by persistently engaging him in live, on-air interviews.

Mr. Aquino told a nationally televised news conference that he will decide whether to approve filing charges after government lawyers examine the report and that the decision will be made once he returns from a visit to the U.S.

The hostage-taking debacle badly strained the Philippines' relations with China, and live coverage of the standoff was broadcast around the world, further tarnishing the Philippines' poor record for maintaining law and order. Mr. Aquino said his administration's goal was to help victims and survivors "get back to their lives" and also to repair relations with China.

But the extensive report and the assessment of whether to file administrative and criminal charges against local officials and journalists also is an attempt to show decisive leadership to overcome the first major test of Mr. Aquino's government since taking office on June 30.

Justice Secretary Leila de Lima on Friday submitted an 83-page report into the hostage-taking, in which sacked policeman Rolando Mendoza hijacked a tour bus in a bid to get his job back after being dismissed for alleged extortion. The 11-hour standoff resulted in Mr. Men-



A sacked policeman seized a bus of Hong Kong tourists in Manila on Aug. 23 in a standoff that left eight hostages dead.

doza killing the eight hostages, according to the report, which said more tests are required to determine whether any of the victims were hit by bullets fired by police. Mr. Mendoza was shot and killed by police.

Parts of the report were publicly released Monday, but didn't include details of the recommended charges against allegedly culpable officials. Mr. Aquino said in his news conference that charges could be filed against recently retired national police chief Jesus Versoza, relieved Manila police chief Rodolfo Magtibay, two negotiators and a number of police commandos involved in a botched attempt to rescue the hostages from the tour bus. Mr. Aquino also said Manila Mayor Alfredo Lim could be held liable for his role in the affair, without disclosing details, and also said Interior Undersecretary Rico Puno was named in the report.

None of the officials could be reached to comment.

Ms. De Lima's report also singled out the role that several journalists played in the hostage-taking, and said their determination to get in-

involved in the unfolding events complicated the task of law enforcers attempting to bring it to a peaceful resolution. The report singled out two broadcasters, Michael Rogas and Erwin Tulfo, who conducted live interviews with Mr. Mendoza and apparently attempted to act as hostage negotiators during crucial moments during the crisis.

"A journalist has the function of recording and reporting events as they happen. Crisis situations should be reported without becoming part of the event being covered," the report stated.

Neither Mr. Rogas nor Mr. Tulfo could be reached to comment.

Mr. Aquino said the journalists were speaking to Mr. Mendoza through a mobile phone at a time when police negotiators were attempting to resume their dialogue with the hostage-taker.

The Philippines' National Union of Journalists has said the journalists were doing their job and police in charge of the area hadn't imposed any limits on what they could and couldn't do.

Ms. De Lima's report blamed po-

lice officials for not preventing the live broadcast of images of police commandos moving into positions around the bus at a time when Mr. Mendoza could view them on the bus's television set. The report also criticized police for allowing Mr. Mendoza's brother, another police officer named Gregorio Mendoza, to get involved in negotiations. Gregorio Mendoza's detention after apparently urging his brother not to give in to police seemed to inflame Rolando Mendoza.

Former Philippine National Police chief Mr. Versoza and former Manila police chief Mr. Magtibay came in for particularly stinging criticism in the government report.

It said the two officers failed to implement a direct order from Mr. Aquino to deploy a special police action force trained in crisis response to tackle the hostage standoff. Instead, the report said Mr. Versoza and Mr. Magtibay dispatched a less-well-trained, poorly equipped SWAT team. "They miserably failed in this task," the report said.

—Josephine Cuneta
contributed to this article.

China mulls new nuclear power plant in Pakistan

By JEREMY PAGE

BEIJING—China's main nuclear-power company said it is in talks to build a one-gigawatt nuclear-power plant in Pakistan, even as the two countries face U.S. and Indian concerns over their cooperation to build other plants in Pakistan.

Pakistan hasn't signed the Nuclear Non-Proliferation Treaty, and U.S. and Indian officials worry that nuclear material might fall into the hands of al Qaeda and Taliban militants based near the Afghan border in northwestern Pakistan.

The state-run China National Nuclear Corp. has already helped Pakistan build its main nuclear-power facility at Chashma in Punjab province, and has contracts to build two more 300-megawatt reactors.

Qiu Jianguang, vice president of CNNC, told a meeting in Beijing on Monday that the first reactor is operating safely, the second is now being tested and expected to start formal operations by the end of the year. "Both sides are in discussions over the CNNC exporting a one-gigawatt nuclear plant to Pakistan," he added, without giving details.

By Monday afternoon, there was no reaction from the U.S. or India. Officials from both countries expressed concern after China signed a deal in February to build the two 300-megawatt reactors. U.S. officials said such plans required special exemption from the 46-nation Nuclear Suppliers Group, which China joined in 2004.

Abdul Basit, a Pakistani Foreign Ministry spokesman, declined to comment on the one-gigawatt plant, but said Pakistan's nuclear cooperation with China was for civilian purposes, saying it is "in accordance with international obligations and comes under [International Atomic Energy Agency] safeguards."

China and Pakistan argue that the U.S. set a precedent with a deal to sell civilian nuclear fuel and technology to India in 2006 even though New Delhi had yet to sign the NPT.

That agreement, which lifted a U.S. ban imposed after India tested its first nuclear device in 1974, is seen as the cornerstone of a new partnership with New Delhi designed to counterbalance China's influence in Asia.

Critics, however, say it undermined the global nonproliferation regime by recognizing India as a global nuclear power, but not Pakistan, even though the rivals developed nuclear bombs simultaneously.

—Zahid Hussain
contributed to this article.



Zimbabwe aims to overhaul central bank

Zimbabwe's central bank is broke, dysfunctional and the custodian of a currency that officially no longer exists. On the bright side, it wants to dismiss three-quarters of its staff and has a comeback plan.

By Farai Mutsaka in Harare, Zimbabwe, and Peter Wonacott in Johannesburg

The Reserve Bank of Zimbabwe has been at the center of much of what has gone wrong with this southern African country. Lending to organizations and projects favored by President Robert Mugabe has left it in debt to the tune of \$1.5 billion. Rampant printing of money sparked runaway inflation, forcing Zimbabweans to line up with stacks of Zimbabwe dollars to buy bread.

To stabilize the economy after violent elections in 2008, the government last year abandoned the national currency in favor of the U.S. dollar. As a result, Zimbabwe's central bank no longer has a currency to manage or loans to make.

But it still retains a staff of more than 2,000, some of whom acknowledge they now spend their days playing computer games—if they come to work at all. The central bank has stopped paying employees.

Zimbabwe officials are now attempting to tear apart the bank in

order to rebuild it. The revamp is intertwined with efforts to revive a struggling economy and restore the luster of mineral-rich Zimbabwe among foreign investors.

The central bank isn't about to reintroduce a now-worthless Zimbabwe dollar. But officials say they hope it can resume its past role as a credible financial regulator and a lender of last resort to head off potential runs on private banks.

"For that to happen, it has to be clean," Finance Minister Tendai Biti said. "We need a strong Reserve Bank as part of measures that can pull us" back to "when our economy was ranked as one of best on the continent." The government had projected Zimbabwe's economy would grow 7% this year, but uncertainty has kept investors at bay, and it has lowered its estimate to 5.4%.

Mr. Biti says the changes at the bank hew to a package of recommendations for the economy outlined by the International Monetary Fund. In an April report, the IMF called Zimbabwe's economic recovery "very fragile" and said "urgent measures" were needed to address the banking system's vulnerabilities.

Among the steps, Zimbabwe's government aims to cut 75% of the central bank's staff; restructure its \$1.5 billion in debt; and stop the bank's practice of pressuring other banks to lend for specific industries



Zimbabwe central-bank chief Gideon Gono, right, displays equipment for a new farming program to President Robert Mugabe, in Harare in 2008.

or projects.

What remains the same, for now, is the person at the top. Zimbabwe's power-sharing coalition government is divided over whether to dismiss the 51-year-old central-bank chief, Gideon Gono. Mr. Biti and fellow members of the Movement for Democratic Change, the party of Prime Minister Morgan Tsvangirai, want the central bank chief to make way for a less contentious candidate. Officials of President Mugabe's party, Zanu-PF, have refused.