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EUROPE NEWS 5

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Bundesbank seeks to ax Sarrazin

BY MARCUS WALKER

BERLIN—Germany's central bank is seeking to oust Thilo Sarrazin, its controversial board member whose comments about the dangers of Muslim immigration have drawn accusations of racism and sparked a national debate about Germany's poorly integrated ethnic minorities.

The Bundesbank said Thursday that its board will ask Germany's president to dismiss Mr. Sarrazin, after German Chancellor Angela Merkel and other politicians called on the bank to take ac-

tion against the outspoken director, warning that his stereotyping of immigrants could damage the reputation of the Bundesbank.

The furor over Mr. Sarrazin's broadsides against Muslim minorities in a new book and in media interviews has become an embarrassment for Bundesbank President Axel Weber, widely seen as the front-runner to become head of the European Central Bank next year. Current ECB President Jean-Claude Trichet told reporters Thursday he is "appalled by the remarks" of Mr. Sarrazin.

The attempt to oust a fellow Bundesbank director is unprecedented and potentially open to legal challenge by Mr. Sarrazin, but analysts say growing consternation in Germany and abroad leaves Mr. Weber with no choice.

German President Christian Wulff must now consider the request to fire the central banker, a power that only Germany's head of state has. Mr. Wulff hinted at his likely answer Wednesday, when he invited the Bundesbank to "take steps so that the discussion does not harm Germany, especially internationally."

The controversy has exposed a gap between the country's political class and many ordinary Germans who share Mr. Sarrazin's belief that Muslim immigrants are unwilling or unable to integrate into German society.

Mr. Sarrazin's dark warnings about a creeping Islamic takeover of Germany are the latest sign of rising unease about Muslim minorities in many Western countries. Politicians associating Islam with extremism and terrorism have led a popular backlash against the religion and its adherents. Dutch politician Geert

Wilders, who wants to ban the Quran, won over 15% of the vote in the Netherlands' June election.

Other recent manifestations include a referendum in Switzerland last year in which the Swiss voted to ban the construction of new minarets, France's proposed law to ban the burqa, and demonstrations in the U.S. against the construction of a mosque near the site of the Sept. 11, 2001, terrorist attacks.

In Germany, Mr. Sarrazin is one of few public figures to argue publicly that Muslim immigration threatens Ger-

many's identity and economy. German politicians, except on the far-right fringe, tend to spurn such arguments.

"There is a stronger fear of such sentiments in Germany than elsewhere because of the history of National Socialism and *völkisch* nationalism," says Gero Neugebauer, a political scientist at Berlin's Free University.

Some observers say German politicians' fear of seeming populist has stifled debate

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Getty Images

Israeli Prime Minister Benjamin Netanyahu, left, shakes hands with Palestinian Authority President Mahmoud Abbas as U.S. Secretary of State Hillary Clinton looks on.

Peace talks yield modest achievement

Prime Minister Benjamin Netanyahu and Palestinian President Mahmoud Abbas agreed to convene a second round of Middle East peace talks in two weeks.

Earlier Thursday, Secretary of State Hillary Clinton had launched the talks, the first direct Israeli-Palestinian peace negotiations in almost two years.

"To those who criticize the process...I ask you to join in this effort," Mrs. Clinton said from the U.S. State Department, where she was flanked by Messrs. Netanyahu and Abbas.

But gaps between the Israeli and Palestinian sides were also evident during the carefully staged ceremony.

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French comedian who specializes in short jokes is cut down to size. Page 29

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Oil platform catches fire in the Gulf

BY LESLIE EATON

A Mariner Energy oil and gas platform caught fire and exploded Thursday morning off the Louisiana coast. All 13 workers were rescued.

The platform continued to burn in the Gulf of Mexico for hours after the explosion, but by Thursday afternoon the company said the fire was contained and was close to being burned out, Gov. Bobby Jindal said at a news conference in Baton Rouge. The state hasn't yet gotten

any details about injuries to the workers, who were taken to Terrebonne General Medical Center in Houma for evaluation, Mr. Jindal said.

The cause of the fire has yet to be determined.

Mr. Jindal emphasized that all information on the accident is preliminary, noting that early reports on the Deepwater Horizon disaster suggested that the well wasn't leaking.

That incident, which began April 20, left 11 dead and unleashed the worst offshore oil

spill in U.S. history.

The Mariner platform is about 395 kilometers southwest of the site of the Deepwater Horizon disaster, operating in relatively shallow water.

Officials have received conflicting reports on whether or not an oily sheen is streaking the waters of the Gulf from the Mariner platform, said Mr. Jindal, a Republican who has been urging the federal government to allow drilling to resume in the Gulf. But Houston-based Mari-

ner has told the state that all seven wells attached to the platform have been successfully shut down, he said, making it likely that the fire is being fed by petroleum stored on the platform.

Mariner is the sole owner of the platform. Apache Corp. said in April it would acquire the company for \$2.7 billion. Apache's bid for Mariner would give it its first foothold in the deep-water Gulf of Mexico, which in recent years has become a major growth area for big oil companies.

The Obama administration is fighting in court to maintain until Nov. 30 a moratorium on new drilling in waters deeper than 500 feet.

But it is not only deep-water drilling that is stirring debate.

The Deepwater Horizon incident, which is costing U.K. oil giant BP PLC billions of dollars, cast doubt on whether smaller oil companies would be able to handle the expense of responding to accidents.

—Stephen Power contributed to this article.

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This may be the moment for Germany to look at how it appoints bank board

[Agenda]

By TERENCE ROTH



The decision by Germany's central bank to request that one of its governors be sacked after broadcasting racially-charged views sets the stage for a messy legal struggle on contract law, free speech and a subject many in Berlin heartily wish would disappear. How Germany winds down this taught scene from here will take careful message-management, and a team of really good lawyers.

Many see the decision, which must be endorsed by German President Christian Wulff, as too long in coming. Thilo Sarrazin's ideas on race first made news last year, but he provoked more of an outcry lately with a media blitz that accompanied his new book, which advances his theories on how the higher fertility rate of Muslim immigrants will erode Germany's economic potential and its collective intelligence in the long term. He also has offered his views on common genetic traits among Jews.

The request for Mr. Sarrazin's dismissal came after Jean-Claude Trichet at an ECB press conference, intended as a forum for discussing monetary-policy aims, issued an Olympic reprimand when asked about the Bundesbank board member's theories.

Mr. Trichet said he was "appalled" and, meaningfully but without specifics, said he was confident that the German central bank would do what's appropriate.

That made Germany's PR disaster complete. An already agitated Bundesbank had been looking into sacking Mr. Sarrazin from its five-member board. The hang-up had been finding a way



The European Central Bank headquarters in Frankfurt.

to do so without a thorny path through Germany's labor courts if Mr. Sarrazin contests the decision.

So far, he has given no sign of going quietly, insisting earlier that he's done nothing wrong and is sticking to his contract. Legal experts attest to Mr. Sarrazin having the law on his side if he fights an outright dismissal because he can't be faulted for his work at the bank.

At best, Mr. Sarrazin is practicing free speech, if only from the wrong pulpit. At worst, he is raising Germany's old ghosts and legitimizing some of the most uncomfortable ideas of Germany's extreme-right political groups.

Another danger is Mr. Sarrazin's becoming a cause célèbre for Germany's far right.

The problem is Mr. Sarrazin's status as a senior German official. The Bundesbank is the crown jewel among Germany's postwar institutions, guardian of the deutsche mark and the core around which the ECB was built. Having one of its board members spinning racial theories is galling

for his colleagues and cringe-worthy among Germany's political establishment.

The case is a new one for the German central bank, but might be taken as a prime opportunity to recast how the institution appoints its board. Unlike the Bank of England, for example, appointments to the Bundesbank's board aren't subject to parliamentary confirmation hearings. The executive board of the U.S. Federal Reserve also is given congressional scrutiny.

At the Bundesbank, Germany's federal government appoints the president and the vice presidents. The nation's 16 states then take turns appointing the board's other three members in rotation. The principle is to represent regional interests on the board, but the practice is prone to political payoffs for the party faithful. Mr. Sarrazin was appointed by the city-state of Berlin, but now even members of his own Social Democrats want him out of the party.

A number of European countries are embroiled in issues with Islam. Denmark has its turban cartoonists, France its burqa ban and the Netherlands a stridently anti-Islamic party that could become part of the next government. But this is, after all,

Germany—a country with a massive Muslim community, particularly of Turkish heritage.

Political pressure on the central bank to muzzle Mr. Sarrazin had been acute. President Wulff, is very likely to sign off on the dismissal after having given undisguised encouragement for Bundesbank President Axel Weber to find a way.

Mr. Weber might have seen his candidacy to replace Mr. Trichet as ECB head next year damaged unless the Affair Sarrazin was managed adroitly. That would have scotched Germany's first real chance to take the euro zone's monetary helm in the ECB's 11-year history. The decision to fire Mr. Sarrazin defuses the crisis, but the topic will continue to make headlines for the duration of a trial if the Bundesbank official contests his dismissal.

Mr. Sarrazin's departure opens other problems for Mr. Weber: the perception that the Bundesbank's statutory independence from politics has been tarnished by the sacking was precipitated by intense political pressure to have Mr. Sarrazin sacked or at least muzzled for comments on subjects that had nothing to do with his Bundesbank activities.

Another danger is Mr. Sarrazin's becoming a cause célèbre for Germany's far right. Fragmented and discredited though they are, extremist parties with Islamophobic and anti-immigration agendas have embraced Mr. Sarrazin as a recruiting magnet. One even offered him membership.

Opinion polls show the vast majority of Germans agreeing with at least some of Mr. Sarrazin's views. And it's the threat that these sentiments could spread to Germany's mainstream parties, particularly Chancellor Angela Merkel's center-right Christian Democrats, is sending shudders through parliamentary offices in Berlin.

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No

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NEWS

What women want on TV: Lots of action

By AMY CHOZICK

In the first few minutes of the new television show "Nikita," a bank robber shoots a witness. A suspect takes down a couple of police officers, and a trained killer in a skimpy red bikini breaks a mobster's neck with her bare hands.

What viewers won't see are shopping sprees, moneyed teenagers or flirty scenes with cute guys.

The show reflects new thinking among television network executives: Their core audience—female viewers—want to see a woman take down the enemy, preferably with a little bloodshed along the way. The approach overturns years of belief that violent shows turn off women who prefer to watch earnest nurses, headstrong housewives or quirky career women.

Viewers who grew up with videogames and Angelina Jolie action movies are driving the types of shows networks will debut this month and redefining how the classic TV heroine is portrayed. On Sept. 9 the CW network in the U.S. will debut "Nikita," about a rogue assassin, played by Maggie Q. In the coming weeks NBC will premiere "Chase" about U.S. Marshal Annie Frost and "Undercovers" about a husband-and-wife spy team. In July USA introduced "Covert Affairs" about a 28-year-old CIA trainee who speaks six languages.

Ever since TV became a way to sell detergent to housewives, networks have tried to stay in tune with changing preferences among women, who watch more TV than men. Female characters evolved from June Cleaver to Murphy Brown and Ally McBeal.

The networks need to refresh their lineup of dramas for women as several big shows are aging. In the season that ended in May, 12.5 million viewers watched "Desperate Housewives" each week down from 23.4 million in 2004. "Grey's Anatomy" and "Gossip Girl" have also declined in popularity, says the TV ratings company Nielsen.

That's prompted networks to dig deeper into the female psyche. Last spring, the CW network commissioned a U.S.-wide study into what women in their 20s and 30s want. More than 60% of the network's viewers are women, mostly between the ages 18 to 34.

Market researchers asked groups of women gathered at coffee shops or a friend's house as well as in traditional focus groups in New York, Los Angeles, Chicago, Atlanta and Denver to make collages of magazine images they liked. They chose Jennifer Aniston paddle boarding over actresses lying on the beach. They preferred absinthe and beer to wine or fruity cocktails and gravitated to athletes in fitness magazines over models in evening gowns.

They also thought men had gotten wimpier and associated the opposite sex with the bumbling losers played by Jonah Hill and Seth Rogen in recent romantic comedies. "It was obvious that these women feel like

they have to take charge and be the hero," says Jane Buckingham, president of **Trendera**, the market research and trend forecasting firm that conducted the study.

Action shows are hard to pull off, and brutal scenes that could be perceived as gratuitous will turn off female viewers, TV executives say.

"In TV you need to shade it so you see the human aspect," says Matt Corman, an executive producer of "Covert Affairs." In that show, CIA trainee Annie Walker escapes certain death when a nearby informant is killed, and then goes to a dinner party at her sister's house. Such moments make viewers okay with action in their living rooms each week, he says. "You never saw James Bond file a tax return."

Network executives regularly commission market research to find out what types of characters viewers like or dislike. They'll often come up with one character type one season—and something completely different the next.

TV has experimented with action heroines in the past with shows like "Buffy the Vampire Slayer" and "Alias," but those shows largely avoided anything too gritty. "Nikita" executive producer Craig Silverstein says he was hesitant when TV studio Warner Bros. asked him to reimagine "Nikita," inspired by the French film "La Femme Nikita" which also spawned U.S. movie "Point of No Return" and a 1997 series on the USA network.

"It's not going to be 'Gossip Girl' with a gun. She's going to kill people. Are they okay with that?" Mr. Silverstein says he asked studio executives.

To test the waters, market researcher Ms. Buckingham showed the groups of young women different images of Nikita. Sexy poses in skimpy bikinis were okay, as long as the bathing suit served a purpose—like in one scene when she sneaks into a pool party to kill a gangster. They preferred sexy outfits that were the result of a vicious fight such as a shredded T-shirt. A too-skimpy outfit, prompted the group to ask: "But where would she put her gun?"

The findings surprised network executives. "We weren't sure what level of violence our viewers would find acceptable," says Dawn Ostroff, president of entertainment at the CW. The research showed that "it's an easy pill for them to swallow." Ms. Ostroff says the violence is no worse than other prime-time action series like "24."

NBC picked up "Chase" thinking an attractive and complicated U.S. Marshal would draw viewers at 10 p.m. But after seeing the first episode, the network worried that an opening scene in which a family is shot at close range might be too much. They asked Ms. Johnson to cut about 30% of the violence. "We trimmed back the body count," says Angela Bromstad, NBC's president of prime-time entertainment. "We don't want to go overboard and turn people off."

NIKITA—and the women who gave rise to her. The rogue assassin in the upcoming TV show 'Nikita' on the CW network is designed to be tough and also relatable to women.

1975 Wonder Woman

1979 Ellen Ripley (center)

1997 Buffy

2001 Sydney Bristow

2001 Lara Croft

1984 Sarah Connor

1995 Xena

1976 Sabrina, Jill, Kelly

Photo illustration by Sean McCabe; photos: The CW Network ('Nikita'); Getty Images ('Alias'); Everett Collection (7)

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EUROPE NEWS

Putin extends ban on exports of wheat

By TOM POLANSEK
AND IRA IOSEBASHVILI

Wheat prices rose after Russian Prime Minister Vladimir Putin said the country would extend its grain-export ban through at least November 2011, fueling fears about tightening supplies.

Mr. Putin's announcement caught traders off guard because Russia, which last year accounted for 14% of world wheat exports, said in August that it would suspend grain exports until the end of this year. A drought devastated Russia's most recent spring wheat crop, which is being harvested now and is delaying planting of next year's winter wheat crop, raising worries about production in 2011.

He said the decision to extend the ban would add "predictability" to Russia's domestic market and prevent "unnecessary nervousness" among grain producers and sellers. He said they were stockpiling grain in anticipation of the end of the ban on Dec. 31.

"Our producers and sellers should work calmly and orient themselves on the internal market," Mr. Putin said Thursday.

To be sure, Russia is known for being unpredictable and could lift the export ban earlier than expected, if planting for the next crop goes well or domestic prices fall.

"The market is skeptical about any announcement from Russia," said James Dunsterville, an analyst at Agrinews in Switzerland. "They may change their mind."

Soft red winter wheat prices approached a two-year high on the Chicago Board of Trade last month after Russia said it would suspend exports. Thursday, soft red winter wheat for September delivery settled 5.25 cents higher, or 0.8%, at \$6.8075 a bushel, up 60% from June lows despite backing off from recent highs.

Russia's grain-export ban has allowed the U.S., the world's top wheat exporter, and other nations



Vladimir Putin said wheat producers and sellers 'should work calmly and orient themselves on the internal market,' instead of stockpiling the grain.

with robust harvests to step in. Wednesday, Egypt, the world's top wheat importer, struck deals to buy 225,000 metric tons from U.S. sellers at prices about 5% higher than a month ago.

"From a commercial standpoint, we certainly are going to do more business," said Vince Peterson, vice president of overseas operations for U.S. Wheat Associates, a national trade group. "Our exports are going to be higher. We're going to have higher volume for the railroads and the barge lines and the elevators."

Countries around the world have been scrambling to secure wheat since the scope of the drought became apparent this summer. Drought in Australia and Argentina, both key producers, and excessive rains in Germany have exacerbated importers' fears about tightening global supplies.

The U.S. Department of Agriculture last month raised its U.S. wheat export estimate for the 2010-11 marketing year, which runs through the end of May 2011, by 20% from July and is expected to push the forecast

higher in coming months.

Corn sales also should benefit from Russia's extended ban because high wheat prices have pushed livestock producers world-wide to use more corn and less wheat for animal feed, analysts said. Stronger corn prices will help support wheat prices in the absence of any more surprises for the wheat market, they said.

Russia is expected to harvest 60 million to 65 million metric tons of grain this year, down from 97.1 million tons last year.

After several downgrades, the United Nations Food and Agriculture Organization projects global wheat production for the 2010-11 marketing year at 646 million metric tons, down 5% on the year.

However, it is unlikely shrinking supplies will push prices back to all-time highs above \$13 a bushel, reached in 2008, because reserves are more comfortable than they were two years ago, analysts said.

—Ira Iosebashvili
and Caroline Henshaw
contributed to this article.

EU finance ministers face tough agenda this autumn

[Brussels Beat]

By CHARLES FORELLE



One hopes that Europe's finance ministers, worn ragged by their marathon efforts this spring to bail out the euro zone, had a restful summer break. *La rentrée* won't be easy.

When the ministers assemble for their first meeting Tuesday in Brussels, an unpleasant reality will be on the agenda: Despite €110 billion (about \$140 billion) in promised loans to Greece and a €750 billion backstop for the whole euro zone, yields on the bonds of Europe's wobbliest countries have spent their vacation rising.

Investors now want nine percentage points more in interest for a 10-year Greek bond than they'll take on a German security. That's about the level in May, at the apex of the crisis. For Ireland, the spread is 3½ points, the highest in years.

Bond spreads fueled the crescendo of panic in the spring. There isn't an air of impending doom as fall arrives, but the rising spreads signal that very real problems remain.

Thanks to the lending commitments, "there is no fear of a sudden sovereign-debt crisis getting out of control," says Nicolas Véron of the Bruegel think tank in Brussels. But it's a stopgap. "Nothing has been solved."

There are two major worries.

First, no one has a firm handle on how many bad loans are out there, or how bad they are. Governments will likely have to pick up that tab. This is bedeviling Ireland, and, to a lesser extent, Spain.

Second, the short-term concerns about liquidity have given way, particularly with Greece, to long-term questions of solvency. Liquidity can be solved—it just takes a lot of money. Solvency has no easy fix.

Both elements figure on Brussels's agenda for the fall. Thursday, negotiators for the European Parliament and European Union countries agreed on details for new financial-supervision bodies, a piece of a broad package of legislation focused on containing risk.

Meanwhile, a task force headed by EU President Herman Van Rompuy is trying to force countries into good budgetary behavior. Its report is due this fall. Ireland has been a relatively good fiscal reformer. Faced with deficits, it quickly—and painfully—cut spending.

But the banking sector has been harder to contain. Last year, the government set up an asset-management agency which is buying €81 billion of loans from five banks at a fraction of their nominal value. The banks take a write-down, but they replace deadwood on their books with shiny government securities that can be handed to the European Central Bank for cash.



Irish Finance Minister Brian Lenihan

This process leaves the banks with depleted capital, a problem that is most severe for the sickest institution, the now-nationalized Anglo Irish Bank, which gorged on commercial property lending during Ireland's building boom. In 2009, Ireland injected the bank with €4 billion in cash. Anglo got an additional €8.3 billion in capital in March 2010, then €2 billion more two months later, and €8.6 billion more in June, for a total just short of €23 billion.

The bank now says it should need no more than €25 billion or so in all.

Investors aren't convinced it's over. Standard & Poor's said last month, as it cut Ireland's credit rating one notch, that Anglo could need as much as €35 billion. S&P is eyeing further downgrades.

Anglo Irish's finance chief, Maarten van Eden, says the €35 billion estimate is "really over the top." But, he says, the future is murky. If the commercial property market continues to slide, or if there's another economic shock, Anglo could find itself sitting on loans even less valuable than it thought. "The question becomes, how much more does the market deteriorate in the future?" Mr. van Eden says. "We really don't know what's going to happen in the property market."

A five-percentage-point increase in the haircut on Anglo's loans implies a depletion of €1 billion in capital, he calculates. And since Anglo is teetering on the edge of its regulatory requirement, if the loans sour, the government will have to pump more money in.

In Greece, the government says it's making real progress on cutting its deficit. Markets don't fear that it will run out of cash immediately, as they did in the spring. Instead, they worry how long Greece can hold out on its searing cuts—particularly a few years down the road, when Greece will be sacrificing just to make interest payments.

That adds another item to the finance ministers' to-do list.

The ministers should "think through what happens" if a country like Greece suddenly throws up its hands and defaults, says Daniel Gros of the Centre for European Policy Studies. Having a plan is essential to reassuring investors that the damage could be contained. Of course, that also means contemplating an outcome they've all said won't come to pass.

What they will do, says Mr. Gros, "Avoid looking at it at all costs."

Bundesbank aims to ax Sarrazin

Continued from first page
about the problem of many immigrants' detachment from mainstream German society.

Germany's large Turkish minority, for example, has below-average rates of educational attainment and above-average rates of unemployment and welfare dependency, according to government figures.

Many middle-class German families fear sending their children to inner-city schools with numerous Turkish or Arab children who speak little German and are viewed as disruptive, says Manfred Güllner, head of Berlin opinion-polling institute Forsa. "Sarrazin makes disputed claims, but he addresses a problem that ordinary people see in their everyday lives," Mr. Güllner says.

Mr. Sarrazin's new book, "Germany Abolishes Itself," blames Muslims' refusal to adapt to Germany's way of life for their lack of jobs and affluence. The book warns of a future in which the Muslim population grows faster than the ethnic Ger-



Thilo Sarrazin in Frankfurt Thursday

man population, and Muslims displace the German language with Turkish or Arabic.

In television appearances this week, Mr. Sarrazin has denied he is racist and argued that he is raising legitimate questions that German

politicians have ignored.

The Bundesbank director has caused particular controversy by claiming that intelligence is largely hereditary and that Muslim immigrants are on average less intelligent than native Germans, so that minorities' high fertility and Germans' low birthrates will make Germany less economically productive.

Mr. Sarrazin said on Sunday that Jews share a gene that sets them apart, a claim he later qualified.

Such views are taboo in Germany, where biological claims about ethnic groups awake painful memories of the Nazis' racial theories.

Mr. Sarrazin's political party, the left-leaning Social Democrats, has begun proceedings to expel him. "He crossed a red line with the claim that the intelligence and performance of different cultures are genetically inherited," SPD Chairman Sigmar Gabriel told mass-circulation tabloid Bild. Using Jews as an example was particularly unacceptable for a German, he said.

EUROPE NEWS

ECB's Trichet dismisses 'double dip'

BY BRIAN BLACKSTONE

FRANKFURT—European Central Bank President Jean-Claude Trichet firmly rejected risks of a double-dip recession in the euro zone, a vote of confidence that the currency bloc can withstand slowdowns in the U.S. and parts of Asia.

But officials are divided on how to proceed in winding down lending programs created during the global financial crisis, amid a widening gap between Europe's fast-growing north and sluggish south.

The ECB extended crisis-era programs, primarily cheap loans to banks in unlimited size, into next year. The decision was taken by "consensus," meaning some dissent among the members of the bank's governing council. The ECB doesn't release vote counts.

A double-dip recession "is not in the cards," Mr. Trichet told reporters after the monthly meeting, in which officials kept their key policy rate at a record low 1%. "I am even more inclined to say that after what we have observed."

Mr. Trichet was referring to 3.9% growth, at an annualized rate, of the euro-zone's gross domestic product in the second quarter, a figure confirmed by the European Union statistics agency Thursday. That was more than double the rate in the U.S., led by a 9% surge in Germany that offset weakness in Greece,

Spain and Portugal. Though the third quarter isn't expected to be as strong, Mr. Trichet said recent data have been "better than expected."

"It surprises me how confident he is in ruling out a double dip," says Nick Matthews, economist at Royal Bank of Scotland, given difficulties in Europe's periphery and signs of slowing in the U.S.

Mr. Trichet played down fears of a renewed downturn in the U.S., saying he isn't "too disappointed" at recent signs of softness because the ECB never expected growth there to stay "extraordinarily dynamic."

ECB staff economists raised their growth forecast for 2010 to 1.6% from 1% just three months ago. ECB staff raised their inflation forecasts slightly but kept them comfortably below the central bank's target of just under 2%, suggesting interest rates will remain steady well into 2011. Mr. Trichet said risks to the staff's growth forecast are to the downside, while inflation risks are skewed slightly higher.

"Looking ahead, the recovery should proceed at a moderate pace, with uncertainty still prevailing," Mr. Trichet said. The ECB raised its 2011 growth forecast marginally to 1.4%.

Recent signs of recovery mask deepening north-south divisions, a potential headache for Mr. Trichet and his colleagues who must set monetary policy for the entire re-



European Central Bank President Trichet speaking Thursday in Frankfurt.

gion. Northern Europe, particularly Germany, posted robust growth last quarter. But Europe's fringe remains vulnerable. Greece's GDP plunged at a 6% rate last quarter, while Portugal and Spain grew at roughly 1%.

Mr. Trichet played down the gap,

calling it "a normal feature of a very, very vast economy."

But the ECB nonetheless took steps to protect its vulnerable flank. Officials added three-month loans for October, November and December—a lengthy maturity by pre-crisis standards.

That ensures European banks' access to long-term ECB funding into next year.

The ECB earlier stopped issuing six-month and one-year loans as conditions started to stabilize.

Unlike the unanimous vote on interest rates, the decision on lending programs had some dissent, as evidenced by Mr. Trichet's use of "consensus" to describe the vote. "It's now clear that disagreements are emerging," said Erik Nielsen, economist at Goldman Sachs.

Mr. Trichet declined to comment on the nature of the disagreement within the ECB board.

Separately Thursday, Sweden's Riksbank raised its key lending rate a second consecutive time, by 0.25 percentage point to 0.75%. Many economists expect another increase, to 1%, by the end of the year.

Sweden's economy has seen a revival in recent months that is expected to continue. In a report Wednesday, Sweden's National Institute of Economic Research forecast GDP growth of 4.3% in 2010.

—Gustav Sandstrom
contributed to this article.

Demand spurs rise in euro-zone GDP

BY PAUL HANNON

LONDON—The strongest rise in consumer spending since the start of the financial crisis in 2007 helped drive the euro zone's strong growth in the second quarter, indicating the currency area's recovery is less vulnerable to expected slowdowns in other parts of the global economy than had been feared.

In its second estimate of gross domestic product during the three months from April to June, Eurostat confirmed Thursday the economy grew by 1% compared with the first quarter.

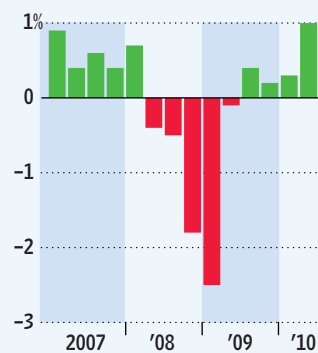
However, it raised its estimate for the pace of the expansion relative to the second quarter of 2009 to 1.9% from 1.7% previously. That reflected an upward revision in Eurostat's estimate of first-quarter growth to 0.3% from 0.2%. Economists hadn't expected the quarter-to-quarter and year-to-year estimates to be revised.

The euro zone's expansion in the second quarter was the fastest in four years, and the currency area outpaced the U.S. and Japan, where growth was recorded at 0.4% and 0.1%, respectively.

The composition of growth indicates the expansion may be more sustainable, and less vulnerable to weaker demand in other parts of the global economy, than many economists had thought. Exports accounted for a relatively small share of the 1% expansion, just 0.1 percentage point.

Instead, growth was largely driven by domestic demand. Consumer spending rose 0.5% from the first quarter, the largest gain since

Strong rebounds
Euro-zone GDP growth, change from previous quarter



Note: Seasonally adjusted
Source: Eurostat

the 0.7% increase recorded in the third quarter of 2007, when the financial crisis began.

Investment surged 1.8%, more than reversing a 0.4% contraction in the first quarter, and indicating that business confidence is recovering after a prolonged slump.

Although the strength of domestic demand didn't persuade the European Central Bank's governing council to raise its key interest rate Thursday, it may bring forward the time it considers doing so.

In the wider European Union, GDP rose 1% from the first quarter, and 1.9% from the second quarter of 2009.

Producer prices rose 0.2% in July from a month earlier and were 4% higher compared with a year earlier.

—Illona Billington
contributed to this article.

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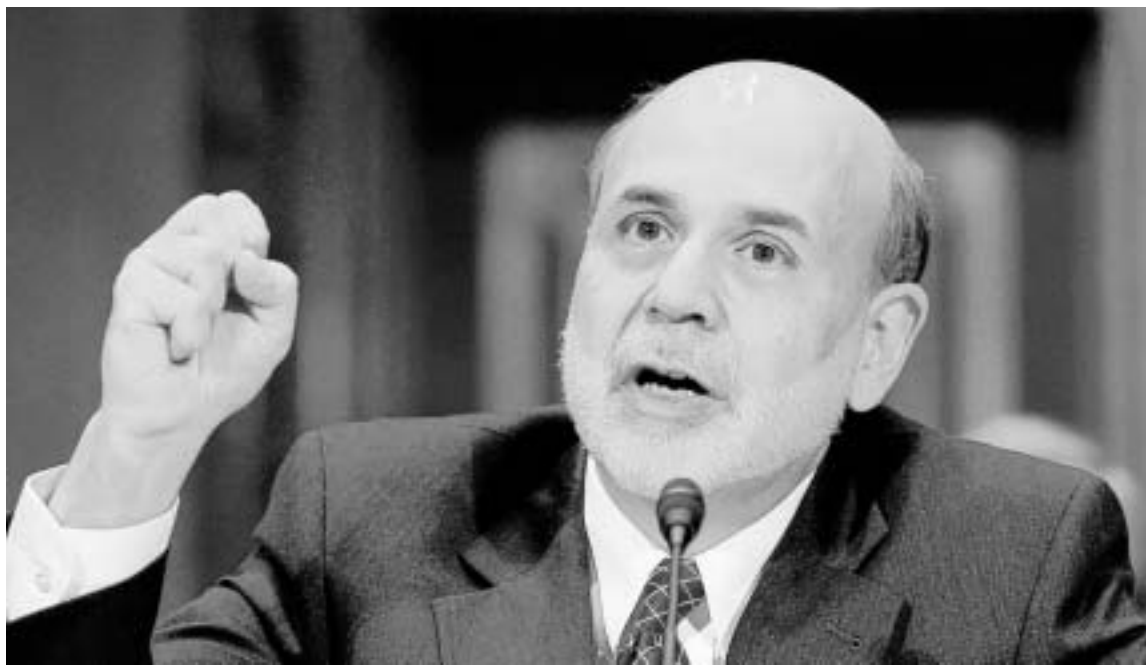
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U.S. NEWS



Reuters

Fed Chairman Ben Bernanke testifies Thursday at a Financial Crisis Inquiry Commission hearing in Washington, D.C.

Bernanke says Lehman was beyond Fed's rescue

BY SUDEEP REDDY

Federal Reserve Chairman Ben Bernanke told a panel examining the U.S. financial crisis that he had no options to prevent Lehman Brothers' failure in September 2008 even though he knew its downfall would be "catastrophic" to the financial system and economy.

The Lehman failure set off severe market turmoil, spurring continuing debate about whether the government should have done more at the time to halt the investment bank's collapse. Speaking to the Financial Crisis Inquiry Commission on Thursday, Mr. Bernanke said legal and practical considerations prevented him from taking action, even though "I never at any time wavered in my view that we should do absolutely everything possible to prevent the failure of Lehman."

The Democratic chairman of the 10-member panel, Phil Angelides, pressed Mr. Bernanke on the move, again calling it a "conscious policy decision," as he did during the commission's hearing on Wednesday, citing comments from other government officials.

The Fed chairman agreed that

that his own statements in the days after the firm's downfall—when he told lawmakers that the Fed and Treasury declined to commit public funds after they "judged" that investors and trading partners had time to take precautionary measures—had supported the public perception that the government had options.

But the Fed had determined that Lehman was already losing customers, so pumping in cash would have been a futile effort that contributed to a run on the company and ultimately saddled taxpayers with tens of billions of dollars in losses, Mr. Bernanke said.

Publicly discussing his view that Lehman had likely been insolvent, at a time when other financial institutions faced threats of runs or panics, "might have even reduced confidence further and led to further pressure" in markets, Mr. Bernanke said.

"This is my own fault, in a sense," Mr. Bernanke said. "I regret not being more straightforward there because clearly it has supported the mistaken impression that in fact we could have done something. We could not have done any-

thing."

While the debate about Lehman drew pushback from Mr. Bernanke, the Fed chairman said that the Fed had made other mistakes, particularly in not using its existing authority earlier to regulate mortgage and lending practices.

"Was this a very significant failure...looking back in retrospect?" Mr. Angelides asked.

"It was indeed," Mr. Bernanke replied. "I think it was the most severe failure of the Fed in this particular episode."

Thursday marked the final day for the commission's Washington hearings, before it heads out to take testimony in other cities. The panel plans to release a report Dec. 15. Despite the heated criticism directed at the Fed since the crisis, Mr. Bernanke's appearance remained low-key as he walked through causes of the financial downturn and the government's response.

Mr. Bernanke said all regulators could have done more to identify broad risks to the financial system and stressed that recent changes in the law were designed to prevent too-big-to-fail firms from causing the trouble they did then.

New jobless claims edge down

BY SARA MURRAY

Fewer workers filed new claims for unemployment benefits last week, the second week in a row such claims declined and a rare bright spot in an otherwise grim job market.

Initial jobless claims fell 6,000 to 472,000 in the week ended Saturday, the Labor Department said Thursday. Several other reports released Thursday were also positive, including one that showed the number of buyers who signed contracts to buy previously occupied homes increased, and another that reported factory orders ticked up.

The U.S. economy still faces stiff headwinds, including a deeply depressed housing market and concerns that economic growth will slow in months ahead. Michelle Girard, an analyst at RBS Securities

Inc., said the latest reports showed "sluggish but sustained growth."

While the drop in jobless claims was a positive sign, the rate of claims remained elevated. The four-week moving average, which aims to smooth volatility in the data, fell 2,500 to 485,500. Continuing claims, which are drawn by workers for more than a week, fell 23,000 to 4.5 million for the week ended Aug. 21.

Employers have largely held off from hiring, opting to find ways to produce more from current workers. But it appeared businesses were close to exhausting that strategy.

Productivity declined 1.8% in the nonfarm business sector in the second quarter, the Labor Department said Thursday. The department had previously estimated productivity fell 0.9%. The second quarter marked the first productivity drop after five quarters of increases.

Productivity, a measure of output per hour, declined as output increased 1.6%, less than the 2.6% previously estimated, as a result of slower economic growth in the second quarter. Hours worked were roughly unchanged, rising 3.5%. Unit labor costs rose 1.1%, more than the previously reported 0.2% increase.

New orders for factory goods also resumed growing in July, rising 0.1% to \$409.5 billion following two months of declines, the Commerce Department said. Orders for durable goods, designed to last at least three years, increased 0.4%. Nondurable-goods orders fell slightly.

The pending home sales index rose 5.2% in July to 79.4, according to a report Thursday from the National Association of Realtors. That was an improvement, but economists noted housing sales remained deeply depressed.

*It's not just the lost jobs.
It's the lost jobs machine.*

[Capital Journal]

BY GERALD F. SEIB



Two basic facts will tell you most of what you need to know about the political picture today.

Fact One: The unemployment rate is the most important of all leading political indicators.

Fact Two: If the August unemployment number to be announced Friday tops 9%—which seems highly likely—the jobless rate will have been above that level for 16 straight months. Already, the U.S. is mired in the longest such stretch of 9%-plus joblessness in more than a quarter of a century.

There is little mystery, then, about why Democrats are in trouble. The party in power is inevitably blamed for so much bad news on the one economic subject that most concerns average Americans.

Yet the political debate on this point, which focuses on what can be done to get Americans back to work right now, is missing a deeper and more troubling reality: The American economy hasn't been a very robust jobs-producer for quite a while. That's the broader question that needs to be discussed, even as we work on the immediate problem.

Indeed, it has been perhaps four decades since America's economy has been the kind of roaring jobs machine that average Americans, aspiring politicians and ambitious business leaders all would like to see. Consider a few historical unemployment-rate numbers—one way to gauge the economy's performance on the jobs front.

Between 1966 and 1970, the U.S. experienced a phenomenal stretch of 48 straight months in which the unemployment rate was at or below 4%—that is to say, a stretch of four straight years when the rate was less than half of what it has been for the last year.

In the three decades since 1970, the rate has fallen below 4% for exactly four months, in the final months of 2000.

Instead, the norm has become unemployment rates in the 5%-to-7% range. When the recession of 1981 hit, the unemployment rate stood at 7.2%. It began to rise, and it took three full years before it was brought back down to that level once again—a depressing thought about how stubbornly high the rate may be as a result of the recession the U.S. is now exiting. During that stretch, the rate stayed at or above 9% for 19 straight months at one point.

The last two years of the 1990s were a period of consistently low unemployment, ranging between 4% and 5%. After that, job growth was only sluggish to moderate for most of this decade, even before the recession hit at the end of 2007.

It would be nice to pull out of the current jobs rut, of course. But it would be nicer still to



Waiting for information on unemployment insurance and jobs.

figure out what combination of public policies and private initiatives would help the national jobs machine rev up to a higher, sustained level.

"It's an economy that hasn't been growing fast enough for a long time," says Douglas Holtz-Eakin, a Republican economist who advised Sen. John McCain's presidential campaign.

The debate over short-term fixes is familiar by now: Is stimulus spending helpful or not? Are tax cuts better than sending aid to the states? Is it better to spend federal dollars to juice the economy or to attack the deficit?

But solutions to long-term job lethargy are equally important.

There are plenty of ideas. Liberal economist Dean Baker, co-director of the Center for Economic and Policy Research, for example, says the key is attacking America's long-term trade imbalance. That requires expanding manufacturing, which, in turn, argues for pushing the value of the dollar down to make American exports cheaper. That isn't politically easy, because driving down the dollar also would drive up the cost of all those imports Americans love. Mr. Baker argues it's a long-term job creator.

The more conservative Mr. Holtz-Eakin suggests a three-pronged attack. First, he would stop using the tax system to achieve social goals and change it to focus, almost obsessively, on fostering economic growth. Second, he'd liberate corporations to devote more capital to jobs by curbing the use of them as "vessels for social benefits" such as health benefits, which would be provided in other ways. And third, he'd radically improve the American education system, which is "failing to a remarkable degree in delivering to the labor force people with the skills needed to compete."

Centrist Democrat Robert Shapiro, chairman of the economic advisory firm Sonecon, says the job-creation problem arises because a globalized economy has brought an explosion of competition for American firms, limiting their ability to raise prices precisely when their fixed costs have started soaring in the areas of health, energy and pensions.

"This is a deep structural problem," Mr. Shapiro says. Its solution, he says, lies in public policies to help the private sector address those three big cost drivers.

U.S. NEWS

Swaths of East Coast brace for Earl

BY JENNIFER LEVITZ
AND VALERIE BAUERLEIN

NAGS HEAD, N.C.—Tropical-storm-force winds were expected to reach the North Carolina coast by Thursday afternoon, with hurricane-force winds expected to arrive near North Carolina's Outer Banks Thursday night, before steadily turning north to New England, the National Hurricane Center said late Thursday morning.

In the latest significant forecast change, the center issued a hurricane warning for the coast of Massachusetts, from Westport, Mass., stretching around Cape Cod, including Martha's Vineyard and Nantucket Island. The hurricane's center should pass near Southeastern New England on Friday night, with the eye of the storm closest to Nantucket, forecasters said.

Hurricane warnings mean hurricane conditions—sustained winds of 74 miles per hour or higher—are expected. The warnings are issued 36 hours in advance of anticipated tropical-storm-force winds, which are between 39 mph and 73 mph.

Forecasters were still predicting that Hurricane Earl would remain offshore, but said the storm could generate winds that span more than 200 miles, and was likely to cause dangerous gusts, heavy rain, high surf, storm surges, downed trees, power outages and coastal flooding mainly in North Carolina, southeastern Massachusetts, parts of Rhode Island and Connecticut—and also



Lifeguards in Kitty Hawk, N.C., remove a stand from the beach Thursday as Hurricane Earl churns north along the coast.

along the mid-Atlantic.

On Nantucket, an island tourist spot and summer colony off Cape Cod, town officials closed public beaches, opened an emergency-operations center and prepared to open a shelter at the local high school. Larger yachts were leaving

the island. Ferries stepped up services to move visitors and their cars off the island, and were running full, said Gregg Tivnan, assistant town manager of Nantucket.

Ferries have given notice that they anticipate canceling Friday services, and the island's airport is ex-

pected to close tonight, meaning that everyone left on Nantucket on Friday will likely have to "shelter in place," he said. There is no evacuation order, and the town is encouraging people who stay to secure their homes, and stock up on food and supplies, from bottled water to

baby food. He said locals are well-prepared, having ridden out many "Nor'easter" storms.

"Nantucket residents are hearty folks who have been through this before," he said.

The National Hurricane Center also placed a hurricane watch—meaning hurricane conditions are possible—from the North Carolina-Virginia border north to Cape Henlopen, Del., and said tropical-storm-force winds could arrive in Virginia by 9 p.m. Thursday.

As Earl moves north, Long Island may see high surf, but the storm's strongest winds should stay well offshore from New York, said Bill Read, director of the National Hurricane Center, in a conference call with reporters.

Earl was packing winds of 140 mph, and was situated 300 miles south of Cape Hatteras, N.C.—on the northern tip of the Outer Banks—and 760 miles south-southwest of Nantucket as of 11 a.m. Thursday. The storm was moving "rather quickly" at a speed of about 18 mph, Mr. Read said.

Federal Emergency Management Agency Director Craig Fugate cautioned that conditions along the East Coast would "deteriorate very rapidly."

Thursday morning brought sunshine and calm skies to the Outer Banks, but by late morning a gusty wind blew along the sandy barrier islands that run from the Virginia border along the North Carolina coast.

Stem-cell plaintiffs cite ethics concerns

BY LAURA MECKLER
AND JANET ADAMY

WASHINGTON—The two scientists behind the lawsuit that has temporarily blocked federal funding for embryonic stem-cell research said Wednesday they were motivated by ethical objections to destroying human embryos for medical research.

The scientists, James Sherley of Boston and Theresa Deisher of Seattle, had never met until this week, when they flew to Washington to confer with House and Senate aides and lobby against research using embryonic stem cells. They were recruited separately by lawyers looking to challenge the federal policy.

"We have a responsibility and are taught to do ethical research," said Dr. Sherley in an interview. "This is impacting the quality of science in this country."

Embryonic stem-cell research is seen as promising by many scientists to treat a range of diseases, because the cells can develop into any type of tissue. But to get the cells, the embryo must be destroyed, which some see as akin to taking a human life. The embryos used are typically left over from fertility treatments.

A federal judge last week ruled the research violated federal law. The decision rocked the scientific community while bolstering social conservatives, who have long argued the experiments are immoral.

The Obama administration is appealing the judge's order, and said

it would require the government to stop funding all embryonic stem-cell research, including that allowed under more-restrictive rules set by the Bush administration.

The scientists bring similar points of view to the issue. Dr. Deisher is Catholic, while Dr. Sherley is Baptist, but both say their views on the matter are driven by ethics, not religion.

Both have been in the news before. Dr. Sherley, 52 years old, staged a 12-day hunger strike in 2007 after the Massachusetts Institute of Technology denied him tenure. Dr. Sherley, who is black, blamed racism for the rejection, a charge the school denied.

Dr. Deisher, 47, has spoken at anti-abortion events and gained attention when she accused a former employer of fraud, a charge that led to a Securities and Exchange Commission investigation. She said she was transformed from a "radical feminist" after she saw the impact abortion had on some of her friends.

Both said research using adult stem cells, the field each of them works in, has more potential to help patients. The public has "been sold this hype and this promise that embryonic stem cells are going to cure everyone and we're all going to get up and dance," Dr. Deisher said. She said researchers involved always wind up reneging on their promises.

"These guys are using a court process in what should be a scientific process," said Curt I. Civin, director of the University of Maryland's stem-cell biology center.

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WORLD NEWS

Japan's Okada takes aim at China

BY YUKA HAYASHI
AND REBECCA BLUMENSTEIN

TOKYO—Japanese Foreign Minister Katsuya Okada warned Thursday that China risks losing foreign investments unless it introduces more transparency and consistency into its business rules, including its legal framework to deal with labor issues.

Swinging back at Beijing in a dispute over the treatment of Japanese companies operating in China, Mr. Okada said a lack of comprehensive rules makes it difficult for foreign investors to solve labor disputes and other problems they face with increasing frequency in the nation.

"Foreign companies have faced problems in China that are unthinkable in a normal business environment," Mr. Okada said in an interview with *The Wall Street Journal*. "We will keep bringing up these issues and we hope China will take notice and make corrections."

China repeatedly has defended its policies toward foreign companies, pointing to continued growth in foreign investment as evidence that it doesn't discriminate.

In the interview, Mr. Okada also discussed Japan's plan for additional sanctions against Iran, and the impact of its political tumult on foreign relations.

Earlier this year, a wave of strikes disrupted local production at Japanese manufacturers, including **Honda Motor Co.** and **Toyota Motor Corp.** During his visit to Tokyo on Sunday, Chinese Premier Wen Jiabao suggested to Mr. Okada that labor disputes were caused by relatively low pay for workers at these factories and requested that companies address the situation.

Among other examples of problems Japanese companies have had to deal with, the foreign minister also pointed to abrupt cuts in exports of rare-earth metals used in manufacturing hybrid cars, and unfavorable local court rulings and weak implementation of favorable rulings for companies facing intellectual-property disputes.

Mr. Okada said that because China is such an attractive market, recent problems aren't enough to discourage companies from reducing investments or withdrawing. "But if these problems continue to occur, there will be negative effects on future investments," he warned.

The foreign minister's complaints about the business environment echo those of executives and offi-



Japanese Foreign Minister Katsuya Okada, left, met with Chinese Premier Wen Jiabao in Beijing on Sunday.

cial from the U.S. and Europe. Separately on Thursday, the European Union Chamber of Commerce in China urged the Chinese government to allow foreign businesses better access to its vast domestic market, and said regulatory barriers could threaten investment despite the economy's rapid growth.

"China is still one of the most heavily controlled economies in the world," Jacques de Boisseson, the chamber's president, said at a news conference in Beijing to mark the release of its annual position paper on business conditions in China, which pointed to several examples of stringent licensing requirements and arbitrarily enforced legislation that create headaches for foreign businesses. While the regulatory problems haven't led European companies to shift investment out of China, Mr. de Boisseson said, that could change if the environment doesn't improve.

He said he expected the government to take steps, noting that the Chinese premier and other officials have repeatedly welcomed foreign investment in China.

Related to Iran's suspected nuclear-weapons program, Mr. Okada said Japan plans to unveil new sanctions as soon as Friday that will be in lock step with the U.S. and the EU. The U.S. and EU have announced

additional steps aimed at discouraging companies from doing business with Iran, including suspending trade finance and banning the supply of equipment and technology for the oil and natural-gas industries.

Mr. Okada didn't provide details of Japan's new sanctions, but said they are comparable to those announced by the U.S. and Europe, which go beyond those recommended by the United Nations Security Council.

A European business group also urged the Chinese government to allow foreign businesses better access to its vast domestic market.

Japan is a huge importer of Iranian oil, and its cooperation is essential in international efforts to prevent nuclear-weapons development in Iran.

Turning to a deepening political turmoil within Japan, the foreign minister said frequent changes in leadership, including in the posts of prime minister and foreign minister,

is "damaging to our national interests" in conducting foreign affairs.

The ruling Democratic Party of Japan, of which Mr. Okada is a senior member, already has seen two prime ministers since taking power a year ago and faces the possibility of yet another change following an internal party vote on Sep. 14.

Party stalwart Ichiro Ozawa is challenging Prime Minister Naoto Kan's bid to stay as party chief, and thus to serve as national leader.

Mr. Okada, who supports Mr. Kan, could lose his job as foreign minister if Mr. Ozawa wins the election, currently seen as a toss-up.

A victory by Mr. Ozawa, who seeks a more "equal" relationship with the U.S., could result in further complications and delay solving a contentious debate over the relocation of a U.S. military base in Okinawa. Mr. Ozawa said this week he wanted to see Tokyo hold "fresh talks" with Washington and the local government of Okinawa to find a solution more acceptable to both parties.

Mr. Okada said that he believes a bilateral agreement signed in May is the best solution for the dispute, which has strained the normally friendly relationship between the two nations.

—Andrew Batson in Beijing contributed to this article.

U.S., China to discuss tensions during visit

BY JASON DEAN

BEIJING—U.S. National Economic Council Director Lawrence Summers and Deputy National Security Adviser Thomas Donilon will travel to Beijing this weekend for high-level talks as the U.S. and China work to iron out tensions on issues ranging from currency policy to military ties to Iran.

The trip was foreshadowed by U.S. President Barack Obama June 26 during a U.S. visit by Chinese President Hu Jintao following talks in the countries' continuing dialogue on strategic, economic and human-rights issues.

The U.S. officials, scheduled to arrive in Beijing Sunday and stay until Wednesday, are to exchange views with top Chinese officials on "U.S.-China relations and other important issues of mutual concern," Chinese Ministry of Foreign Affairs spokeswoman Jiang Yu said at a regular news briefing in Beijing Thursday. She didn't elaborate.

The visit by the White House delegation—also expected to include Jeff Bader, the U.S. National Security Council's senior director of Asian affairs—comes as strains between the U.S. and China intensify on a number of issues after a period of improving ties earlier this year.

Mr. Summers' meetings with his Chinese counterparts are likely to include discussion of China's currency policy amid mounting frustration in Washington that Beijing's announcement in June that it would make the exchange rate more flexible has yielded minimal change.

Separately on Thursday, Catherine Ashton, the European Union's top foreign-affairs official, said she had urged Chinese officials during a visit to Beijing to cooperate with international sanctions against Iran. "My message was meant to be very clear," Ms. Ashton told reporters in the Chinese capital. "That we would expect that we wouldn't see...backfill, but rather that they would see that these are important sanctions and respect them." Ms. Ashton said there was "no negative response" by Chinese officials to her remarks.

New malaria drug candidate holds promise

BY GAUTAM NAIK

An international team of scientists has identified a promising drug candidate that represents an entirely new class of medicines to treat malaria, one of the biggest killers in the developing world.

The new drug was shown to be effective when tested in a small number of mice, according to a study appearing in the journal *Science*. Human trials, backed by Swiss pharmaceutical giant **Novartis AG**, could begin later this year.

The discovery comes amid two key developments in the fight against the mosquito-borne illness. Several parts of Africa are showing a decline in malaria deaths, thanks to wider use of insecticides and bed nets to ward off mosquitoes that

carry the disease, as well as use of artemisinin, a potent drug.

At the same time, there are worrying signs that the malaria parasite in parts of Southeast Asia is becoming resistant to artemisinin, which is the mainstay of combination therapy for as many as 100 million patients world-wide. Resistance has already rendered some older therapies less effective.

"We welcome a new class of drug because it could help us stay one step ahead of the parasite," said Robert Newman, director of the global malaria program at the World Health Organization, who wasn't involved in the *Science* study. However, he cautioned, "it's a long route to making the drug marketable... many drugs fall by the wayside."

The malaria parasite can cause fever, joint pain and death. Last year, there were an estimated 240 million cases of malaria. Of total deaths, 91% occurred in Africa and 85% were children under the age of five, according to the WHO.

But the battle against malaria is making progress, and a potent new drug could help sustain the momentum.

In 2009, malaria deaths worldwide fell to 836,000 from more than one million a few years earlier, including declines in Eritrea, Rwanda, Zambia and Zanzibar.

Most anti-malaria compounds being tested today are derivatives of existing drugs. Finding a drug that can kill malaria in a new way is hard.

When malarial parasites infect

people, they spend part of their life cycle in the blood and part of it in the liver. In 2007, Elizabeth Winzeler of the Scripps Research Institute in La Jolla, Calif., who also works for Novartis, used robots to screen 12,000 naturally occurring chemicals against plasmodium falciparum, the deadliest malaria parasite. Dr. Winzeler and colleagues at Novartis and elsewhere came up with NITD609, a compound that killed two species of parasites in their blood stage and also proved effective against drug-resistant strains.

The drug, a class of compounds known as spiroindolones, was then tested in mice. A mouse with malaria usually dies within a week. But when NITD609 was orally given to five infected mice, they were cured

with no side effects.

What makes the discovery unusual is that it harks back to an older way of finding novel drugs. The modern, "molecular" approach is to first identify a protein vital to the survival of the malaria parasite, and then screen various drugs until one is found that targets the protein. In the past few years, this approach has been tried on millions of compounds against malaria, with modest success.

The more traditional way is to bombard the entire parasite with various chemical compounds, and see what happens. The hitch is that even if a particular compound is effective, no one knows exactly how it worked. That uncertainty can make it harder to develop the drug for people.

WORLD NEWS

Israelis, Palestinians set new talks

By JAY SOLOMON

WASHINGTON—Israeli Prime Minister Benjamin Netanyahu and Palestinian President Mahmoud Abbas agreed to convene a second round of Middle East peace talks in two weeks, President Barack Obama's special envoy for Middle East said Thursday.

Following morning meetings with Messrs. Netanyahu and Abbas, former Sen. George Mitchell told reporters the two had agreed to convene talks in the Middle East on Sept. 14 and 15, and meet every two weeks thereafter.

The next round of talks come days before the closely watched date of Sept. 26, when Israel's 10-month freeze on settlement-building in the West Bank is due to end. Mr. Abbas has already said he will back out of talks if the construction resumes.

Hours earlier, Secretary of State Hillary Clinton had launched the talks, the first direct Israeli-Palestinian peace negotiations in nearly two years, imploring Arab states to back the initiative.

"To those who criticize the process...I ask you to join us in this effort," Mrs. Clinton said from the eighth floor of the U.S. State Department, where she was flanked by Messrs. Netanyahu and Abbas. "Now is the opportunity to start contributing to progress."

During that meeting, Mr. Netanyahu, as he did Wednesday at the White House, turned toward Mr. Ab-

Summit starts | The players in the Mideast peace talks and their agendas



U.S.
President Barack Obama

Holds Arab-Israeli peace as central to his efforts to stabilize the broader Mideast.



ISRAEL
Prime Minister Benjamin Netanyahu

Supports a two-state solution but risks splintering his government if he makes concessions on land and Jerusalem.



PALESTINIAN AUTHORITY
President Mahmoud Abbas

Has overseen economic growth in the West Bank, but is limited to cut a deal by the splintering of the Palestinian leadership, with the Hamas faction opposed to talks.



EGYPT
President Hosni Mubarak

Seeks peace to stabilize Egypt's border with the Gaza Strip and to reassert Cairo's diplomatic influence in the Mideast.



JORDAN
King Abdullah

Views peace as central to placating Jordan's large Palestinian population.

Photos, left to right: Abaca, European Pressphoto Agency, Reuters, European Pressphoto Agency, Bloomberg News

bas and called the Palestinian leader Israel's "partner for peace."

Mr. Abbas, meanwhile, stressed that his government's strengthening security forces and administrative offices were prepared to safeguard Israel as part of a negotiated two-state solution.

The gaps between the Israeli and Palestinian sides were also evident during the carefully staged 30-minute opening ceremony for the long-

awaited direct talks.

Mr. Netanyahu hit hard on the needs for all parties to safeguard the Jewish state's security interests amid a growing arms buildup in the region.

He cited Iran's growing influence across the Middle East and its funding and arming of the militant groups Hamas in the Palestinian territories and Hezbollah in Lebanon. He said Hamas's Tuesday attack in

the West Bank town of Hebron, which killed four Israeli settlers, served as an example of why Israel places a priority on security.

"Finding security is a must. Security is a foundation for peace," Mr. Netanyahu said.

Mr. Abbas, meanwhile, stressed that Israel must end all settlement construction in disputed territories in order for the peace process to move forward.

"We call on the Israeli government to end all settlement activity and lift the siege on the Gaza strip," Mr. Abbas said.

U.S. diplomats had been modest in their expectations for Thursday morning's first round of talks—hoping that the Israelis and Palestinians would agree to a time and place to hold a more regular dialogue for the peace process. They also expected to agree on a general outline for the talks.

More U.S. funds sought for Yemen's forces

WASHINGTON—The U.S. military's Central Command has proposed pumping as much as \$1.2 billion over five years into building up Yemen's security forces, a major investment in a shaky government, in a sign of Washington's fears of al Qaeda's growing foothold on the Arabian Peninsula.

By Adam Entous,
Siobhan Gorman
and Julian E. Barnes

The timing and the final funding amount will depend on how supporters of the effort overcome resistance from some officials at the State Department and the Pentagon, who have doubts about Yemeni President Ali Abdullah Saleh and the ability of his government, seen by many as corrupt, to effectively use a flood of American-taxpayer money.

The threat to the U.S. from al Qaeda's affiliate in Yemen has become a priority concern for the Obama administration, fueling a robust internal debate over how to calibrate assistance to address what many officials see as the biggest counterterrorism challenge outside Afghanistan and Pakistan.

Central Command, which oversees military operations across the Mideast and South Asia, argues a large infusion of cash is necessary to stanch al Qaeda gains and enable Yemen's security forces to conduct more effective counterterrorism operations, U.S. military officials and diplomats say. The money would be used primarily for training and equipment.

But senior U.S. diplomats and experts warn of a widening imbalance between fast-growing U.S. military support and the slow pace of civilian

development assistance, which is aimed at peeling away popular support for Islamists. "It tends to encourage a negative perspective in Yemen that all we care about is U.S. security," said a senior U.S. official.

More safeguards are needed, officials say, to ensure U.S. equipment and resources aren't diverted by the Yemeni government to its fight against domestic rivals. In addition to battling the homegrown group al Qaeda in the Arabian Peninsula, the government in San'a faces rebels to the north and secessionist groups in the south of the country.

U.S. Special Operations teams in Yemen, birthplace of Osama bin Laden's father, already play an expansive role in the country. Some spearhead an effort to track and kill al Qaeda leaders as part of a campaign authorized by President Barack Obama. Other teams run small development projects, a role typically handled by State Department aid officials.

The U.S. military accelerated strikes against Yemen-based al Qaeda in the Arabian Peninsula following December's failed attempt by the group to blow up a Detroit-bound American airliner.

Over the past nine months, the U.S. military has carried out a handful of missile strikes on alleged al Qaeda operatives in Yemen, according to U.S. officials briefed on the operations. All of the strikes were approved by Washington's then-ambassador to San'a, Stephen Seche, the officials said. Mr. Seche recently returned to Washington.

The White House is now weighing a proposal to add armed, aerial drones operated by the Central Intelligence Agency to the arsenal against al Qaeda in Yemen, mirror-



Yemeni security forces in San'a, the country's capital, stand guard outside the trial of two al Qaeda members in July.

ing the CIA's drone campaign in Pakistan. Tensions between Central Command and the State Department have simmered for months over the size of the U.S. military's security assistance to Mr. Saleh's government, according to U.S. officials.

U.S. officials said Central Command originally floated the idea of a bigger, \$1.6 billion package for Yemen, but scaled it back after objections from the State Department and some in the Pentagon.

Mr. Seche and others have argued that Yemen doesn't have the capacity to absorb such large sums, according to officials involved in the deliberations. They also voiced concerns that the Pentagon's plans risked overly militarizing Yemen, and potentially fueling a wider insurgency in the country.

"We can't just throw dollars at Yemen and think it will solve itself," said a U.S. official who has taken part in the Yemen debate. "This is

the mistake we've made in efforts to combat the Taliban in Pakistan."

The State Department has been particularly concerned that the large influx of funds to Yemen could be diverted to the government's war against a Shiite group known as the Houthis. The U.S. doesn't believe claims by Yemen and Saudi Arabia that the Houthis are being funded and trained by Iran.

Aid to Yemen under the U.S. government's main counterterrorism program has grown from less than \$5 million in fiscal 2006 to more than \$155 million in fiscal 2010, the Pentagon said. But that effort has been piecemeal, prompting calls within the military for a more concerted, sustained campaign.

Jeremy Sharp, a specialist in Middle Eastern affairs at the Congressional Research Service, said the proposed increase was significant in terms of the large dollar amounts involved, but more importantly be-

cause "it would send a message that cooperation is expected over a longer time period."

A Pentagon spokesman said the proposal by Central Command is being evaluated as part of the fiscal 2012 budget process in consultation with the State Department. "Any discussion on the outcome of this process would be premature at this time," the spokesman said.

A senior U.S. military official said the Pentagon was taking a close look at how much aid Yemen can accept. "There are times when we don't spend money, when the partner doesn't have the carrying capacity," the senior military official said.

One of the most vocal supporters of aid to Yemen, Gen. David Petraeus, left his position as head of Central Command in July to lead coalition forces in Afghanistan. It is unclear if his successor, Gen. James Mattis, will fight for all of the funds or push for a scaled-back version.

Some at the Pentagon think a one-year to two-year package makes more sense because it could give the U.S. more leverage to encourage Mr. Saleh to remain cooperative.

The State Department recently committed \$120 million in development assistance to Yemen over the next three years. That pales in comparison to the aid provided to other countries where counterterrorism is a high priority, such as Pakistan, which has been promised \$7.5 billion over five years.

"It's a cycle: Which comes first, security or development? Security has really hampered these efforts," said a Yemeni official, who described civilian development efforts so far as "minimal" compared to military and security expenditures. "That is a problem."

WORLD NEWS

Deaths disputed in Afghan airstrike

BY MARIA ABI-HABIB
AND HABIB TOTAKHIL

KABUL—Afghan officials said a coalition airstrike hit the election convoy of an Afghan parliamentary candidate on Thursday, wounding him and killing as many as 10 campaign aides, but the NATO coalition said only insurgents were killed.

President Hamid Karzai condemned the airstrike, which occurred in the Kiwan area of the northeastern Takhar province bordering Tajikistan.

U.S. Secretary of Defense Robert Gates, who met with Mr. Karzai and coalition commander Gen. David Petraeus in Kabul on Thursday, said the strike killed a senior militant official. "This is the first I had heard that civilians have been killed, and we certainly will look in to that," he said.

The U.S.-led North Atlantic Treaty Organization coalition said earlier that no civilians were killed in the airstrike. The coalition didn't

disclose which country's aircraft carried out the raid. The vast majority of such missions are flown by U.S. forces.

Mr. Gates said the airstrike targeted and killed a "very senior official" from the Islamic Movement of Uzbekistan, or IMU, a militant group formed in Uzbekistan that found refuge in Taliban-controlled Afghanistan in the 1990s and in al Qaeda hideouts in Pakistani tribal areas following the Taliban regime's downfall in 2001.

The IMU, which the U.S. has designated as a terrorist organization, returned to northern Afghan provinces in the past year, bolstering the insurgency's strength in what were relatively peaceful areas along the Tajikistan and Uzbekistan borders.

"This was an individual who was responsible for organizing, orchestrating a number of attacks here in Kabul and in northern Afghanistan," Mr. Gates said.

The IMU official, NATO said in a statement, was colluding with the Taliban and was "assessed to be the

deputy shadow governor for Takhar province."

In a news conference with Mr. Gates, Mr. Karzai struck a less strident tone than in earlier comments, but asserted that reports he had received said a candidate for parliament and two others were injured and 10 civilians were killed.

"We are investigating it and as it turns out will share the information with our allies, the United States and NATO," Mr. Karzai said.

The Afghan president has been increasingly vocal about civilian casualties inflicted by U.S.-led troops.

Takhar, like many other northern provinces, has a large ethnic Uzbek population. Afghan provincial officials said the parliamentary candidate they said was injured in the bombing, Abdulwahid Khorasani, was Uzbek.

The Takhar governor's spokesman, Faiz Mohammad Tawhidi, said the armed men in the sedan were likely bodyguards for the parliamentary candidate, and no insurgents

were found among the casualties. Two jets and two helicopters were involved in the strike, he said.

The coalition said the airstrike killed and injured up to 12 "insurgents" after NATO forces identified several armed men in a sedan that was part of a six-car convoy. Only the sedan was hit, it said.

"We're aware of the allegations that this strike caused civilian casualties and we'll do our best to get to the bottom of the accusations," U.S. Marine Corps Maj. Gen. David Garza, the coalition's deputy chief of staff for joint operations, said in the statement. "What I can say is these vehicles were nowhere near a populated area."

NATO wasn't yet able to deploy a team to investigate the scene of the airstrike. Takhar authorities have already examined the site.

Incidents of civilian deaths in coalition airstrikes have been a concern for U.S. strategists, who say the fatalities undermine the U.S. counterinsurgency effort, which is aimed

at protecting the population and shoring up support for the Afghan government.

Gen. Stanley McChrystal, who preceded Gen. Petraeus as coalition commander, in July 2009 issued a tactical directive limiting airstrikes and artillery strikes as part of an effort to protect civilians.

Gen. Petraeus, after taking command in July, clarified that troops can request strikes against insurgents hiding in dilapidated and abandoned buildings. But he has largely kept in place limits on the use of airstrikes.

In a separate incident Thursday, two U.S. soldiers died in insurgent attacks in the south and east of the country, according to a NATO spokesman.

August was the second-most deadly month for international coalition forces in the nine-year war, with 80 deaths, including 56 Americans.

—Julian E. Barnes
contributed to this article



Agence France-Presse/Getty Images

Afghan depositors hastened to withdraw money from accounts in Kabul Bank, Afghanistan's largest, on Thursday.

Kabul Bank clients pull funds

BY MARIA ABI-HABIB

KABUL—Crowds of depositors gathered Thursday at the branches of Afghanistan's largest lender, trying to withdraw their cash amid concerns about Kabul Bank's soundness.

The panic erupted following news that the bank is deep in the red after issuing secret loans to its own management and to politically connected Afghans, and heavily investing in Dubai real estate.

While few Afghans own bank accounts, Kabul Bank—the country's largest by deposits—is critical to the nation's stability, in part because it is used to pay the salaries of Afghan National Army troops. Kabul Bank also holds the accounts for the majority of government ministries.

Kabul Bank's chairman, Sher Khan Farnood, who owns a 28% stake, and Chief Executive Khalilullah Fruzzi, who also owns 28%, resigned Monday under pressure from Afghanistan's central bank. President Hamid Karzai's brother Mahmood Karzai is another major investor, with 7% of

Kabul Bank.

Afghan government officials and the central bank have told Kabul Bank depositors that their money is safe. Despite these assurances, about five hundred Afghans crowded into the bank's main branch in the Afghan capital Thursday morning, with some trying to clear out their entire deposits.

Two Afghan soldiers waited to transfer their \$200 salaries from the bank to their families in Baghlan province, in the north. Amid the chaotic crowd, and no real line formation, the soldiers took a number and were still waiting to be called by one of the branch's 15 tellers two hours later. "There are so many people, they are all worried the bank will collapse," said another customer, Adisha Mahmoud, the owner of an Afghan construction company. Dressed in a light blue shirt and a pin-striped vest, Mr. Mahmoud had been waiting for an hour, trying to withdraw his entire \$40,000 deposit.

"It comes down to the weak government. They issue licenses to people to open banks to use as their

own personal accounts," said another customer, Mohammed. He had been waiting several hours since the morning to collect the \$3,000 in his bank account and had yet to reach the teller.

Kabul Bank—with about \$1 billion in deposits—is one of 10 private banks in Afghanistan, a country more accustomed to using "hawalas," an informal money-transfer system based on trust.

"The culture of banking in Afghanistan is new," said Sanjar Bek, a 21-year-old university student with bank accounts in both Kabul Bank and Azizi Bank, the country's second-largest lender. "Kabul was the first bank in the market and had the trust of the people. Afghans are worried the problems will spread to other banks."

But as of late Thursday morning, Azizi Bank was calm and there was no sign the panic was spreading to other Afghan financial institutions.

The Afghan finance ministry urged government employees to keep banking with Kabul Bank.

—Habib Totakhil
contributed to this article.

Petraeus says U.S. lacked Afghan tribal knowledge

BY JULIAN E. BARNES

KABUL—The U.S. military's effort in Afghanistan has been hampered by a poor understanding of individual tribes and local leaders, Gen. David Petraeus said Thursday.

Unlike in Iraq, the U.S. has long lacked a detailed knowledge of the motivations and allegiances of various Afghan tribes and tribal elders, said Gen. Petraeus, the top allied commander in Afghanistan.

"We have never had the granular understanding of local circumstances in Afghanistan that we achieved over time in Iraq," Gen. Petraeus said. "One of the key elements in our ability to be agile in our activities in Iraq during the surge was a pretty good understanding who the power brokers were in local areas, how the systems were supposed to work, how they really worked."

Earlier this year, under Gen. Petraeus's predecessor, Gen. Stanley McChrystal, the North Atlantic Treaty Organization tried to overhaul its intelligence collection, to focus more on learning about individual tribes and local Afghan leaders. Gen. Petraeus said only now is the military getting an "understanding of local circumstances, customs and

tribal relationships."

Although he has said many times that Afghanistan isn't Iraq, Gen. Petraeus on Thursday sketched out an Afghan strategy that literally took a page from his Iraq approach. Gen. Petraeus's diagram of his Afghan strategy was based on a slide he showed Congress during the Iraq surge and used the same name: "Anaconda," a title meant to evoke a snake encircling the insurgency.

After his talk with reporters, Gen. Petraeus met with U.S. Defense Secretary Robert Gates, who arrived in Kabul Thursday from Baghdad. The two men met later in the day with Afghan President Hamid Karzai.

Even as he ramps up the effort in Afghanistan, Gen. Petraeus is under pressure both from U.S. officials and NATO leaders to outline an aggressive timetable for handing over swaths of the country to Afghan forces.

Gen. Petraeus said he would present a "measured projection" of the planned transition next year at a NATO conference in Lisbon that is scheduled for November.

In most cases, the allied military command will hand over responsibility for districts, rather than larger provinces, Gen. Petraeus said.



Getty Images

Gen. David Petraeus greets U.S. Defense Secretary Robert Gates in Kabul.