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Stress tests missed debt at EU lenders

By DAVID ENRICH

LONDON—Europe's recent "stress tests" of the strength of major banks understated some lenders' holdings of potentially risky government debt, Wall Street Journal analysis shows.

As part of the stress tests, 91 of Europe's largest banks were required to publicly reveal how much government debt from European countries they were holding on their balance sheets. Regulators said the figures showed banks' total holdings of such debt as of March 31.

At the time, many analysts and investors greeted the data as a much-needed dose of clarity since the murkiness surrounding bank sovereign-debt holdings was fanning fears about the health of Europe's banking system.

But a closer examination of banks' disclosures indicates that some didn't provide as comprehensive a picture of

the institutions' holdings as European regulators claimed. Some banks excluded certain sovereign bonds from their tallies, and many reduced the sums to account for "short" positions they were holding—facts that neither regulators nor most banks disclosed when the test results were published in late July.

Because of the limited nature of most banks' disclosures, it is impossible to gauge the number of banks that excluded portions of their sovereign portfolios from their disclosures, or what the overall effect was.

But at least some banks' exposures to individual European countries were reduced by billions of euros, according to industry officials. Adding to the haziness, the stress tests' reported sovereign-debt levels differed, sometimes widely, from other international tallies and from some banks' own financial statements.

Representatives of several

banks said they were simply following the guidance provided by the Committee of European Banking Supervisors, the London-based group that coordinated the tests. CEBS faced intense pressure from national regulators and politicians across Europe to craft the tests in a manner that would portray the continent's banking system as healthy, according to industry and regulatory officials.

A CEBS spokeswoman declined to comment.

Analysts said they were dismayed to learn that some of the banks' disclosures about their sovereign debt in the stress tests didn't present a comprehensive look at their portfolios. They said that undermines the stress tests' primary goal of improving transparency.

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France and Britain hit by strikes



Reuters

Teachers in Lille protest against French government education reforms and job cuts on Monday. The placard reads 'back to the pillory for contract workers.' Throughout France, train services began to taper off as a major strike began against pension reforms that would raise the retirement age to 62 from 60, with as many as 200 demonstrations planned for Tuesday. In London, a 24-hour Tube strike began Monday evening and quickly began to affect thousands of commuters. **Related article page 3**

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The Quirk



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Jamie Whyte on what's wrong with the Big Society. Page 12

Oil tycoon's defense says auditor caved to pressure

Defense lawyers for jailed Russian oil tycoon Mikhail Khodorkovsky are turning their legal guns on one of their client's former allies: auditor PriceWaterhouseCoopers.

The attorneys for Mr. Khodorkovsky—once the main shareholder and chief executive of petroleum producer OAO Yukos and now on trial for allegedly embezzling tens of billions of dollars from the company—say PWC acted improperly when it withdrew its seal of approval from 10 years of Yukos's financial statements.

Mr. Khodorkovsky's legal team contends that PWC, which served as Yukos's audi-

tor and adviser for years, withdrew its audit opinions in order to protect its own business interests in Russia and to shield its partners from possible jail time—not because of any real questions about the reliability of Yukos's books.

PWC said in a statement that it stands behind its 2007 decision on the audit opinions. The firm said it acted after it received new information "suggesting that Yukos's former management may have made inaccurate representations" during its audits.

PWC's entanglement in the legal travails of Mr. Khodorkovsky highlights the ethical and legal dilemmas that can face auditors in emerging

markets where corporate governance and judicial systems are weak, industry observers say.

Mr. Khodorkovsky's lawyers are eager to cast doubt on PWC's motivation for pulling its audit opinions, a move that robbed the defense of critical evidence for their client's assertion that he is innocent of financial wrongdoing at Yukos. They say PWC reversed course under pressure from a Russian government pursuing a politically motivated prosecution.

Prosecutors declined to comment for this article.

- Lawyers eager to cast doubt on PWC's motives 14-15

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PAGE TWO

Can one regulator really fit all 27?

[Agenda]

BY PATIENCE WHEATCROFT



Markets need regulation. Few serious voices would dissent from that simple proposition. But does a single market demand a single system of regulation? As the European Union moves closer to taking regulatory control of the territory's financial markets, there are some, particularly in the City of London, who are questioning what superficially seems a perfectly logical step.

EU finance ministers meeting this week are expected to endorse proposals for a pan-European supervisory structure for the banking, insurance and securities markets. The powers entrusted to the four new regulatory authorities it will create are limited but it opens the way for "regulatory creep," which could see the new bodies assuming ever-increasing power. Remarks by Michel Barnier, the EU's commissioner for internal markets, indicate that he certainly envisages the new regulators achieving increased muscle power as they become established.

On one level, this would seem easy to justify. The failings in the current system of national regulation have been made glaringly clear. Much of the trade in financial markets is cross-border and the inter-relatedness of institutions requires cross-border regulation.

But within the 27 countries that constitute the EU, attitudes to, and dependence on, financial services differ hugely. This has been very clear as battle has raged over the Alternative Investments and Financial Markets Directive, once the subject of more than 1,000 proposed amendments. Some countries wanted to legislate all financial activity into the tightest of straight jackets while others maintained that private equity, for



Michel Barnier, the EU commissioner for internal market and services.

instance, should remain outside the legislation. The latter group lost and the suspicion is that in the new regulatory structure those who would be most restrictive would also prevail.

As Open Europe, a lobby group that campaigns for change in the EU, points out in a new report, the U.K. controls 36% of the wholesale financial market in the EU while Poland has just 0.3%. However, many of the matters to be decided on by the new regulatory authorities will be determined by simple majority, meaning that both countries will have an equal voice. There is a risk that the voting might in time disadvantage European financial centres against their competitors elsewhere in the world.

Open Europe accepts that a

The U.K. controls 36% of the wholesale financial market in the EU while Poland has just 0.3%.

pan-European dimension to financial regulation would have positive aspects. The proposed European Systemic Risk Council will be charged with watching out for potential problems in the EU's financial system, a role which, properly fulfilled, might have enabled member states to lessen

the impact of the financial crisis. Given the role played by the ratings agencies in fuelling the crash, there can be few objections to the proposal that a new pan-European body would regulate those agencies.

But, ratings agencies apart, in the wake of the financial debacle regulators both national and international are making strides to try to ensure that a repeat is avoided. This week in Basel, central bankers will be attempting to reach agreement over new capital requirements for banks. In the U.K., the failed regulator is being disbanded and new, enhanced powers handed to the Bank of England. To superimpose another layer of regulation could lead to confusion.

The new bodies would have regulatory power to tackle firms directly where a national regulator had avoided taking action, if the Council of Ministers had declared "an emergency." It is not easy to envisage a scenario in which such action would have to be taken, on the other hand a regulator in possession of powers may feel tempted to exercise them.

This proposal goes further than had been envisaged by the modestly titled High Level Report on Financial Regulation in the EU, led by former IMF managing director Jacques de Larosiere. In its recommendations, it was unambiguous that "[the EU

supervisors] should be neutral with respect to national supervisory structures: national supervisory structures have been chosen for a variety of reasons and it would be impractical to try to harmonize them."

Open Europe does see some attractions in harmonizing them and producing a single rule book for financial markets. But, with the sort of honesty that is unlikely to advance its case with other EU members, it declares that "A 'single rulebook' could benefit the City but that assumes that the U.K. will write it."

But instead, the rule book will be written by a committee of disparate interests. The issue is just the latest to highlight the tensions in the EU that emanate from the fact that it encompasses some very different economies. While the initial powers proposed for the new regulatory bodies are limited, there is scope for them to become much stronger.

There could be battles ahead.

The power of the Net

The power of the bloggers cannot be overestimated. The U.K.'s foreign secretary was forced last week to deny rumors that had been circulating on websites but had not appeared in print. The episode provides a stark warning for business as much as it does for politicians. Managing reputation is now a multi-dimension task.

Rumors, whatever their basis, can be posted online and become the stuff of widespread gossip within moments. Companies have to be ready to respond quickly and decisively. Ignoring the chatter could be an expensive mistake. Organizations which have experienced concerted attack from lobby groups, such as Nestlé and McDonalds, now have sophisticated strategies in place for rebutting internet allegations. Other companies need to be prepared to fight back, even if it is by quickly confessing to an error and making amends.

The age of the Internet demands transparency.

What's News

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Quentin Fottrell on how the Anglo Irish Bank may hurt Ireland's economy



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NEWS

Strikes give bicycle-sharing a push

European cities are determined to get citizens pedaling in greater numbers, promoting bicycles as a way to cut pollution and ease traffic congestion—and even survive transit strikes, such as those hitting London and Paris this week.

By *Javier Espinoza and William Lyons in London and Kimberly Peterson in Paris*

But to insure these efforts' success, authorities need to improve safety and prevent vandalism and theft, advocates say.

When London rolled out Europe's latest bike-sharing program in July, environmental and public-health groups embraced it. Mayor Boris Johnson called it a "revolution in cycling" and said he hopes it will lead to tens of thousands more bike trips in the city every day.

London officials are expecting huge demand for its so-called Boris bikes on Tuesday, a spokeswoman for the transport authority said. The agency provides bike-route directions on its website, but cautions that during the 24-hour transit strike, bikes will be hard to find during peak hours.

People can join London's bike-sharing system, which is run by the agency with financial support from Barclays PLC, for a fee that allows them access to a fleet of about 5,000 bikes stationed at more than 300 sites around London. More than 40,000 people have signed up.

Ashley Thompson, a 30-year-old working at an investment bank in London's financial district, says the program, known as Barclays Cycle Hire, has allowed him to save money, but he worries about inexperienced cyclists and tourists.

"You have to be ready to brake at every moment and have to be mindful of lorries and large vehicles," Mr. Thompson says. "I am surprised wearing a helmet isn't mandatory."

Other cities with bike-sharing programs have experienced increases in bicycle-related accidents. In 2007, the first year of the Vélib bike-sharing program in Paris, there were 694 bicycle-related accidents and five deaths.

As drivers and cyclists have gotten more accustomed to sharing the road, however, those numbers have declined, according to the Paris police. In the first half of this year, injuries to cyclists fell 5.7%, compared with the same period a year earlier. There were no fatalities.

Vandalism and theft of bicycles also has been a serious problem. Virtually the entire fleet of 20,000 Vélib bicycles in Paris has had to be replaced since the program started. Some bikes ended up tossed into the Seine; others were taken home by foreign tourists.

"The vandalism beat our expectations," said a spokesman for Paris city hall. "We didn't expect as many bikes to be stolen."

In London, cycling organizations are focused on safety and urge riders to bike defensively. "Cyclists have to be aware of their surroundings in a busy, congested city like London," says Martin Gibbs, director of policy and legal affairs for British Cycling.

Mr. Gibbs says he expects that over time, there will be "more people on the road and the more people there are, the safer it is, because drivers become more aware and more careful."

Authorities say cyclists themselves also need to be more responsible. Françoise Hardy, chief of road safety for the Paris police, says that in her city, bikers "don't behave well on the street." She said cyclists often ignore traffic signals, speed and ride on the sidewalk where they pose a risk to pedestrians.

Paris wants to double the number of bike journeys in the city by 2020. The city government decided in June to spend €25 million (\$32.2 million) to add 260 kilometers of dedicated bike lanes, including one in each direction along the iconic Champs-Élysées. The city also plans to add 10,000 bike-parking places by 2014.

Ms. Hardy expects the new lanes to help decrease the number of bicycle injuries by segregating cyclists from automobile traffic.

Advertising company JCDecaux runs the Vélib program in exchange for the right to operate ad panels around Paris. The company won't



A commuter rides home on a rental during London's rush hour Monday, above; a Vélib bike-share participant, right, pedals through Paris in July.

say how much it spends to run the program. A JCDecaux spokeswoman said thefts were such a problem that the company renegotiated its contract so the city will pay replacement costs above an undisclosed amount.

In London, there has been little vandalism. Early adopters seem pleased. "I wasn't sure London was up for it and was worried that I would get hit," says Paul Robinson, a retired police officer who regularly uses Barclays Cycle Hire bikes.

But, he says, "I have been really surprised by the general awareness from buses and taxis on the roads."

The real test is whether the bikes can be properly maintained, he says. "They are fine at the moment as they are shiny and new. I just hope they stay that way."

—Holly Bleach
contributed to this article.



Londoners cope with transport disruptions

By JAVIER ESPINOZA

LONDON—Strikes in London's transport systems, which started late on Sunday and were due to continue until Tuesday evening, could become the first in a series of strikes affecting millions of commuters ahead of government cuts later in the fall, a powerful transport union has warned.

On Sunday night, 200 maintenance staff on two major underground lines—the Jubilee and Northern—walked out over a dispute over pay rises. Separately, about 10,000 staff of the Rail Maritime and Transport union, or RMT, and the Transport Salaried Staffs Association, or TSSA, were set to walk out for 24 hours starting Monday afternoon as a sign of protest over the termination of 800 jobs, representing less than 5% of the London Underground's work force.

Drivers, signalers and station staff were expected to join them Monday night.



Commuters waited for a bus during the London Underground strike on Monday.

Transport for London, the transport authority, made a last-minute attempt to kick-start stalled talks over pay. "London Underground has

called on the leaderships of the RMT and TSSA unions to call off their threatened strike action and return to talks to avert disruption to

Londoners," a Transport for London statement said.

But an RMT representative said the strikes were due to continue and warned of more strikes ahead. "We were categorically clear last week that we are prepared to talk but not with a gun in our head," he said, adding two more 24-hour strikes are scheduled for October and November should both parties fail to reach an agreement.

TFL has vowed to "keep Londoners moving" by making available extra services to help commuters cope with the disruptions. Other modes of transport included 100 extra buses, escorted bike rides, marshaled taxi ranks, and space for 10,000 more commuters to journey by boat on the Thames.

Despite these options, business leaders haven't concealed their discontent over the industrial action. "Transport strikes are more than an irritation; they cost the economy millions of pounds in lost productivity," said Mark Heraghty, director of

Virgin Media Business. His company, however, was exploring ways to get around the strike by encouraging employees to work from home. "Although some jobs clearly cannot be performed remotely, for most office workers it's a real possibility," Mr. Heraghty added.

The strike is a huge inconvenience for London commuters, says Keshav Bhojania, a 25-year-old investment banker. "I had to take a cab to work this morning, which is quite expensive, and will probably need one tomorrow as well."

This strike is the fourth expected to shut down large parts of the tube network since 2002.

With over 3.5 million commuters using the tube network each day, the strike is expected to cost London an estimated £48 million (\$62 million) in lost productivity each day, according to Colin Stanbridge of the London Chamber of Commerce and Industry.

—Sujatha Santhanakrishnan
contributed to this article.

EUROPE NEWS

Bank taxes in EU spotlight

BY CAROLYN HENSON

BRUSSELS—Ways to protect taxpayers from bearing the cost of any future banking crisis will top the agenda at a meeting of European Union finance ministers on Tuesday.

EU countries paid out sums amounting to 16.5% of the bloc's gross domestic product to prop up financial firms during the credit crunch, according to EU figures, sending government debt skyward. Governments are keen to ensure that banks and other financial institutions that caused the crisis contribute to the cost of these and any future bailouts.

Two kinds of financial taxes will dominate discussions by the EU's 27 finance ministers at their monthly meeting, which will precede a meeting of 16 finance ministers from countries that use the euro. At center stage is a plan for an annual levy on banks and financial firms that could raise billions of euros to create a safety net for any future bank losses.

Germany, France and the U.K. have already agreed to act together to introduce such a tax from January. Other EU nations are likely to agree in principle that a coordinated EU approach is needed to avoid a patchwork of different tariffs across Europe or multiple tariffs on cross-border companies, according to diplomats.

But consensus will be harder to achieve on the technical details of the tax, such as how much it should be, how it should be calculated and what the money should be used for.

Some nations, including France and the U.K., want the money raised to go into national budgets to recoup bailout funds. Others want the money kept in reserve for any fu-



ECB's Jean Claude Trichet, left, with Belgian Finance Minister Didier Reynders and European Commissioner Olli Rehn.

ture financial crisis, while others still fret that the creation of such a fund could encourage banks to take risks, safe in the certainty that there is a net if their ventures fail.

"We have to try to reduce moral hazard so that we don't encourage financial bodies to take risks in the knowledge that governments will pick up the bill," Spanish Finance Minister Elena Salgado said when the matter was discussed in June.

The tenor of Tuesday's discussions will guide a proposal for an EU-wide levy to be drafted by the European Commission, the EU's ex-

ecutive arm, later this year. The ministers will also want to find a common position ahead of the next meeting of the Group of 20 major economies in Seoul. Progress has been harder to achieve at the G-20.

Also under discussion will be a separate suggestion for a levy on currency-exchange transactions, often known as a Tobin tax after a 1978 proposal by U.S. economist James Tobin. The EU deliberations will include widening the idea to include transactions on stocks, bonds and derivatives. In this area opinion is strongly divided, diplomats said.

Proponents of the Tobin tax have argued it would reduce speculative trading and reap substantial revenues. The European Parliament has backed the idea, calling for revenues to be used to swell the EU's budget. European Commission President José Manuel Barroso has suggested revenue from the tax could help fund climate-change projects.

But some countries, including Sweden, are fiercely opposed and few countries are willing to introduce the tax unilaterally, fearing traders will simply transfer their business to nontaxed markets.

U.K. mulls reopening its inquiry into paper

BY ALISTAIR MACDONALD

LONDON—A four-year-old tabloid scandal has resurfaced to dog U.K. Prime Minister David Cameron's chief spokesman, as police here said Monday they will consider reopening their investigation into alleged widespread use of dubious reporting tactics by the News of the World newspaper when the spokesman was its editor.

The long-running saga involves the paper's use of private investigators to obtain personal information about celebrities, politicians and other public figures, particularly through breaking into mobile-phone voice mailboxes, a practice known as hacking.

The News of the World's royal-family correspondent and a private investigator employed by the Sunday tabloid were jailed in 2007 after a two-year investigation found them guilty of hacking into the phone messages of some members of the royal family.

Andy Coulson, now Mr. Cameron's Director of Communications, stepped down as editor in January 2007. Mr. Coulson denied that the hacking went beyond the reporter involved, Clive Goodman, and has repeatedly said that he was unaware that such practices were used in his newsroom.

In the years since then, Mr. Coulson has re-emerged as a powerful spokesman and strategist for Mr. Cameron, even while periodically fending off the phone-hacking allegations, as he did a year ago when the Guardian newspaper in the U.K. reported extensively on the issue.

Mr. Coulson's tabloid past sprang up again last week, when the New York Times examined the phone-hacking saga and quoted a former reporter, Sean Hoare—as well as unnamed others—saying that Mr. Coulson had been aware of the improprieties and indirectly encouraged it.

On Monday, Mr. Coulson told the Metropolitan Police Service that, if asked, he will "happily" meet them to discuss allegations made by Mr. Hoare in both the Times and on the British Broadcasting Corp.

News of the World is owned by News Corp., which owns Dow Jones & Co., publisher of The Wall Street Journal. News Corp. said in a statement, "We reject absolutely any suggestion there was a widespread culture of wrongdoing at the News of the World."

A police spokesman said that the New York Times has been asked for any additional information related to Mr. Hoare's remarks, which it will consider in deciding whether to revisit the matter. The spokesman said the police had examined new accusations from media organizations in July 2009 but concluded there "was no new evidence and consequently the investigation remains closed."

Mr. Hoare couldn't be reached to comment.

In a letter to the New York Times, Bill Akass, managing editor of News of the World, said that the article was a "rehash of old material" and contained no new evidence.

Tests missed debt

Continued from first page

parenity. The stress tests' upbeat results—only seven banks flunked and were deemed short of just €3.5 billion (\$4.51 billion) of capital—initially soothed markets. But fears have flared up again as economies and financial systems in heavily indebted countries like Ireland and Greece continue to struggle.

"Clearly the attempts of policy makers to restore confidence seem to have failed," said Jacques Cailloix, chief European economist at Royal Bank of Scotland.

The banks based their sovereign disclosures on a template provided by CEBS. The template asked for banks to disclose their "gross" and "net" exposures to sovereign risk in each E.U. country. Most banks' disclosures didn't define "gross" and "net" beyond saying that the latter were "net of collateral held and hedges." The implication was that the disclosures—especially the gross exposure figures—were all-encompassing.

But some banks' figures didn't represent their total holdings.

Barclays PLC excluded a large swath of sovereign bonds that it was holding for trading purposes. The rationale, according to Barclays officials, was that the bonds were directly related to transactions for corporate or government clients, and that the holdings vary widely from day to

day. Barclays didn't disclose that it wasn't listing its full holdings.

Excluding those bonds reduced Barclays' portfolio of Italian sovereign debt—which the bank said was €787 million (\$1.22 billion)—by about €4.7 billion, Barclays officials said. The bank's holdings of Spanish government bonds, listed at €4.4 billion, shrank by about €1.6 billion.

Barclays said it excluded the holdings based on guidance from CEBS, which was communicated to the bank via the U.K.'s Financial Services Authority. An FSA spokeswoman declined to comment.

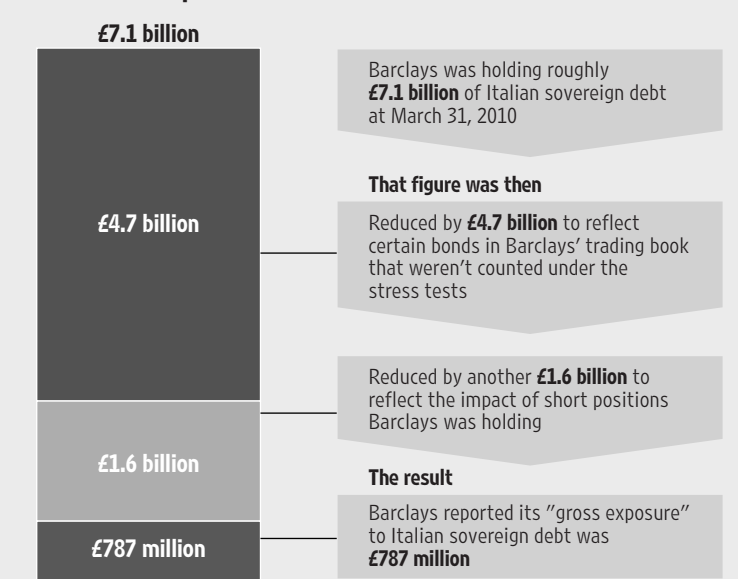
Other banking companies excluded bonds held by subsidiaries. France's **Crédit Agricole SA** didn't count sovereign debt held by its insurance unit. A **Crédit Agricole** spokeswoman said the company followed guidance from regulators.

Some banks' figures also were whittled down by accounting for "short" positions they held in various countries' debt. For example, if a bank held €100 million of Greek debt and €25 million of short positions in Greek debt, the gross figure was listed as €75 million.

CEBS didn't disclose that the banks were calculating the figures in that way.

Most banks also were mum, although the practice of "netting out" short positions was widespread, according to industry and regulatory officials. One exception was **HSBC Holdings PLC**,

Minimum exposure



Sources: Barclays, WSJ reporting

Divergent data

French banks' total exposure to sovereign debt varies widely depending on the source of information



Note: Data as of March 31. BIS data encompasses all French banks, while stress tests included the four largest French banks, which represent nearly 80% of assets in the French banking system. Sources: Bank for International Settlements; Banque de France; Royal Bank of Scotland



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U.S. POLITICS: THE BATTLE FOR CONGRESS



Associated Press

Rick Snyder, former CEO of computer maker Gateway, won the Republican nomination for governor of Michigan.

Search for fresh voices boosts CEO candidates

BY STEPHANIE SIMON

GRAND RAPIDS, Mich.—The nerd took the stage to a standing ovation.

Rick Snyder, former CEO of computer maker Gateway Inc., won the Republican nomination for governor of this troubled state with the slogan “One Tough Nerd” and a promise to run Michigan like a business.

At a town hall meeting here, Mr. Snyder told an enthusiastic crowd that it would take business-world know-how to fix a broken economy. “We need to take that knowledge base from the private sector into the public sector,” he said.

It’s a message resonating with voters in many states.

A hunger for fresh faces, especially among Republicans, has propelled a bumper crop of novice politicians into the electoral fray. Prominent among the rookies are several CEO candidates, running on their business resumes.

The best-known are on the ballot in California: Carly Fiorina, who ran Hewlett-Packard Co. and is now the Republican nominee for Senate; and Meg Whitman, the former eBay Inc. CEO who is now the GOP candidate for governor. But boardroom veterans are also mounting strong campaigns for Senate and governor in Florida, Connecticut, Massachusetts, New Hampshire and Michigan. Several polls show Mr. Snyder with a double-digit lead over Democrat Virg Bernero to succeed departing Democratic Gov. Jennifer Granholm.

The CEO candidates have tapped into anxiety about the economy and disgust with politics as usual. They are also running at a time of deep unease in the business community about the nation’s direction. The U.S. Chamber of Commerce has accused the president and Congress of vilifying industry and injecting uncertainty into business planning with complex overhauls of health care and financial regulation.

But running on a record of corporate success can be as much a liability as an asset, with political rivals attacking former CEOs for decisions to lay off workers, move factories overseas or take advantage of perks such as corporate jets.

Boardroom politics

Some former CEOs running for office this fall

- **Carly Fiorina**
GOP Senate nominee, California
Former CEO, Hewlett-Packard
- **Meg Whitman**
GOP gubernatorial nominee, California
Former CEO, eBay
- **Rick Snyder**
GOP gubernatorial nominee, Michigan
Former CEO, Gateway
- **Linda McMahon**
GOP Senate nominee, Connecticut
Former CEO, World Wrestling Entertainment
- **Rick Scott**
GOP Senate nominee, Florida
Former CEO, Columbia/HCA
- **Charlie Baker**
GOP gubernatorial nominee, Massachusetts
Former CEO, Harvard Pilgrim Health Care
- **Bill Binnie**
GOP Senate candidate, New Hampshire (Sept. 14 primary)
Former CEO, Carlisle Plastics

Amid this year’s stubbornly high unemployment, several CEO candidates are facing accusations from opponents that they shipped U.S. jobs abroad. Bill Binnie, a Republican Senate candidate in New Hampshire, is battling charges that as CEO of Carlisle Plastics Co., he moved a California plant to Mexico. He says he opened the Mexican plant as part of an international expansion but also built new facilities in California so that “more American jobs were created every year.”

Democrats in California are leveling a similar charge against Ms. Fiorina, pointing out that she laid off thousands of workers and moved jobs abroad. Ms. Fiorina’s campaign responds that she “had to make tough choices in very difficult times,” steering the company through the dot-com bust.

In Michigan, Democrats plan to hammer Mr. Snyder for the outsourcing of jobs at Gateway after he stepped down as president but while he was still on the board. Mr. Snyder says he opposed the outsourcing but was powerless to stop it.

Voters are left to sort through dueling interpretations of a candidate’s career.

Ms. Fiorina, for instance, presents herself as a trail-blazing getter. She boasts that H-P’s revenue doubled during her tenure.

“She’s created jobs, met a payroll and she understands how to cut a very big and complex budget,” said Ms. Fiorina’s deputy campaign manager, Julie Soderlund.

Democrats, however, point out that Ms. Fiorina was fired by the board in 2005 following a difficult merger with Compaq Computer Corp. Sen. Barbara Boxer, her Democratic opponent, has filled a website with scathing comments from business analysts on Ms. Fiorina’s performance at H-P.

In Florida, the CEO on the hot seat is Rick Scott, the GOP gubernatorial nominee, who bills himself as “one of America’s foremost entrepreneurs.” He touts his success cutting costs at hospital group Columbia/HCA. His opponents, however, are fond of pointing out that Mr. Scott left the company in 1997 amid a federal investigation into billing practices. Columbia/HCA paid \$1.7 billion to settle with the government. Mr. Scott says he takes responsibility for the company’s mistakes but notes that he wasn’t personally charged with wrongdoing.

The wave of CEO candidates comes as voters have made clear in early primaries, polls and interviews that they’re looking for outsiders with a fresh perspective.

Democrats say this is no time to put a political novice at the helm. “People have this myth that someone with no experience in government who describes himself as a ‘successful businessman’ can somehow become a savior,” said Mark Brewer, chairman of the Michigan Democratic Party.

November vote to set stage for 2012 presidential race

[Capital Journal]

By GERALD F. SEIB



Making predictions about election outcomes is a dangerous business, but here’s one that’s a safe

bet: The 2012 presidential race will begin Nov. 3, the day after this fall’s congressional election.

In fact, the presidential sweepstakes already is under way to some extent, and November’s vote will do much to determine its contours. The Congress that emerges will determine how President Barack Obama positions himself for a re-election run, while the way some Republicans have maneuvered this year may help or hurt their prospects for 2012.

For Mr. Obama, there’s no more important question than whether he will spend the next two years working with a Congress under partial or complete Republican control, or one with his Democrats narrowly in charge. The president surely will take some short-term lumps if his party loses control, and tea party-inspired conservatives would periodically upset the congressional apple cart. But in the long run he, like President Bill Clinton before him, might be better off dealing with a Congress in which Republicans have some control and, consequently, an incentive to get things done—or risk being blamed if they don’t.

The other, predictable question about Democratic strategy in 2012 is whether the president will dump his vice president from the ticket—in this case, dropping Joe Biden in favor of Secretary of State Hillary Clinton. But this is a recurring parlor game, and usually turns out to be a silly one.

More substantively, the sheer depth of the economic problems dogging Democrats this year suggests President Obama’s re-election bid will turn on one simple word: jobs. Unemployment has been above 9% for 16 straight months, a ditch so deep the nation may be in it for several years. The key factor will be whether voters think the president has begun pulling out of it by 2012.

On the Republican side, speculating about who’s up and who’s down is much more freewheeling. To the extent such things matter, CNN and Opinion Research Corp. asked Republican voters in mid-August whom they preferred as the next Republican nominee. Former Massachusetts Gov. Mitt Romney led, followed by former vice presidential nominee Sarah Palin and former House Speaker Newt Gingrich.

More important is to look at how some top GOP contenders have or haven’t improved their positions this year:

■ **Mitt Romney:** He has said and done all the right things, and stepped in to help fellow Republicans. But he also has a problem that has grown in the last year: The Democrats’ health-care overhaul has proven toxic to Republican primary voters, and analyses that draw parallels



Republican former Gov. Mitt Romney.

between it and the state health overhaul Mr. Romney engineered in Massachusetts are an issue that won’t easily go away.

■ **Sarah Palin:** Lots of Republican heavy-hitters bet she won’t run, but her decision to speak this month at a party dinner in Iowa, home of the opening nominating caucuses, suggests otherwise. The outcome of this year’s election may matter most to her. She has proven that her endorsement can power Republican nobodies to primary victories. But if those Palin choices fall in November, many Republicans will conclude that she and her acolytes have limited appeal to the broader electorate.

■ **Newt Gingrich:** His stock has risen. Beyond opposing President Obama, new ideas haven’t been plentiful for the GOP, and he’s an idea machine. He has also shown he knows how to use new media to mobilize forces.

■ **Mississippi Gov. Haley Barbour:** Nobody has improved his or her position more. He is leading Mississippi through a fiscal mess, while also overseeing what figures to be a highly successful national campaign committee for Republican gubernatorial candidates. He has raised a ton of money for the effort, and will end up with friends in key places who owe him a debt of gratitude.

■ **Former Arkansas Gov. Mike Huckabee:** He is a candidate to fill the slot always available for a Christian conservative in the Republican field. But he hasn’t done much this year to cement that spot. Instead, the guy working hard to take that slot is:

■ **Former Sen. Rick Santorum:** He is flying under the radar, but piling up a lot of chits in both Iowa and New Hampshire. He was in New Hampshire Aug. 21, in Iowa Aug. 16-18, in New Hampshire July 26, in Iowa June 25-26...you get the idea.

■ **Minnesota Gov. Tim Pawlenty:** Watch this space. He isn’t flashy but has earned the respect of his party’s fiscal conservatives by handling a state budget gap with spending cuts, fending off tax increases and Democratic legislators along the way. He has an appealing working-class background and a political action committee that made some smart interventions to help other Republicans this year.

U.S. POLITICS: THE BATTLE FOR CONGRESS



Getty Images (2)

Republican challenger Sharron Angle, left, and Senate Majority Leader Harry Reid, a Democrat, face off in Nevada in one of this November's marquee battles.

Nevada race tests Democratic pros

By PETER WALLSTEN

HENDERSON, Nev.—Supporters across the country are sending money to boost Sharron Angle's U.S. Senate campaign.

In this Las Vegas suburb, accountant David Hannuksela fumes that "government has gone wacko" with spending and vows to vote for Ms. Angle this fall. The same goes for limo driver Don Bannai, underwater on his mortgage and losing income amid a drop in tourism.

Like other Republicans, Ms. Angle is benefiting from a wave of voter anger in this year's midterm elections. Feelings are running so strongly against the Democrats that pollsters and strategists say the party is on track to lose a historically large number of races in November.

But Ms. Angle's opponent, Senate Majority Leader Harry Reid, believes he has a tool to weather the storm: A get-out-the-vote operation years in construction, made of professional staff and armed with well-researched voter lists.

As the general election season begins, Nevada is emerging as the most prominent test of whether the anti-incumbent wave threatening the Democratic majorities in Congress can be minimized by strong campaign organizations seeking to mobilize the party's most committed voters. Democratic Party officials, armed with a \$50 million investment, are preparing a national program to target voters who turned out in 2008.

In Nevada, Republican activists concede that Mr. Reid's machinery is superior to that of Ms. Angle, a tea-party favorite who came from behind to win the GOP primary in June. While the sour public mood is expected to drive a large number of Angle voters to the polls, Mr. Reid is trying to work voter by voter, making personal connections to mobilize support.

"If this comes down to a dead-heat tie and it's decided on turnout, don't be surprised if Reid pulls it out," said Chuck Muth, a conservative activist in Las Vegas who helps run a political action committee planning to air anti-Reid ads. "The Angle campaign is getting better, but there's no way they can put to-

gether in four or five months what Reid has been building for years."

Where Ms. Angle "needs to put up the sail and ride the wave to victory," said Ryan Erwin, a GOP strategist in Las Vegas, "Reid's got to dig in and find individual voters to piece together victory almost one household at a time."

Ms. Angle, asked about Mr. Reid's get-out-the-vote operation, described the race as "a contest between good-old-boy politics as usual—Washington, D.C., machinery as personified by Harry Reid—and the mainstream majority...who are ready to go to the polls and express their disapproval of the system."

Her spokesman, Jarrod Agen, said the Angle campaign was building a strong get-out-the-vote system but declined to offer specifics.

A piece of Mr. Reid's machine could be seen on a recent Saturday morning, as about 200 Reid volunteers gathered at a campaign office here before hitting neighborhood canvassing routes in the 100-degree heat.

Mr. Reid showed up to rally the troops, telling them their job was similar to that of a baseball team that might not have the best players but can win with the best execution. "You steal bases," he said.

Both campaigns have money for advertising and other campaign tasks, such as hiring field staff to coordinate volunteers and guide outreach programs, but Mr. Reid has far more. As of June 30, the end of the latest reporting period, he had raised \$19.2 million in the current election cycle, while Ms. Angle had raised \$3.5 million.

Angle aides say she has gained momentum in recent weeks with an aggressive online fund-raising program, bringing in more than \$3 million through the Internet.

Mr. Reid, however, has had a years-long advantage in building his get-out-the-vote operation—one he built partly because of election scares in the past.

"No one has ever seen a better campaign organization than I have," Mr. Reid boasted in an interview. "And I know, because in 1998, I had the worst."

In that contest, Mr. Reid won a second term by a mere 428 votes. Four years later, his party was dealt

How some tea party favorites have fared

★Senate candidates with tea party support

	Kentucky, May 18	★ Rand Paul 58.8%	<input checked="" type="checkbox"/>	WON
		Trey Grayson 35.4%		
		Next up: Paul faces Democrat Jack Conway		
	Nevada, June 8	★ Sharron Angle 40.1%	<input checked="" type="checkbox"/>	WON
		Sue Lowden 26.1%		
		Danny Tarkanian 23.3%		
		Next up: Angle faces Democrat Harry Reid		
	California, June 8	Carly Fiorina 56.4%		
		Tom Campbell 21.7%		
		★ Chuck DeVore 19.0%	<input type="checkbox"/>	LOST
		Next up: Fiorina faces Democrat Barbara Boxer		
	Utah*, June 22	★ Mike Lee 51.1%	<input checked="" type="checkbox"/>	WON
		★ Tim Bridgewater 48.9%		
		Next up: Lee faces Democrat Sam Granato		
	Alaska, Aug. 24	★ Joe Miller 50.9%	<input checked="" type="checkbox"/>	WON
		Lisa Murkowski 49.1%		
		Next up: Miller faces Democrat Scott McAdams		
	Florida, Aug. 24	★ Marco Rubio 84.6%	<input checked="" type="checkbox"/>	WON
		Next up: Rubio faces Democrat Kendrick Meek and independent Charlie Crist		

Note: Chart lists only leading candidates in each primary.
*Both candidates defeated incumbent Robert Bennett at the state convention in May.
Source: Associated Press; Photos: Getty Images (Angle and Rubio), Associated Press (all others)

a major setback at the polls, losing the governor's race and other statewide contests. For Mr. Reid, facing re-election in 2004, it was an ominous sign.

On the morning after the 2002 elections, Democratic strategist Billy Vassiliadis drove to Mr. Reid's home in Searchlight, Nev., to commiserate. As Mr. Reid took calls from the likes of Sen. Edward Kennedy, Messrs. Vassiliadis and Reid vowed to raise the money and hire the professional staff that could help prevent similar defeats.

"We can't keep living like this," Mr. Vassiliadis said he was told by Mr. Reid.

In addition to raising money, the men recruited full-time professionals who would remain in the state between elections, a change from past practice.

A key development came when Mr. Reid persuaded Democratic officials to make Nevada the second caucus state on the 2008 presidential primary calendar. The Nevada caucuses, which featured a high-interest fight between Barack Obama and Hillary Clinton, drew more than 100,000 participants—and expanded the party's list of energized Democrats by four times.

Today, Democratic officials in Nevada can draw from a pool of

3,000 potential volunteers. The party also has a nearly 60,000-voter registration advantage in the state, thanks partly to registration drives at caucus time.

The voter lists being used now by the Reid campaign have been continually refined since Mr. Reid last won re-election in 2004.

The lists allow phone banks and canvassers to tailor their messages to different types of voters. Obama supporters are told Mr. Reid is a "loyal partner" to the president. Undecided voters, by contrast, are told Mr. Reid is independent of the White House, and that as majority leader he is best-positioned to help Nevada's struggling economy. Environmentalists are told that he is pushing to locate renewable-energy programs in the state.

Several conservative groups, acknowledging the organizational gap, are starting to spend money in Nevada to help battle Mr. Reid.

American Crossroads and an affiliated group, advised by top GOP strategists Karl Rove and Ed Gillespie, report they have spent about \$1.7 million in ads attacking the majority leader.

The group plans to spend \$10 million calling voters in Nevada and other battleground states, and on sending anti-Reid mailings as part of a get-out-the-vote program, officials said.

Another newly formed group, Americans for New Leadership, has hired canvassers to identify independent voters willing to back Ms. Angle.

The weeks of bitter TV ads seem to have had an effect. A new Mason-Dixon survey for the Las Vegas Review-Journal found that large numbers of voters dislike both Mr. Reid and Ms. Angle, with Mr. Reid viewed more unfavorably overall but a majority of Republicans wishing their party had nominated someone else.

The survey showed the two in a statistical tie, just as the wave approaches and the machinery begins its work.

"It is possible for a well-run campaign to withstand an adverse political wave," said Steven Law, president of American Crossroads. But, he added, "the volatility we're seeing in this election is off the charts."

U.S. NEWS

Big tax break to be unveiled

BY JONATHAN WEISMAN
AND JOHN D. MCKINNON

President Barack Obama, in one of his most dramatic gestures to business, will propose that corporations be allowed to write off 100% of their new investment in plant and equipment through 2011, a plan that White House economists say would cut business taxes by nearly \$200 billion over the next two years.

The proposal, which administration officials said would be laid out in an economic address in Cleveland on Wednesday, tops a rush of announcements, from a proposed expansion of the research and experimentation tax credit to \$50 billion in additional spending on roads, railways and runways.

Unlike the R&E tax credit and infrastructure spending plans, the full-write-off of investments isn't the revival of a presidential campaign proposal but rather the embrace a long-held wish by conservative economists and businesses that had never won support from either Republican or Democratic administrations.

"Temporary investment incentives like this can have big effects because they really pull investment forward," said R. Glenn Hubbard, dean of the Columbia University School of Business and a former chairman of the Council of Economic Advisers under President George W. Bush. "This could have a big stimulative effect."

Administration officials say businesses spooked by the faltering recovery but with investments already on the drawing board will rush to take advantage of the tax break. The tax would be retroactive to Sept. 8, the day it is announced, so businesses will not hold off with planned investments to wait for congressional action.

The president will pitch the plan as the largest temporary investment incentive in U.S. history. All but \$30 billion of the cost to the Treasury should be recouped over the next decade because businesses would not be able to deduct the cost of the investments over time, as they do now, officials said.

The proposal would work essentially like a tax-free loan, said N. Gregory Mankiw, a Harvard University economist and another former



President Barack Obama on Monday in Milwaukee, before he proposed new infrastructure spending in a speech.

CEA chairman under President Bush. Mr. Mankiw said that focusing on business investment incentives is the right approach to sparking faster economic growth, but added that it's not clear how powerful an incentive full-tax deductibility would be, given that interest rates are already so low.

"They'll all take it," he said of businesses planning new investments, "but I don't think it's going to change a lot of calculations on marginal investment projects."

Kevin Hassett, an economist at the conservative American Enterprise Institute praised the Obama plan, saying it "goes to show they've learned their lesson" from the 2009 stimulus. Mr. Hassett estimated the tax change it would expand business equipment investment by 5% to 10%.

An administration official said about 1.5 million corporations—those with tax liabilities and investments in the works—are expected to take advantage of the proposal.

The official strongly disagreed that the tax break would have little impact with interest rates low because banks have been reluctant to lend in the wake of the financial crisis. He noted that the stimulus law included a provision that allowed

small businesses to write off new investments, but that expires at the end of this year.

The business investment deduction would supplement other Obama proposals, especially a permanent extension of an expanded research and experimentation tax credit. Since his presidential campaign, Mr. Obama has been pushing for a permanent R&E credit, to replace the short-term extensions that have passed Congress 13 times since the credit was created in 1981.

At a Labor Day union picnic in Milwaukee Monday, Mr. Obama also proposed another round of infrastructure investments to supplement the billions of dollars already being spent from the 2009 stimulus act. Administration officials say the upfront, \$50 billion boost in spending would pay for 150,000 miles of refurbished roads, 4,000 miles of high-speed rail, and 150 miles of airport runway, along with advanced in air-traffic control technology.

White House Chief of Staff Rahm Emanuel said the three proposals together would move money quickly into the economy through the government and the private sector.

Politically speaking, Mr. Emanuel said the rapid-fire release of proposals, followed by an economic ad-

dress on Wednesday and a White House press conference on Friday, has put the president on offense. "Without a doubt with this series, the president has seized the initiative," he said.

The immediate tax deductibility of domestic business investment has one other distinction: It will be hard for Republicans to oppose. Infrastructure spending has had bipartisan appeal, but the 2010 midterm campaigns have seen Republican candidates embrace austerity. In Wisconsin, where Mr. Obama laid out his infrastructure plan, a stimulus-funded, high-speed rail link between Madison and Milwaukee has become a contentious campaign issue. Milwaukee County Executive Scott Walker, a Republican gubernatorial candidate, has labeled it a boondoggle.

Large tax deductions for business investment would be more difficult for Republicans to politicize. Full deductibility for business investments has been part of the conservative wish list since the early 1990s when Stanford University economists Robert Hall and Alvin Rabushka made it a centerpiece of their plan for a flat tax, a radically simplified tax system with one income tax rate.

Petraeus condemns burnings of Quran

BY JULIAN E. BARNES
AND MATTHEW ROSENBERG

KABUL—The top U.S. commander in Afghanistan said the planned burning of Qurans on Sept. 11 by a Florida church could put the lives of American troops in danger and damage the war effort.

Gen. David Petraeus said the Taliban would exploit the demonstration for propaganda purposes, drumming up anger toward the U.S. and making it harder for allied troops to carry out their mission of protecting Afghan civilians.

"It could endanger troops, and it could endanger the overall effort," Gen. Petraeus said in an interview with *The Wall Street Journal*.

"It is precisely the kind of action the Taliban uses and could cause significant problems," he said. "Not just here, but everywhere in the world we are engaged with the Islamic community."

Hundreds of Afghans attended a demonstration in Kabul on Monday to protest the plans of Florida pastor Terry Jones, who has said he will burn the Quran on Sept. 11.

Afghan protesters chanted "death to America," and speakers called on the U.S. to withdraw its military convoy.

Some of the protesters threw rocks at a passing military convoy although officials told the rock-throwers to stop.

Military officials fear the protests are likely to spread beyond Kabul to other Afghan cities. In interviews with various media outlets, Mr. Jones has denied his protest would put U.S. troops in danger.

Mr. Jones has been denied a permit for the demonstration but has said he planned to go forward with the his protest anyway.

Mr. Jones leads a tiny church of just 50 people, but his threat to burn the Muslim holy book has been condemned around the world and has garnered him international attention.

Gen. Petraeus declined to elaborate on precisely what kinds of threats or violence could occur in the wake of such a demonstration. But Westerners in Afghanistan have been warned away from restaurants and other public places as tensions arise over the matter.

A report in *Newsweek*, later retracted, that a U.S. interrogator at the Guantanamo Bay prison had flushed a Quran down a toilet set off riots in Afghanistan and elsewhere in the Muslim world.

Officials fear that video of members of Mr. Jones's church burning Qurans could set off similar violence and stepped-up attacks against U.S. troops.

Military leaders usually try to distance themselves from politics, so the decision by Gen. Petraeus to speak out to try and stop the burning is unusual.

But last year Gen. Ray Odierno, the top commander in Iraq, asked President Barack Obama to stop the release of photos showing the abuse of Iraqi detainees, arguing pictures of Muslims being abused could touch off violence in Iraq and potentially slow down the withdrawal.

Obama seeks infrastructure boost

BY GARY FIELDS

President Barack Obama planned to use an appearance at a Labor Day rally in Milwaukee to unveil a \$50 billion proposal to improve the U.S.'s highways, airports and railways.

The infrastructure proposal, which includes new construction and repair of problems, is part of a larger plan Mr. Obama will outline in Cleveland on Wednesday to boost the economic recovery and provide long-term growth. The White House said the plan would build on the infrastructure investments that have already been made through the stimulus legislation adopted early in 2009.

Officials who briefed reporters about the plan said it shouldn't be seen as a stimulus plan for immediate job creation, and they couldn't say how many jobs might result from the plan, or when hiring might begin. One administration official

said the package might begin to boost hiring in 2011. He said the White House had no expectation that the plan would create "a lot of jobs in October 2010. That is not the way we've created this."

Part of the plan calls for the funding of a permanent infrastructure bank to invest in projects.

In recent weeks some Democrats and budget analysts have suggested the original stimulus package totaling around \$800 billion was too small. But with the midterm elections expected to deliver big gains for Republicans in both the House and Senate, it is unclear whether the president's latest proposal will

get much GOP support, as many Republican candidates this year have focused on reining in the widening deficit.

Republicans pounced on the package. "If we've learned anything from the past 18 months, it's that we can't spend our way to prosperity," House Republican Leader John Boehner of Ohio said in an email. "We don't need more government 'stimulus' spending."

Senate Minority Leader Mitch McConnell of Kentucky was just as blunt. "A last-minute, cobbled-together stimulus bill with more than \$50 billion in new tax hikes will not reverse the complete lack of confidence Americans have in Washington Democrats' ability to help this economy," he said.

Some analysts have suggested that time is running out on the various Democratic economic proposals. The latest unemployment figures re-

leased Friday showed that unemployment has risen to 9.6% from 9.5%, despite gains in the private sector.

Part of the infrastructure plan being released Monday calls for the funding of a permanent infrastructure bank that would invest in projects most critical to the economy. The investment would go to the U.S. highway system and focus on modernizing the system while providing jobs. There also would be investment in the nation's bus and rail systems, including an overhaul of Amtrak's fleet. The final cog would be the modernization of the air traffic control system.

Republicans in the Senate say there will be little time to address the plan. A top GOP aide said Congress will be returning from the August break next week, leaving about four weeks before it breaks again for the midterm elections.

WORLD NEWS

Hon Hai digs into China's interior

BY JASON DEAN
AND PETER STEIN

SHENZHEN, China—The world's biggest contract manufacturer of electronics, facing rising wages for its huge Chinese work force, is making a big investment in the country's hinterland in a bet that China can retain its role as the world's factory floor for decades.

Hon Hai Precision Industry Co. plans investments near two inland cities that will together employ half a million people, including suppliers. In just one of those locales, near Chengdu, the capital of Sichuan province, the maker of **Apple Inc.** iPads and other gadgets is investing \$3.5 billion to build an industrial park that Chairman Terry Gou hopes will become a model for how other big companies operate in China.

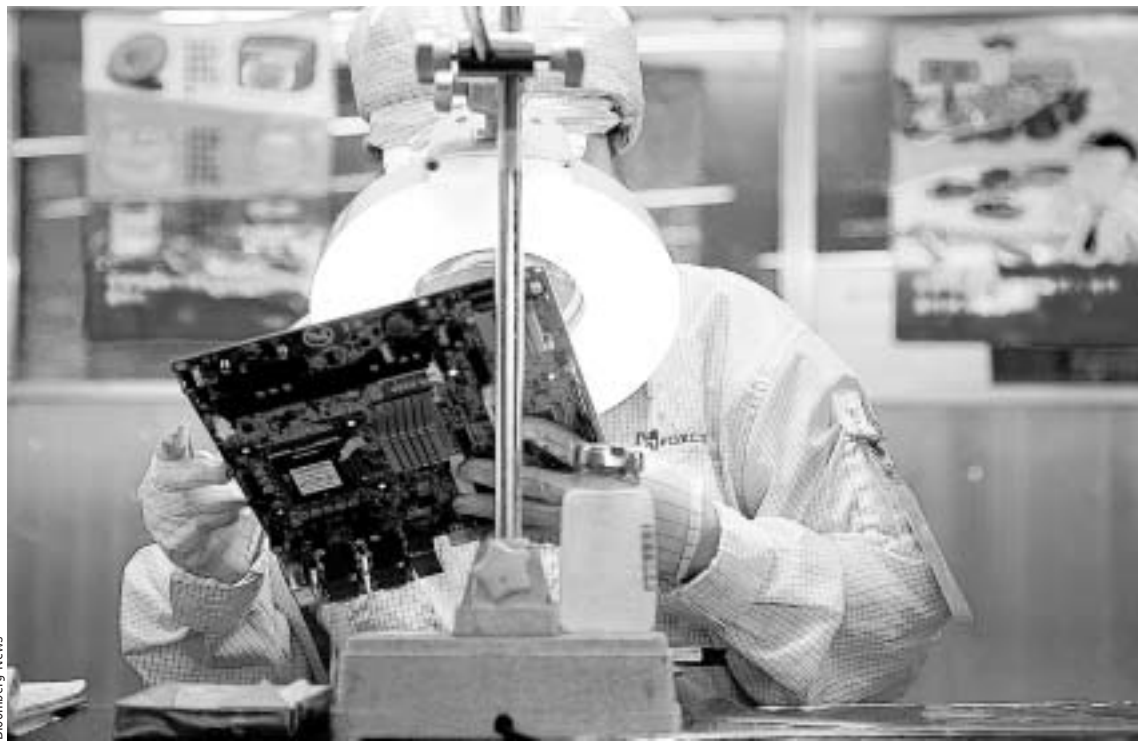
The inland investments come as workers demand better treatment and manufacturers face challenges in China's coastal belt, including a spate of worker suicides earlier this year at Hon Hai, the sharp wage increases that Mr. Gou implemented afterward and recent strikes at other Chinese factories producing cars and parts for **Toyota Motor Corp.** and **Honda Motor Corp.**

Hon Hai's success in managing rising wages could ultimately keep prices down for the Apple iPads, **Nokia Corp.** phones and **Hewlett-Packard Co.** printers that global consumers buy. And the shift inland by Hon Hai and other companies could help solidify China's dominance as a low-cost exporter, fending off challenges from emerging-market rivals in Asia, Latin America and elsewhere—even as China also makes progress up the value chain in higher-end, more capital-intensive industries.

Mr. Gou, whose company has factories in a dozen other countries, dismisses the idea that any of them could supplant China with its advanced infrastructure, business-friendly policies and still-large pool of surplus labor. In a nearly three-hour interview, he outlined his plans to keep plowing billions into the country. "I think in the next 20 years China won't have a competitor" as the world's main manufacturing center, Mr. Gou said.

His response to the challenges he faces lies in two shifts already under way at Hon Hai: one geographic, the other philosophical.

He is rapidly relocating the core manufacturing work of his business

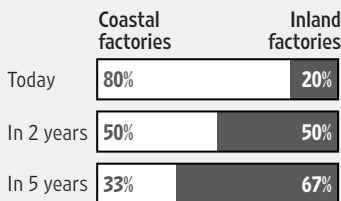


A Hon Hai employee works in coastal Shenzhen, China. The electronics maker plans to add more inland sites.

Inland move

Hon Hai is shifting its work force to China's interior, where costs are lower

Share of work force in...



Source: the company

away from its historical home in the coastal special economic zone of Shenzhen, where more than half of Hon Hai's 920,000 Chinese workers are employed. He is building facilities in less-developed areas further inland: Chengdu, Wuhan and Zhengzhou, cities that supply most of the laborers for the wealthier coastal provinces. In those areas the typical wage could be two-thirds that of the more developed coastal provinces, or less. Within two years, Mr. Gou expects 50% of all Hon Hai's workers to be located inland, compared with 20% today. In five years, the inland ratio will rise to 66%, he said.

And Mr. Gou expects his Chinese work force to keep growing during

that period, eventually expanding to as many as 1.5 million.

At the same time, Mr. Gou is trying to build industrial centers that hire more local labor. Gone will be the factory towns where Hon Hai runs not only assembly lines but dormitories, cafeterias, security, recreational facilities and hospitals—comprehensive responsibilities that Mr. Gou says his company is ill-suited to handle. Instead, he is enlisting local governments to build towns to house Hon Hai's staff and take over the social functions that the company has long kept in-house.

"We're not just moving a factory from one location to another location," Mr. Gou said in his austere, concrete-floored office at the company's enormous Longhua factory complex in Shenzhen. "We move to a new concept, new ideas."

Mr. Gou's plans have outside importance in China because of Hon Hai's massive scale. Since Mr. Gou, who turns 60 next month, founded the company in Taiwan in 1974, it has come to dominate the business of outsourced electronics manufacturing. In addition to iPads and iPhones for Apple, Hon Hai makes personal computers, cellphones and videogame consoles for most of the world's biggest electronics brands, including H-P, **Dell Inc.**, **Nokia**, **Sony Corp.** and **Nintendo Co.** Hon Hai's

revenue is larger than that of its 10 main global competitors combined.

Analysts on average expect Hon Hai's revenue to reach nearly \$85 billion this year, up from \$61 billion last year and 30 times its size a decade ago.

In China, Hon Hai and its affiliates, known collectively as **Foxconn Technology Group**, are the nation's third-biggest employer, Mr. Gou said, after China's top oil producer and the monopoly electricity-network operator—both state-owned companies.

Mr. Gou's plans for Hon Hai reflect a broader shift in China's economic development toward faster growth in the hinterland. This week, Shenzhen, a boomtown that has one of the highest per-capita income levels in mainland China, is celebrating its 30th anniversary. For more than a decade, China's government has been trying to extend the success of Shenzhen and the rest of the coast inland.

It has created a national highway system tens of thousands of miles long, built scores of airports and constructed the world's fastest rail network. That has made giant interior provinces such as Sichuan, home to more than 80 million people, more appealing for companies like Hon Hai. Last year, the fastest-growing region for foreign invest-

ment was Chongqing, which sits next to Sichuan, and where Hon Hai and its customer H-P have factories.

That growth is prompting many laborers to want to stay closer to home, rather than move to the coast for work. Last year, the number of migrant workers going to the Pearl River Delta region—the southern manufacturing heartland that includes Shenzhen—shrank by 22.5%, according to government figures.

The trend is likely to continue, exacerbating a tightening labor supply on China's coast, said Michael Wang, managing partner of McKinsey & Co. in Shanghai.

Mr. Gou began investing inland years ago, but the suicides this year prompted him to revise and accelerate his plans. Ten employees at the Longhua campus jumped to their deaths between late January and late May.

Mr. Gou met with about 200 managers and told them to do whatever they could to stop the suicides, said Louis Woo, one of his senior advisers. Today, safety nets ring all the buildings on Longhua's 2.3-square-kilometer campus.

The company also has hired counselors, established employee support groups and rolled out a care center with an elaborate computer-database system to help monitor those who call for help.

Most notably, Hon Hai has sharply increased minimum salary levels to let employees work fewer overtime hours without taking a hit to their incomes. Minimum base pay for assembly-line workers in the Shenzhen operation will rise to 2,000 yuan, or about \$295, a month in October, from as little as 900 yuan earlier this year. Mr. Gou said he was making the move in part because Chinese officials told him they plan to start enforcing a legal cap of 36 monthly overtime hours per employee, compared with the 80 hours Hon Hai and other factories use.

In the interview, Mr. Gou said he had "felt guilty" about the suicides, but he also vehemently denied that they reflected poor working conditions. "I can personally guarantee, nobody commits suicide due to low salary, the workload, too much pressure or Foxconn management style," he said. He and other Hon Hai officials said many of the suicide attempts appear to have been made on impulse, when workers had difficult personal problems.

—Ting-I Tsai
contributed to this article.

Thailand activists test limits

BY JAMES HOOKWAY

PATTAYA, Thailand—Months after their marathon Bangkok street protests ended in a bloody crackdown, Thailand's antigovernment Red Shirt protesters are testing the limits of what political and military leaders will allow, with a large fundraising concert over the weekend in this bawdy seaside resort and another rally planned for the capital.

The movement's leaders have set themselves a specific goal: the release of opposition activists arrested in the aftermath of May demonstrations. In their Bangkok rally, set for Sept. 17, they plan to lay red roses outside the prison where several Red Shirt leaders are held on terrorism charges. They are also encouraging supporters to stage other events

to commemorate the 91 people killed during clashes between protesters and government security forces.

Tens of thousands of protesters gathered in Bangkok in April and May for demonstrations calling for fresh elections. The action ended May 19 after a series of deadly clashes with security forces. Much of the country was put under a state of emergency, which has since been lifted in many areas outside of the capital. By returning to Bangkok, where a state of emergency prohibiting political demonstrations is still in effect, the Red Shirts risk another confrontation with Thailand's powerful army.

But Red Shirt leader and opposition lawmaker Jatuporn Phromphan said in an interview at Saturday's Pattaya concert—which drew about

4,000 people and featured a telephone message from the driving force behind many of the rallies, fugitive former premier Thaksin Shinawatra—that the crackdown had left the movement uncowed. He said that while the Red Shirts might lack strong leadership at the moment because of the detention of its leaders, rank-and-file activists learned from their Bangkok experience and can put together their own smaller-scale protests.

Some observers say the protesters might not gain much traction. The state of emergency in the capital makes staging protests there difficult.

But the rekindled ambitions suggest government efforts to bridge social fissures are progressing slowly, if at all, political analysts say.

Bahrain files charges against Shiite activists

BY MARGARET COKER

Bahrain accused 23 Shiite activists, including political leaders and prominent clerics, of promoting terrorism and plotting to overthrow the monarchy, a move expected to add to sectarian tensions ahead of elections in the Gulf Arab nation.

The accusations come after a wave of arrests last month of members of the country's majority Shiite community, which has long complained of discrimination by Bahrain's Sunni leadership, despite political overhauls ushered in by King Hamad bin Isa al Khalifa. Activists say the arrests and charges against respected leaders of the community

could alienate disaffected Shiites.

On Saturday, state prosecutors announced charges against 23 men, including the heads of two splinter political groups and prominent Shiite clerics. The charges include plotting against the king, terrorist financing, arson and sabotage.

"This sophisticated terrorist network with operations inside and outside Bahrain has undertaken and planned a systematic and layered campaign of violence and subversion aimed squarely at undermining the national security of Bahrain," said Abdulrahman al Sayed, an official at the Public Prosecutor's office.

Lawyers for the charged men weren't available for comment.

WORLD NEWS

Reliance to offer infrastructure loans

By AMOL SHARMA

NEW DELHI—Indian conglomerate **Reliance ADA Group** plans an ambitious move into financing infrastructure projects, which could help alleviate one of the main bottlenecks to improving India's creaky roads and electrical grid.

Reliance Capital Ltd., the financial arm of the conglomerate, which is backed by billionaire Anil Ambani and operates India's largest mutual fund, plans to target infrastructure firms as it builds its lending business from a current book value of about \$2 billion to as much as \$10 billion within about three years, company officials said.

The move comes as Indian companies look for new sources of financing to meet the government's goal of spending \$514 billion on infrastructure in the five years ending March 2012, and \$1 trillion in the following five years. Domestic banks are lending to the nation's big infrastructure players, but small and medium-size firms have trouble getting the loans they need for everything from cranes to dump trucks to mining equipment.

Amitabh Jhunjhunwala, vice chairman of Reliance Capital, said the company "is looking forward to playing an active role in financing the thousands of project developers, equipment vendors, contractors, logistics providers and other players who will be engaged in building this infrastructure in India." Reliance will charge interest rates of 12% to 14% a year, significantly more than what banks charge big construction outfits such as **GMR Group** and **Larsen & Toubro Ltd.**, because there is



Anil Ambani, seen above in May, aims to increase lending to as much as \$10 billion for Indian infrastructure projects.

increased risk from dealing with smaller firms. The company expects a return on equity of 18% to 20% from this business.

Indian Prime Minister Manmohan Singh has said unlocking new sources of financing for infrastructure will be necessary for the country to reach its goal of 10% annual economic growth in coming years. Despite a flurry of construction in major cities such as New Delhi, building highways and upgrading airport terminals, political and business leaders agree that India's generally

creaky infrastructure—from potholed roads to an outage-prone power grid—saps national productivity.

Gross domestic product grew 8.8% year-to-year in the three months ended June 30, the fastest rate in two years and one that far outpaced Western economies. But it is still short of what national leaders say is necessary to maintain brisk job growth and to reduce poverty.

Reliance, which also has a construction and engineering unit, is a major player in the Indian infrastructure push. The company plans

to spend \$40 billion on power projects, bridges and metro lines over five years. While it can finance much of that spending with its own cash and by issuing debt domestically, it is also in talks with international banks to arrange India's first-ever private infrastructure bond offering. The government has encouraged the creation of such infrastructure bonds to attract foreign investors to the Indian building spree.

Reliance hopes to attract investors for projects such as the **Bandra-Worli Sea Link**, a bridge that con-

nects downtown Mumbai with the north of the city to bypass traffic, company officials said. Many locals have hailed the road as a success, despite years of delays in building it. Reliance won a bidding competition to operate and maintain the **Sea Link** beginning in December. Reliance also built a new metro link between Delhi's international airport and the city center.

Other nonbanking firms are getting into infrastructure financing as well. The financing arm of **Larsen & Toubro Ltd.**, one of India's largest construction and engineering firms, already provides loans for equipment used in earth-moving, road construction and mining, as well as for commercial vehicles. The company said it has more than 7,000 clients for that line of its business.

Reliance ADA Group has announced a range of deals in recent months in its media and telecommunications units, including a television joint venture with **CBS Corp.** of the U.S. Reliance Capital, known primarily for its mutual fund, also manages investments for pension funds and life-insurance plans—overall, more than \$33 billion in assets. Its total loan portfolio now is about \$2 billion, including \$1.2 billion for businesses and the remainder for mortgages and other consumer financing.

But now Mr. Ambani wants to increase lending in a big way. The company will offer several options to infrastructure firms, including short- and long-term loans, convertible debt and lease financing for equipment. It also could inject equity into builders in some cases, company officials say.

Japanese political battle jolts bond yields

By MEGUMI FUJIKAWA

TOKYO—The risk of a new prime minister who strongly favors higher fiscal spending continues to send yields in Japan's jittery government bond market sharply higher.

Ichiro Ozawa, a powerful political kingmaker, is challenging Prime Minister Naoto Kan for leadership of the ruling Democratic Party of Japan in what is seen as a close race. The party's members of Parliament, local officials and individual party members will vote on Sept. 14, with the winner becoming the nation's prime minister.

Mr. Ozawa is pushing for a sharp increase in government spending to bring the country out of its deflationary spiral and long-running economic slump. While he has said he can find much of the money in savings, economists believe that higher borrowing is inevitable.

The prospect of increasing an already large program of deficit spending has again raised the question of whether the government is close to running out of willing buyers for its debt. With a fast-growing debt load now at nearly 200% of annual gross domestic product, plus stagnant tax revenues, Japan has long looked like a sell-off in the making. For this fiscal year, the national government is borrowing 48% of its total spending.

The International Monetary Fund said last week that Japan is very close to its "debt limit"—a point at which markets might react to the threat of default by boosting inter-

est rates on new borrowing.

Two tests for the market this week will be Wednesday's sale of 600 billion yen (\$7.11 billion) of 30-year bonds and Friday's sale of five-year bonds. The super-long sector has been hit particularly hard by worries about the country's fiscal health. Monday, the 30-year yield jumped 0.05 percentage point to 1.97%.

"Anxiety over Japan's fiscal health may intensify due to the DPJ election, especially because Japan's budget conditions are already difficult," said Tetsuya Miura, chief market analyst at Mizuho Securities.

Predictions of a market calamity have come and gone many times in the past and yet major banks, insurers and cash-rich Japanese corporations have remained reliable buyers.

But the political machinations have brought a new uncertainty. Mr. Kan has been in office a scant three months and has had little chance to put through his plan for fixing Japan's finances. Mr. Ozawa has pledged that if elected, he would implement the ambitious spending plans his party promised when it came to power in September 2009.

Polls conducted by local media over the weekend showed that Mr. Kan leads Mr. Ozawa in pledges of support from local DPJ assembly members, rank-and-file party members and registered supporters eligible to vote in the election. Support for Mr. Kan stood at 66%, compared with support for Mr. Ozawa at 18%, according to a survey in the *Yomuri Shimbun*. A poll in the *Asahi Shimbun*, meanwhile, pegged Mr. Kan's



Challenger Ichiro Ozawa, left, and Prime Minister Naoto Kan are fighting for top spot in the Democratic Party of Japan.

public support at 65% and Mr. Ozawa's support at 17%. Both surveys were conducted over the weekend.

A separate poll conducted by the *Yomuri Shimbun* newspaper among DPJ lawmakers and others eligible to vote in the leadership election showed that Mr. Kan and Mr. Ozawa are neck-and-neck in the race for party president. The two are believed to each have the support of about 160 party legislators, according to the poll, taken two days after official campaigning began. But about 90 lawmakers have yet to disclose whom they favor. Some market participants said prices were due in any case for a fall, pushing up yields.

"The market was looking for a

cue to sell JGBs, but the Ozawa news turned out to be an unexpected trigger," said Maki Shimizu, a strategist at Citigroup Global Markets Japan. Investors had thought any discussion of increased fiscal spending would come after the election, she said, so the Ozawa commitment to spend took the market by surprise.

The benchmark 10-year yield touched 1.195% Monday, part of a two-week reversal from the seven-year low of 0.895% touched on Aug. 25. It ended the day up 0.055 percentage point at 1.19%, driven in part by a surge Friday in U.S. Treasury yields. The 20-year yield rose 0.045 percentage point to 1.91% Monday, up from a seven-year low of 1.51% on Aug. 24.

If the Kan administration's fiscal consolidation plan gets sidetracked, rating firms may downgrade the country's debt, which could raise its borrowing costs. Standard & Poor's Ratings Services sovereign analyst Takahira Ogawa said the firm may review its ratings on Japanese debt if the domestic economy deteriorates and remains mired in deflation.

Mr. Ogawa said the frequent changes of government in recent years are a major problem for Japan, making it "difficult to have confidence in any long-term fiscal rehabilitation programs." Japan has had five prime ministers in the past four years.

"There could be a time ahead when we may need to consider whether our Japan rating is appropriate," he said. S&P downgraded its outlook on Japan's double-A credit rating to negative from stable in January.

The role of China and other Asian nations is also a new uncertainty in the market—although potentially a positive one.

While traditionally dominated by Japanese investors, the market has already seen an influx of money from China, which bought a net 508.0 billion yen of short-term Japanese bonds in June, after purchasing 694.8 billion yen in May, its largest monthly net purchase ever, according to data last month from the Ministry of Finance. July's data is due out Wednesday.

—Takashi Mochizuki
contributed to this article.