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THE WALL STREET JOURNAL.

VOL. XXVIII NO. 154 | EUROPE | Wednesday, September 8, 2010

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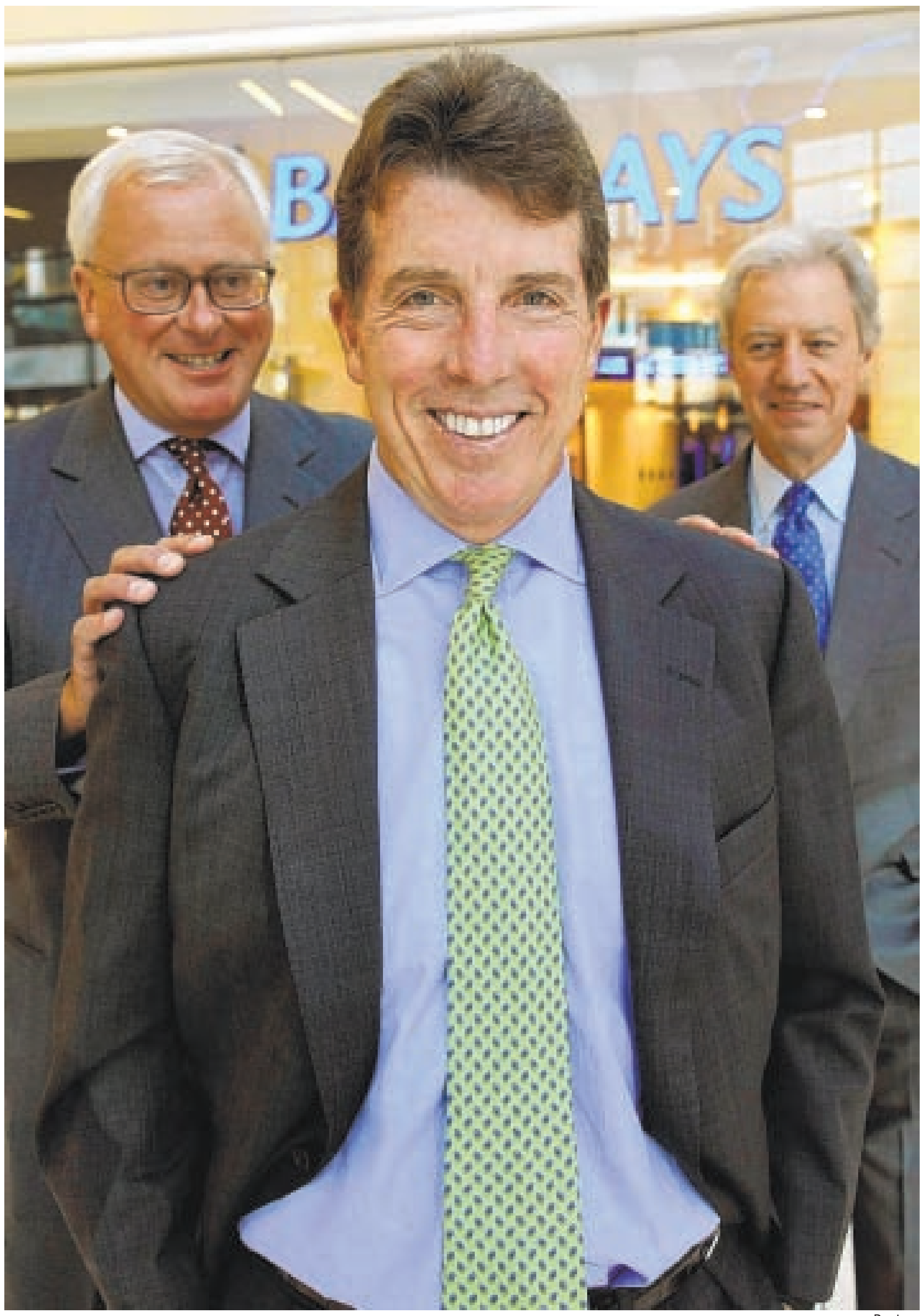
Barclays plays its Diamond hand



Reuters

Barclays PLC President Robert Diamond gets a big hand from current CEO John Varley, left, and Chairman Marcus Agius, after being named as the company's next chief executive officer in London on Tuesday. On a day of moves at the top, HSBC's Stephen Green announced that he was stepping down as chairman to become the U.K.'s new trade minister. **Related articles on pages 4, 5, 36**

Bank worries return, hitting euro, stocks

A new round of hand-wringing about Europe's debt woes sent the euro tumbling, dragged down global stock markets and drove up borrowing costs for a slew of European nations.

By Gregory Zuckerman, Neil Shah and Brian Blackstone

The latest focus of investors' anxiety: questions about the rigor of recently completed stress tests imposed on European banks. The Wall Street Journal on Tuesday reported that the recent tests understated some lenders' holdings of potentially risky government debt.

The flip in sentiment shows the extent of investor jitters about Europe, worries that were put to the side in recent months after the European Union defused the spiraling crisis in Greece. Difficulties in the U.S. economy had seemed more troublesome to many investors of late.

The Stoxx Europe 600 Index closed down 0.5%, while a key index of European banking stocks lost 2.4%. Among the region's biggest lenders, France's **Crédit Agricole** and **Société Générale** lost 2.7% and 3.8%, respectively, while Italy's **UniCredit** slumped 2.4%.

In one of its biggest moves in weeks, the euro dropped 1.2% against the dollar to $1.2719, its lowest level this month, from $1.2875 late Monday. It sank 1.7% against the Japanese yen, which investors scramble to buy in times of trouble.

Fears that Europe's banks are still vulnerable to losses on risky bond investments also sent shivers through Europe's bond markets, especially those in Ireland, Portugal and Greece.

Ireland, which is grappling with an increasingly costly bailout of troubled state-owned lender **Anglo Irish Bank**, was among the biggest casualties. The premium that Ireland has to pay over Germany, considered the euro-zone benchmark, to borrow from investors in the bond market hit its highest level since the euro was created in 1999. The yield premium for Portuguese debt also hit a post-euro record. '

The cost of insuring government debt in Spain, Portugal, and Ireland against the risk of default, using credit default swaps, all jumped in price, suggesting investors are more worried about these countries defaulting on their debts.

To be sure, investors appeared to be differentiating between the relative health of individual countries. The yield premium for Spanish government debt over Germany, for example, didn't react significantly on Tuesday.

"Confidence in Spain has been relatively better," says Cagdas Aksu, European fixed-income strategist at Barclays Capital in London.

That could be a sign that investors aren't fleeing the entire region.

Analysts said a number of factors were fueling fears in Europe, including renewed doubts about Europe's recent stress tests, concerns over how much capital banks in Germany will need to satisfy upcoming bank regulations and an expected flood of new bond sales by European governments. Bond-trading volumes were also limited, which could be exacerbating price movements.

Still, Tuesday's spill suggests that traders' worries are

Please turn to page 25

Pope will meet with abuse victims in U.K.

Pope Benedict XVI plans to meet with victims of clerical abuse during his visit to the U.K., according to a church group helping to arrange the session, but the Vatican faces criticism from victims' supporters about the secrecy surrounding such gatherings.

By Cassell Bryan-Low in London and Stacy Meichtry in Rome

The first papal visit to the U.K. since 1982 comes amid a wave of sex-abuse allegations against the Catholic Church in Ireland and elsewhere in Europe. The matter has shed a spotlight on how the pope, in an earlier post in his native Germany, handled the case of a priest who was a sexual offender.

During his U.K. trip next week, Pope Benedict is expected to talk with as many as 10 individuals in a private meeting, said Bill Kilgallon, chairman of the National Catholic Safeguarding Commission, which sets standards for preventing abuse and dealing with abuse allegations in the Catholic Church of England and Wales.

Mr. Kilgallon, who is helping to arrange the meeting, declined to name the participants or give a location for the gathering. "For the individuals it's a private matter," he said, adding that an intimate setting allows both the victims and the pope to be candid.

Representatives of the Catholic Church in England and at the Vatican wouldn't confirm a meeting, but said that any that does take place would be conducted in private to protect the victims.

The pope's meetings with sexual-abuse victims during recent trips, including to the U.S. and Australia, have at times helped to defuse criticism that he is out of touch with the crisis. Some victims praised an April meeting in Malta and recounted how the pope's eyes welled with tears during their talk.

Other victims criticize the secrecy, saying it mirrors the church's refusal over decades to publicly acknowledge abuse cases.

The church typically shuns victim-advocacy groups that have openly criticized the pope, these victims say. For the meetings, critics say, church officials hand-pick individual victims and ask them not to discuss the meeting publicly before allowing them to speak with the pope.

"Why can't we talk to the pope in public?" said Margaret Kennedy, of Minister and Clergy Sexual Abuse Survivors in the U.K. A more-open encounter would be a public acknowledgment by the Vatican of the abuse, she said, and allow survivors to request measures that the church should take to address these issues.

Mr. Kilgallon said the safeguarding commission approached abuse victims whose

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The Quirk

In short supply: Pinball wizards who can fix old machines. **Page 33**

Editorial & Opinion

Poland is caught in a Russo-German pincer—again. **Page 15**

PAGE TWO

Europe is acting as though it wants to be left behind by new powerhouses

[Agenda]

By Iain Martin

If José Manuel Barroso was hoping to emulate successive presidents of the United States with his first "state of the union" address to the European Parliament on Tuesday, he will have been disappointed. Typically, in Washington, the president is applauded wildly by his supporters, receiving numerous standing ovations at appointed moments. Even his opponents tend to behave politely, in recognition of his status as head of state.

The European Commission president was received mainly in silence by Europe's Parliament. Applause was thin on the ground, and afterward Mr. Barroso was attacked on a number of fronts.

There were complaints that he hadn't objected strongly enough to France's recent deportation of the Roma. A left-wing grouping demanded the banning of hedge funds and the trading of assorted derivatives. The Greens wanted the European Commission to focus more on saving the planet. The leader of the center-rightish EPP also regretted that Mr. Barroso isn't ambitious enough about expanding the reach of the EU, adding that he should explain to nation states and their taxpayers that their money is "better used by the 27 together than by each member state separately."

Very little was heard from MEPs that addressed directly the enormous economic challenge facing a continent steadily being eclipsed by hungry new economic powerhouses.

In contrast, Mr. Barroso's speech was at least hinged on the rather practical question of growth in the European Union, surely the subject that should trump most others in the current climate. "The recovery is gathering pace, albeit unevenly within the Union," he said. "Growth this year will be higher than initially forecast. The unemployment rate, whilst still much too high, has stopped increasing."

Reuters

European Commission President José Manuel Barroso in Strasbourg Tuesday.

Europe needs to recover from the after-effects of several massive multiple economic cardiac arrests.

He deserves credit for attempting to zero in on what really matters. Europe needs to recover from the after-effects of several massive multiple economic cardiac arrests. With the patient fragile, it might be wise to keep the focus on what will aid the recovery process rather than impede it.

But then Mr. Barroso's prescription is something of a jumble. He wants to improve the workings of the common market, which seems reasonable. But he is, along with most of the rest of the Brussels elite, interested primarily in constructing a vast new European-wide system of regulation for the financial industry. There will be three new regulatory bodies, covering banks, insurance companies and securities firms. European finance ministers approved the plan on Tuesday.

They couldn't agree on the details of a financial transactions tax, but it has enough backing to mean that British opposition is unlikely to be enough to stop it, even though London will be hit hardest. If it happens it is unlikely to prove a draw for global investors.

Is Europe interested in competing? It is difficult to avoid the conclusion that it is not.

Away from the world of the European Parliament and the concerns of its members, trade unions were on the march on Tuesday against austerity measures. In France there was a nationwide strike over the government's plans to raise the retirement age to 62 from 60. Workers wanting to claim full entitlements will also have to wait until 67, rather than 65. Commuters in London also faced disruption with an Underground strike held by workers objecting to modernization plans. Much more such action is expected in other parts of Europe.

Some of the old comforts of the continental social model are being withdrawn, and those losing out do not like it much. Yet, if these cuts in entitlements aren't made, where is the money to pay for people to retire at 60 to come from? The opponents of belt-tightening seem to be saying that they want it paid for by higher taxes, which will hit wealth-creation prospects. Or they want it borrowed at a high price from the markets they regard as immoral.

Why do those who want to curb financial markets so much with new regulation and taxes, so often also want to pursue a course of action that makes their governments even more dependent on the same money markets? It doesn't make sense.

But then voters are only rarely confronted by their leaders with the cold, hard reality of what is happening here. Europe is at risk of being left behind unless its various economies become more efficient and its workers work harder for longer.

Mr. Barroso addresses some of this, but not as directly as he might. In that he is typical of the elites that want to skirt around the existential nature of the crisis on the continent. The driving impulse behind the European project, beyond the desire to avoid more war, was that together these states could pack a bigger economic punch than they could apart.

If that's not going to be the case, with the superstructure of the EU so wieldy and its policy-making machinery a barrier to future economic efficiency, then its leaders and citizens have a problem. If the EU is incapable of organizing itself in a way that improves growth prospects, or at least doesn't hinder them, then it is perfectly legitimate to ask what the point of it is.

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Paul Hannon on U.K.'s newly appointed trade minister Stephen Green

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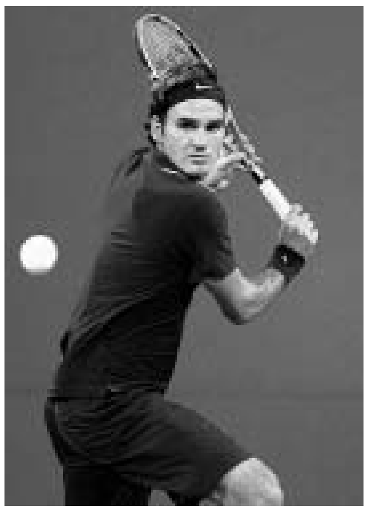

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Question of the day

Vote and discuss: Do you think Barclays was right to promote Robert Diamond Jr. to CEO?

Vote online today at **wsj.com/polls**

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Q: Where will the Dow be by Sept. 30?

10000 or above	55%
Above 9000	33%
Above 8000	6%
Lower than that	6%

What's News

■ **French workers staged** a nationwide one-day strike and rallies to protest a planned rise in the retirement age in a challenge to Sarkozy's economic policy. Hundreds of thousands took part in all major cities. **6, 36**

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

SUBSCRIPTIONS, inquiries and address changes to:
Telephone: +44 (0) 20 3426 1234. Calling time from 8 a.m. to 5 p.m. GMT. E-mail: subs.wsje@dowjones.com. Website: www.services.wsje.com
ADVERTISING SALES worldwide through Dow Jones International. Frankfurt: 49 69 29725 390;
London: 44 203 426 1111; Paris: 331 40 17 17 01.
Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Basinevi.
Registered as a newspaper at the Post Office.

Editeur responsable: Patience Wheatcroft M-17936-2003.
Registered address: Boulevard Brand Whitlock, 87, 1200 Brussels, Belgium

NEWS

At Sochi dinner, an expansive Putin

By Stephen Fidler


RIA-Novosti/Associated Press
Prime Minister Vladimir Putin gestures during a discussion at the Black Sea resort of Sochi, in Russia, on Monday.

SOCHI, Russia—Prime Minister Vladimir Putin invited 50 foreign guests to dinner this week and told them he was conscious of the risk that Russia's autocratic political system could concentrate too much power in one man.

That is why, he said, he and President Dmitry Medvedev—the man he helped elevate to Russia's top job in 2008—were sharing power. Longer term, he said, Russia will need to develop political institutions to broaden decision-making.

Despite his suggestion, delivered near the end of an elaborate dinner Monday, most guests took away the opposite message: power in Russia isn't going to be decentralized soon. And the person it would be centralized on was their host, who many guests felt sent a signal that he plans on returning as president in 2012.

Mr. Putin told his guests, including a reporter from The Wall Street Journal, that Franklin D. Roosevelt was elected president of the U.S. four times in a row, and that didn't damage the U.S. Constitution.

"Neither I nor President Medvedev would do anything to run counter to the federal constitution," he said.

The Russian Constitution would allow Mr. Putin, who stepped down in 2008 after eight years in power, to run for two successive six-year terms until 2024.

Angela Stent, director of the Center for Eurasian, Russian and East European Studies at Georgetown University, said Mr. Putin appeared to be planning a return as head of state. "The impression that came over is that he is not leaving power and that he will likely be president in 2012," she said.

However, Lord Robert Skidelsky, the British historian and economist, said he sensed the opposite: that Mr. Putin's taste for power was waning. "He didn't say anything forward-looking," he said.

This is the seventh time Mr. Putin has submitted himself to questions from an invited group of foreign academics and journalists, an annual exercise rare for the leader of an important state.

The venue this year was a Soviet-era sanatorium built for senior Communist Party officials and converted into a luxurious government guest house in the Black Sea resort of Sochi. Its elegant marble terraces overlook gardens of lawns, palm trees and the sea.

Inside, the 50 or so guests sat down to a five-course meal including Siberian pelmeni, a ravioli-like dish filled with venison, and green shchi soup, with chicken and sorrel. The tables were festooned with glasses for three wines, water and vodka. Mr. Putin, looking relaxed and younger than his 57 years, in an open-necked shirt and beige jacket, ate and sipped wine, which regular attendees said rarely happened in the past.

However, they said, it was a typical Putin performance. Combative when challenged, the prime minister didn't try to engage personally with his audience. He never admitted error, ignorance on any subject, nor the need for Russia to draw on other countries' experience.

"The message was that Russia's modernization doesn't need lessons from Europe, China or anywhere else," said Piotr Dutkiewitch, head of the Center for Governance and Public Policy at Carleton University, Ottawa.

He laced his answers with anecdotes about individual Russians, including the elected mayor who ran away rather than visit a district suffering in the recent fires that didn't vote for him. Democracy, he implied, at least at the local level, throws up some suspect officials.

One device Mr. Putin used repeatedly was to throw back questions to his interrogators. Asked by a British reporter about whether Lenin's tomb should be moved from Red Square before the 2017 centenary of the Russian revolution, he pointed out there were statues of Oliver Cromwell, the 17th-century English Puritan leader who overthrew the monarchy, all over England. "Who do you think was worse: Cromwell or Stalin?"

Why did Russian police need to deal so brutally with street protestors? It was no different, he responded, from the way police in London and Paris handled demonstrators.

Asked why in Russia's autocratic political system most problems landed at his door, he said it was the same in the U.S. with the oil spill in the Gulf of Mexico, where President Barack Obama was expected to step in.

He praised Mr. Obama, in contrast with his tirade against the U.S. president last year, saying the two leaders' common views on problems would provide a basis for better U.S.-Russia relations. And Mr. Putin said several times, sometimes unprompted, that Russia saw no threat in China.

Globalization would trigger, he said, a competition for global leadership—including military competition. But "I don't think this will be between Russia and China. Russia and China will be natural partners in solving many problems," he said.

It was the third time Mr. Putin has invited the group to Sochi, which seems improbably far south to be the site designated for the 2014 Winter Olympics, a project that Mr. Putin himself is leading.

However, construction is evident all over the city, which lies just a few miles away from the disputed Georgian territory of Abkhazia, over which Georgia suffered a defeat to Russian forces in a war in August 2008.

Since then, Russia has recognized Abkhazia's independence and that of the other breakaway Georgian region of South Ossetia, but remains the only country to have done so.

Mr. Putin said the International Court of Justice, which decided in July that Kosovo's 2008 declaration of independence from Serbia was legal, could rule on the independence of the two regions. He talked of "cooperation" between Georgia and the two regions but said: "I don't know what form that cooperation would take."

Robert Legvold of Columbia University said the comments on Georgia were one of the surprises of the session. "He implied that there was a path to restoring Georgian territorial integrity," he said.

Mr. Putin was asked about the development of "Putinism" outside Russia, a reference to the domination of a political system by one individual. "What is Putinism?" he retorted. "Is it good or bad?"

Pope to meet with abuse victims in the U.K.

Continued from first page

cases had been investigated and sent to the authorities. He said those he expects to meet with the pope represent a variety of experiences and backgrounds. The group doesn't include individuals now living in Ireland, a focus of attention on abusive clergy.

The Irish government last year released two reports detailing decades of widespread abuse in schools and other institutions. About 80% of Ireland's population is Catholic, compared with about 10% in Britain.

England also has seen cases of abuse. Cardinal Cormac Murphy-O'Connor, former head of the Catholic Church in England and Wales, faced scrutiny for his decision in the mid-1980s, while in a previous post, to allow a priest accused of abuse to continue working. The priest was convicted on two occasions for sexual assaults on boys—in 1997 by a U.K. crown court and in 2002 by the central criminal court in London, receiving a five-year sentence on each occasion.

Cardinal Murphy-O'Connor wasn't available to comment. He has apologized publicly and instigated reforms on how the church handles abuse allegations.

The pope in recent months has taken steps to address the matter, such as defrocking abusive priests, stepping up Vatican rules for reporting abuse, and accepting the resignation of bishops who decades ago failed to report abuse. The pope doesn't require church officials to report sex abuse to civil authorities.

Some victims remain frustrated. Bernie McDaid, of Boston, was among those who met privately with the pope during his U.S. visit in 2008, but now dismisses the gathering as a Vatican "PR move."

Mr. McDaid says he was contacted by church officials in Boston before the pope's visit and asked not to discuss the meeting with anyone until afterward. Mr. McDaid was flown to Washington and escorted by church officials to the Holy See's embassy for the meeting.


European Pressphoto Agency
Pope Benedict XVI visits Carpineto Romano, south of Rome, on Sunday.

"I put my hand on [the pope's] heart and told him you have a cancer in your flock, and you need to do something about it. And he did nothing," Mr. McDaid said.

Another problem, victims say, is that many people are left out of the meetings. When the pope visited Australia in 2008, Anthony and Christine Foster, the parents of two girls who were abused by the same priest, requested a meeting.

Their request riveted local media because one of their abused daughters had died from a drug overdose.

For days Vatican and church officials declined to comment on whether Pope Benedict planned to meet with victims in Australia.

On the final day of his trip, the pope held a private meeting with four victims whose names weren't disclosed. The Fosters' surviving daughter wasn't among them.

"They claim to feel the pain of victims, but they seem not to want to listen to the victims that have hurt the most," Mr. Foster said.

Barclays: Diamond pick isn't a shift

BY DAVID ENRICH

LONDON—**Barclays** PLC confirmed Tuesday that investment-banking boss Robert E. Diamond Jr. will become the U.K. bank's chief executive next spring, as officials tried to dispel the notion that the move represented a fundamental change for the centuries-old British institution.

Mr. Diamond, a baseball-obsessed American who is the architect of Barclays's rise as a global investment-banking powerhouse, will replace John Varley, a British graduate of Oxford who is a skilled fly-fisherman and hails from Barclays's retail businesses.

The two cut starkly different figures, but they have forged a successful partnership in which Mr. Diamond has enjoyed wide latitude to run the company's investment-banking business as he sees fit. Barclays officials describe Mr. Diamond as a "co-author" of the bank's current strategy, which they said will remain in place.

"While it's a significant moment for the bank ... it's still very much business as usual for us," said Barclays Chairman Marcus Agius. Mr. Diamond added: "There is absolutely no space between John and Marcus and I on the strategic direction of Barclays."

Mr. Diamond has spent virtually his entire career—including 14 years at Barclays—in investment banking and trading and has never run a retail-banking or credit-card business. In a move last November designed to broaden his portfolio, he took charge of Barclays's wealth-management and corporate-banking arms.

His Wall Street pedigree suggests to some observers that he will cement Barclays's current reliance on corporate and investment banking as the company's primary profit engine, which some consider a vulnerability given the volatility of investment banking.

Barclays's elevation of Mr. Diamond is "likely to make even more pronounced what we consider to be its main weakness: too much [corporate and investment bank], too little retail," said Arturo de Frias, a London-based banking analyst at Evolution Securities.

The move also may prove controversial among U.K. political figures. While Barclays has remained profitable during the financial crisis, its emphasis on investment-banking is often attacked by British politicians and policy makers as risky "casino banking." The bank is trying to fend off proposals from some politicians and regulators to require the separation of investment banking and trading activities from bread-and-butter retail banking.

Mr. Diamond already is trying to ease concerns that he marks a departure from Barclays's 300-plus-year history.

He said in an interview that his top priority is to focus on businesses outside his Wall Street-oriented comfort zone: retail and commercial banking, wealth management and credit cards. He is especially intent on expanding Barclays beyond its home turf of the U.K. He wouldn't comment on the bank's appetite for buying a retail bank or credit-card company in the U.S.

"We want to get deeper in the areas we're in now, not broader" by building in new areas or locations, Mr. Diamond said. In the past, "sometimes we were focused more on breadth rather than depth," an apparent nod to the bank's history as an aggressive acquirer.

In the U.K., Mr. Diamond at times has become a political punching bag in part because of his history of lucrative paydays. On Tuesday, Barclays disclosed that Mr. Diamond will earn an annual salary of £1.35 million ($2.01 million) and that he is eligible to collect more than £10 million in additional annual and long-term bonuses, depending on Barclays's performance.

On a conference call with reporters Tuesday morning, Mr. Agius defended Mr. Diamond's expected salary and bonus.

"In designing that package, we took great care to make sure that the proposal was well-benchmarked against the peer group that Bob will be operating against," Mr. Agius said. He added that Barclays relied on advice from outside consultants in setting the parameters.

Barclays executives stressed Tuesday that the CEO change was the product of prudent succession planning and wasn't triggered by any surprise event.

Mr. Varley said he told the board back in 2004 when he became CEO that he viewed the job as a roughly seven-year gig. When Mr. Agius became chairman in January 2007, Mr. Varley privately reiterated that point.

Early this year, Mr. Agius spoke with Mr. Varley and confirmed that he wanted to retire sometime in the spring of 2011. "As we emerge from the crisis strong and independent and confident, it seemed to me a good time to pass on the reins," Mr. Varley said in an interview Tuesday. He said he doesn't have a new job lined up.

The chairman didn't try to dissuade him. "The intensity of the job and its obligations has been awesome," Mr. Agius said. He added that the board was "absolutely respectful" of Mr. Varley's decision to step down.

When Mr. Agius launched a hunt for a successor, Mr. Diamond, who had the title of Barclays president and was passed over for the CEO job in 2004, was the immediate front-runner.

Barclays enlisted executive-search firm Egon Zehnder International to conduct an official search for outside candidates. The firm put out a few feelers to banking executives in the U.S. and Europe. But the process never got far. Directors decided there was no point in inviting prospective CEOs in for interviews when a consensus had jelled around Mr. Diamond, according to people familiar with the matter.

Mr. Agius this summer paid a visit to Hector Sants, the head of the Financial Services Authority, the U.K. regulator that has veto power over senior personnel moves at British banks, these people said. As is standard practice, the FSA summoned Mr. Diamond to an interview at the regulator's Canary Wharf skyscraper, down the street from Barclays's headquarters. Several FSA officials, including Mr. Sants, peppered Mr. Diamond with questions to gauge his credentials for the job.

The FSA approved Mr. Diamond's promotion in the past few days, these people said. Barclays's full board held a conference call Monday to formally approve the change.

—Carrick Mollenkamp contributed to this article.

Bloomberg News

'BUSINESS AS USUAL': Barclays said its strategy won't change with U.S. investment banker Robert Diamond as CEO.

Robert E. Diamond

American investment-banking chief will take over as Barclays CEO. It is a sea change for the venerable British bank, whose roots date to the 1600s. Mr. Diamond's path to the top:

- 1996: Joined precursor to Barclays Capital
- 2005: Joined Barclays PLC board as executive director and president of Barclays PLC
- 2008: Drove purchase of Lehman's North American broker-dealer
- 2009: Reaped $26 million when Barclays sold its wealth-management unit, Barclays Global Investors, to BlackRock Inc.
- 2010 Tapped to succeed John Varley as Barclays CEO

BarCap taps lieutenants from Lehman deal

[Deal Journal]

BY MATT TURNER

When then-Treasury Secretary Hank Paulson called Robert E. Diamond Jr. on Sept. 11, 2008, to suggest Barclays Capital bid for Lehman Brothers, it was Jerry del Missier and Rich Ricci who flanked the unit's American architect on a commercial flight to New York.

Almost exactly two years later, the duo have been named co-chiefs of **Barclays** PLC's investment-banking arm, which was transformed by that deal.

Along with Lehman President Bart McDade, Mr. Ricci, then chief operating officer of Barclays's investment-banking and investment-management businesses, and Mr. del Missier, then president of Barclays Capital, worked through the night on a deal for BarCap to acquire Lehman Brothers North America, the broker-dealer arm of Lehman Brothers, as it became apparent that Lehman would file for bankruptcy.

Within days of the deal being done, Lehman's old headquarters was decked out in BarCap's colors.

Having helped put the deal together, Mr. Ricci was put in charge of the integration of the Lehman units BarCap acquired, based in Lehman's New York headquarters. Mr. del Missier focused on the front-office integration, putting together BarCap's fixed-income U.S. business with Lehman's U.S. operations.

The duo were named co-chief executives of the corporate- and investment-banking business in November 2009 as part of a management rejig, joining Barclays's executive committee.

Mr. Ricci arrived at Barclays in 1994, three years prior to Mr. del Missier, having previously worked at Bank of Boston and Bank of New England. A nuts-and-bolts man, he became chief operating officer of Barclays Global Investors in 2000 and a member of the BGI executive committee two years later.

In January 2005, he was named chief operating officer of Barclays's investment-banking and investment-management businesses, comprising Barclays Capital, Barclays Wealth and BGI.

Canadian-born Mr. del Missier joined Barclays in 1997 from Bankers Trust in London, having been a senior managing director responsible for the European derivatives-product business. He had started his career at Bank of Nova Scotia, before moving to Bankers Trust in Toronto, where he ran the Canadian dollar interest-rate-derivatives business.

Based in New York, Mr. del Missier is responsible for the firm's global markets businesses, encompassing the trading, sales and research functions.

—More at efinancialnews.com

Bloomberg News

Jerry del Missier, shown in 2008, has been named co-CEO of BarCap.

Investment bankers win in jobs race

[Analysis]

By William Wright

The elevation of Barclays Capital's Robert E. Diamond Jr. to chief executive at **Barclays** PLC, and the departure of **HSBC Holdings** PLC's chairman Stephen Green, raises a possibility that investment bankers are heading for a clean sweep of running the biggest U.K. and European banks.

Mr. Diamond adds to a list of investment bankers who have been given bigger roles despite the financial crisis. Stephen Hester, chief executive at **Royal Bank of Scotland Group** PLC, is the former co-head of investment banking at **Credit Suisse Group** AG's investment-banking unit. **Lloyds Banking Group** PLC is chaired by Sir Win Bischoff, a former banker with Schroders.

In continental Europe, **Deutsche Bank** AG has been run by an investment banker—Josef Ackermann—for eight years. **UBS** AG brought former bond trader Oswald Grübel out of retirement last year to rescue the Swiss bank, while **Credit Suisse Group** AG is run by Brady Dougan, who revived its investment bank between 2004 and 2007.

At HSBC, the departure of Mr. Green (who ran the group's investment bank for five years) opens the door to another investment banker taking the job. There are at least three strong internal candidates. Two are investment bankers.

The über-connected Sir Simon Robertson, the group's senior non-executive director, used to run Kleinwort Benson before moving to **Goldman Sachs Group** Inc. John Thornton, the former co-No. 2 and president at Goldman Sachs, is chairman of its U.S. business. Mr. Thornton has excellent connections in China—HSBC's most strategic market. The third candidate is Michael Geoghegan, chief executive of HSBC, who moved to Hong Kong to reflect the eastward shift in HSBC's business. With youth on his side, Mr. Geoghegan is in pole position.

This would leave a vacancy for the role of CEO. There are two obvious internal choices.

Sandy Flockhart ran the group's successful Asian business between 2007 and this year, when he became chairman of personal and commercial banking and insurance. The only obvious internal challenger is Stuart Gulliver. He heads the banking and markets business, plus private banking. In the first half of this year, banking and markets produced 51% of pretax profits.

This scenario— Mr. Geoghegan moves upstairs and Mr. Gulliver is promoted—would mean that three of the big four U.K. banks would be run by investment bankers. Two would have former investment bankers as chairmen.

After the financial crisis, triggered in part by the excesses of the investment-banking industry, this is probably not what regulators had in mind.

—More at efinancialnews.com

Chairman's exit jolts HSBC

By Sara Schaefer Muñoz

European Pressphoto Agency

HSBC Chairman Stephen Green leaves No. 10 Downing St. in London on Tuesday after agreeing to become trade minister.

LONDON—The sudden departure of **HSBC Holdings** PLC Chairman Stephen Green for the post of U.K. trade minister has touched off a scramble to find his replacement that could significantly reshape the bank's senior management team.

HSBC announced Tuesday that Mr. Green, 61, would step down as chairman by the end of the year to take the position of U.K. trade minister in the new coalition government led by Prime Minister David Cameron. The bank said it has been working with external advisers to find a successor by the end of the year, but people familiar with the matter said Mr. Green had been expected to stay until at least the spring of 2011. He has held the role of chairman since 2006.

The departure of Mr. Green, a prominent figure in London's financial community who had worked closely with the government on various regulatory issues, is likely to renew questions about whether HSBC will move its headquarters back to Hong Kong, where it was based until 1993.

The bank has been beefing up its presence in China in recent years to gain access to the lucrative Chinese market, and senior executives recently said that, if U.K. bank regulation became too onerous, it would consider the move.

The board could choose among several options for Mr. Green's successor. In one scenario, HSBC Chief Executive Michael Geoghegan, 56, who has logged more than 35 years at HSBC, would be promoted to chairman. Mr. Geoghegan has held a number of roles around the world and recently moved to Hong Kong as a way to emphasize the bank's Asia focus.

However, a hurdle to Mr. Geoghegan getting the chairmanship is his current position as CEO. In the U.K., tapping an executive director for the role of chairman is seen as poor corporate governance and could antagonize bank regulators and politicians, damaging the image of responsible management that HSBC has been eager to project. HSBC didn't receive capital from the U.K. during the banking crisis, and Mr. Green has been vocal in promoting prudent corporate behavior.

The other path to choosing a successor would involve plucking an HSBC nonexecutive director for the job. People familiar with the matter say a leading candidate is John Thornton, who is a former president of Goldman Sachs Group, an HSBC board member and nonexecutive chairman of HSBC North America. But given HSBC's quest to distance itself from the excesses of investment banks, his association with Goldman could be a strike against his appointment, one of the people familiar with the bank said.

Other possible candidates could include nonexecutive directors Simon Robertson, 69, and Rona Fairhead, 48, the current chief executive of **Pearson** PLC's Financial Times Group and head of the HSBC board's audit committee.

An outside candidate also hasn't been ruled out, according to people close to the bank.

An HSBC spokesman said members of the bank's board declined to comment on their possible candidacies.

—Ainsley Thomson and Monica Langley contributed to this article.

Filling Green's shoes | Possible candidates for HSBC chairmanship

Michael Geoghegan	Simon Robertson	John Thornton	Rona Fairhead
Current CEO	Non-executive director of HSBC Holdings and former chairman of Kleinwort Benson	Non-executive director of HSBC North America and a former President of Goldman Sachs	CEO of the Financial Times Group and non-exec director on HSBC holdings, head of audit committee

Photos: Bloomberg News, Agence France-Presse/Getty Images, Bloomberg News, Newscast

Facing the U.K.'s problems with exports

[The Source]

By Paul Hannon

The U.K. has a problem. Despite a big depreciation in the pound over the past two years that should have made British-manufactured goods cheaper for foreign buyers, its exports haven't risen rapidly, and don't appear likely to offer an alternative source of growth to the debt-fueled consumer- and public-spending booms of the last decade. The poor performance of U.K. exporters has puzzled and disappointed successive governments, and the Bank of England.

There is an emerging consensus that the U.K. sells to the wrong places, the slow-growing developed economies that are its closest neighbors. The U.K. needs to re-establish strong trading links with much faster growing developing economies in Asia, Latin America, and Africa. In 2009, the U.K. exported twice as much to Ireland than to India and China combined.

For Prime Minister David Cameron's government, boosting exports and winning investment are central to its promise to entrench the recovery and build a more balanced, sustainable economy. Which is where Stephen Green comes in. In naming the chairman of **HSBC** to be its new trade minister, the coalition government has borrowed a move from its predecessor's play book.

Like Mervyn Davies, who was chairman of Standard Chartered when he was made trade minister, Mr. Green leads a bank that has a major presence in many of the most significant developing economies. The question is, can Mr. Green make a big difference?

The U.K.'s problem isn't that it doesn't understand the global economy, it's that it doesn't make the kinds of things that fast-growing developing economies want to buy. Mr. Green may be able to open doors, but he won't be able to re-engineer the U.K.'s manufacturing sector.

Just don't expect any miracles.

—More at blogs.wsj.com/source

French unions protest overhaul of pension age

BY DAVID GAUTHIER-VILLARS

PARIS—French workers staged a nationwide one-day strike and rallies Tuesday to protest a planned rise in the retirement age in a challenge to President Nicolas Sarkozy's economic policy.

Hundreds of thousands of workers, including train drivers, teachers, firemen and some private-sector employees, took part in walkouts in all major cities. The Paris metro and other transport services operated reduced schedules. More than two million people took part in demonstrations, according to the unions, but police put the figure at about one million.

Unions were planning to meet Wednesday to discuss further action. A further one-day strike was seen as likely, but analysts say this wouldn't be enough to derail Mr. Sarkozy's plan. An indefinite strike would threaten the president, but union members appear not to be willing to sacrifice their wages over an extended period.

The pension proposal is a crucial test for Mr. Sarkozy. Past attempts to amend France's generous welfare system have led to extended mass protests and forced governments to back down. The move comes less than two years before the next presidential election and at a sensitive time for Mr. Sarkozy, who is currently under pressure from accusations of irregularities in the financing of his 2007 presidential campaign. And, despite his promise to put France back to work, unemployment remains high and economic growth low.

Reuters

Workers carry a mask of Sarkozy as they demonstrate over pension reforms in Lille in northern France on Tuesday.

Mr. Sarkozy is focusing on the state-run pension system as the French live longer and so spend more time drawing pensions. The system's shortfall could reach €32 billion ($41.2 billion) this year, including €15 billion for retired civil servants, according to a council advising the government. Without changes, the annual deficit could exceed €45 billion by 2020, the council said. Mr. Sarkozy has said increasing the retirement age to 62 years from the current level of 60 would help to reduce the shortfall.

But unions are unlikely to relent on the standard retirement age of 60, adopted in 1983. They say it represented a major social victory, on a par with universal health insurance and paid annual vacations.

Unions say that the distribution of wealth between corporate profits and salaries has tipped in favor of profits in recent years, and so it is time to increase payroll and other corporate taxes.

"Demography is a bad argument," said Jean-Claude Mailly, 57 years old, general secretary of the Force Ouvrière. "What's needed is to divide differently between corporations and citizens."

Mr. Sarkozy has ruled out tax increases, saying France already has some of the highest payroll and corporate taxes in the industrialized world.

The strike was timed to coincide with the start of a parliamentary debate on the retirement plan on Tuesday. Mr. Sarkozy's ruling Union pour un Mouvement Populaire party holds a majority, and could approve the pension bill as soon as October.

But Mr. Sarkozy's calculations have recently been disrupted by controversy surrounding his labor minister, Eric Woerth, who is in charge of channeling the pension bill through parliament.

Due to Mr. Woerth's relations with Liliane Bettencourt, heiress to the L'Oréal SA cosmetics empire, he has been cited in preliminary judicial probes into alleged illegal political financing and conflicts of interest. That has fueled public outcry over Mr. Sarkozy's alleged favoring of "les riches," or the wealthy.

Mr. Woerth has said that he collected only legal political donations and has denied any conflict of interest. Mr. Sarkozy has said that talk of illegal campaign financing was an attempt to tarnish his reputation.

—Sebastian Moffett contributed to this article.

Reaction to austerity pain challenges Europe's resolve

[Analysis]

BY TERENCE ROTH

Strikes and other protest actions that now have spread from Greece to Europe's big economies cast a cloud over EU reforms and economic recovery.

Scenes from France and the U.K. this week are confirmation that the political elite haven't sold workers and households on the austerity thing. Brussels and national leaders are nobly pursuing fiscal rehab, but their electorates aren't going down without a fight. That's dangerous, with financial markets and ratings agencies never blinking when looking for signs of weakening on deficit-reduction programs.

France could become the toughest test. Say what you will about a retirement age at a generous 60 years. French workers are now told they need to work another two, *and* pay higher taxes during their working lives for good measure. U.S. workers would shake their heads in disbelief at retiring at that age with full benefits. But they aren't in Lyons and haven't paid into a generous system for others that now looks more elusive for them.

Expect similar actions elsewhere in Europe as the austerity programs decided in the spring begin turning into law after the summer break.

The earliest end game will come in Greece. The Greek treasury now is paying nearly 12% interest on its 10-year bonds, an unsustainable rate that is 9.6 percentage points more than the Germans pay. Governments in the rest of Europe, tempted to lower the steam with a few concessions, need only take a trip to Athens.

U.S. Treasury blacklists German bank

By Peter Fritsch
And David Crawford

WASHINGTON—The U.S. Treasury added German-based **European-Iranian Trade Bank** AG to its key blacklist Tuesday, saying the bank has provided a financial lifeline to Iranian companies involved in weapons proliferation.

The move bans the Hamburg-based bank—known as EIH Bank for its German initials—from the U.S. financial system. The Wall Street Journal reported in July that Tehran was increasingly reliant on EIH to conduct business on behalf of the regime's blacklisted companies.

In recent years, larger European banks have been unwinding their business ties with Iran under pressure from U.S. officials eager to frustrate Iran's ability to do business in support of its controversial nuclear and weapons programs.

"As one of Iran's few remaining access points to the European financial system, EIH has facilitated a tremendous volume of transactions for Iranian banks previously [blacklisted] for proliferation" said Stuart Levey, the Treasury's top counter-terrorism official.

EIH, which is owned by the Iranian government but licensed as a German bank, becomes the 17th financial institution blacklisted by the U.S. for supporting weapons proliferation or international terrorism.

EIH is also the first financial institution designated a supporter of Iran's allegedly illicit activities since the July passage of a sweeping U.S. sanctions law that allows the Treasury to impose sanctions also on banks that do business with entities, such as EIH, named on its so-called Specially Designated Nationals list.

The Treasury said EIH has handled "billions of dollars" of transactions for Iranian banks and provides financial services to Iranian entities already blacklisted by the U.S. for allegedly supporting proliferation. They include: **Bank Mellat**; **Persia International Bank**; the **Export Development Bank of Iran**; and **Post Bank of Iran**.

U.S. officials cited four examples between 2007 and 2009 in which EIH allegedly facilitated business for Iranian missile and weapons companies, including **Iran Electronics Industries**. In one six-month period beginning in late 2007, Treasury said, EIH and Bank Mellat helped Iran's missile program purchase more than $3 million of material.

The U.S. has accused Bank Mellat of supporting Iran's Atomic Energy Organization, which reports directly to Iranian President Mahmoud Ahmadinejad and is responsible for developing the country's nuclear capabilities. Iran says it wants nuclear power for peaceful purposes—a claim disputed by the U.S. and its allies.

A spokeswoman for EIH declined to comment. A spokesman for the Bundesbank, which oversees banks in Germany, declined to comment. A German foreign-ministry spokesman said the U.S. informed its German counterparts about the Treasury action in advance.

The foreign-ministry spokesman said EIH has been placed under "stringent controls" by the German banking-oversight agency, pending a review of imposed sanctions. As part of this, "all information relevant to the listing of corporations will be collected and evaluated," the foreign-ministry spokesman said.

In blacklisting companies or individuals, Germany takes its cue from the United Nations Security Council, which hasn't designated EIH a supporter of Iranian proliferation. The U.S. blacklist is far more extensive. Critics of the global sanctions regime say the lack of harmonization among U.N., EU and U.S. sanctions allows Tehran to exploit the differences and continue to finance its nuclear ambitions.

■ South Korea to target Iranian bank branch 12

EU divided on bank tax

By Charles Forelle

BRUSSELS—European Union finance ministers remained divided after a debate Tuesday on a bloc-wide bank levy and a fresh tax on financial transactions, indicating that neither measure is likely to materialize in coming months.

The bank levy was put forward as a key piece of postcrisis market reform. As envisaged by the European Commission, the bloc's executive arm, the proceeds from a tax would flow to dedicated resolution funds that could be used to wind down troubled banks in a future crisis, preventing taxpayers from bearing the direct costs of rescue measures—as they do now.

But finance ministers gave the proposal a cool reception—pushing back principally against the notion that the monies raised should be put aside for later use. The resistance reflects a simple reality: In a time of strained government budgets, a pot of money collected from banks is simply too tempting not to touch.

"We're very clear that it is up to national governments and parliaments to decide what should happen to those revenues," George Osborne, the U.K. chancellor of the exchequer, said after the meeting. The U.K. and others "did not support proposals for a European resolution fund," he said.

The U.K., France and Germany all plan to impose a bank levy, but of them only Germany has pledged the revenues to a resolution fund. French Finance Minister Christine Lagarde reiterated Tuesday that France intends bank-tax revenue to go to the general budget.

The commission plans to propose bank-levy legislation next year.

There was even less agreement on a tax on financial transactions. Ministers tussled over how such a tax would be assessed, what it would fund and whether it would be prudent to implement if the world's other financial centers—particularly the U.S.—don't go along.

Support appeared slim. Anders Borg, Sweden's finance minister, said his country was opposed. "The banking levy is more suitable as it will give us revenues to deal with a future crisis," Mr. Borg said. Sweden tried a tax on purchases and sales of securities in the mid-1980s, but abandoned it in 1991 after watching its trading activity flood offshore to London. Sweden has had a bank levy, dedicated to a financial-stability fund, since 2008.

ZUMA Press

German Finance Minister Wolfgang Schauble, left, speaks with President of the European Central Bank Jean-Claude Trichet on Tuesday at the EU headquarters.

Mr. Osborne also opposed the measure. "It is very difficult to see in practice how you could make a transaction tax operate," he said.

The tax is backed principally by France. Ms. Lagarde said the idea remained "technically feasible, practically difficult, politically desirable and financially unpredictable," but she urged the commission to keep working on it.

Also Tuesday, the countries took a modest step toward closer coordination of their national budgets, pledging to begin a cycle of peer "monitoring" in 2011. Reining in the bloc's fiscal ne'er-do-wells has been a priority since the spring. Greece's years of overspending were the proximate cause of the euro-zone meltdown that necessitated €860 billion ($1.12 trillion) in bailout pledges.

Such coordination is easier said than done, however, since countries are wary of any steps that cede control of national finances to a central authority in Brussels. It doesn't help that nearly all of them, at one point or another, have violated the bloc's rules on debt or deficit levels.

Still, the agreement reached Tuesday pledges the 27 countries to "review their medium-term budgetary strategies" each April and to receive "policy advice" from the assembly of EU ministers in June and July—before the next year's budgets are completed. (The calendar is modified for the U.K., which has a different fiscal year.) The agreement doesn't go so far as to give countries an up-or-down vote on one another's budgets.

The deal came out of a task force headed by EU President Herman Van Rompuy. Mr. Van Rompuy is expected to make additional proposals later this month that would touch on more controversial topics, such as how budget scofflaws should be sanctioned.

—Matthew Dalton contributed to this article.

Turkey's divisive referendum is headed for a vote

By Joe Parkinson

ISTANBUL—Turkey's tightly contested referendum on constitutional reform Sunday will be a test of support for a government eager to secure a third term and to push changes that strengthen its case for European Union membership.

The reform package, sponsored by Prime Minister Recep Tayyip Erdogan's AK party, focuses on restructuring the judiciary and curbing the power of the military, which has deposed four governments since 1960. The country's constitution was drafted in the wake of one such coup 30 years ago.

Many of the 26 proposed amendments to the constitution—such as protection of privacy and personal information, and collective bargaining for civil servants—aren't controversial, but the package has been the subject of intense and increasingly hostile debate here. Mr. Erdogan says the reforms are necessary to bring Turkey closer in line with the European Union, while opposition parties charge that the moves to give parliament control over top judicial appointments are a smoke screen for undermining Turkey's secular state.

Polls point to no clear victor, underlining the divisiveness of the amendments. One survey published by pollster A&G Research Monday gave Mr. Erdogan and his party an edge of just one percentage point, with 10% of voters still undecided.

Analysts warn that investors have underestimated the impact of the vote. A narrow margin of victory or a defeat could unnerve the government ahead of national elections due next summer and raise the prospect of a spending spree to secure votes.

"Opinion polls of the past few weeks show one thing: Although support for a 'yes' still seems to prevail, the margin in favor has become tighter over time. ... The call is going to be very close," said Simon Quijano-Evans, head of emerging-market strategy at Crédit Agricole Cheuvreux SA in Vienna.

Morgan Stanley economists on Monday told clients to hedge their positions, noting that many investors, especially nonresident ones, have been "assuming a comfortable margin of support."

Merrill Lynch & Co. said the referendum looks like "a toss-up."

Doubts about the government's commitment to fiscal discipline have escalated following last month's decision to suspend plans for legislation limiting the budget deficit.

Mr. Erdogan's government in recent years won plaudits for its prudent fiscal management, and the Turkish economy is enjoying a rapid recovery, expected to grow 6% this year.

But economists note that the AK party loosened purse strings during election campaigns in 2007 and 2009. Ratings agencies are warning Turkey's government that a more expansive fiscal policy would lead to bigger budget and current-account deficits.

Senior government ministers, meanwhile, say a rejection of the referendum reforms would deal a blow to the Turkish economy. Deputy Prime Minister and Economy Minister Ali Babacan told a delegation of young business leaders Thursday that Turkey would suffer "traumatic consequences" if investors doubted the country's economic stability.

The Turkish army most recently deposed a predecessor to Mr. Erdogan in 1997, when it forced Necmettin Erbakan's Islamist-led coalition government to resign.

Today, dozens of military officers are under investigation over an alleged 2003 plot to overthrow the current prime minister.

The EU on Tuesday reiterated its support for Ankara's attempt to reorganize the judiciary, but accused the government of failing to conduct a broad public debate on planned constitutional reforms.

Back to school with new rules

By Stephanie Banchero

CHICAGO—When Marshall High School opened for the new school year Tuesday, it had an almost entirely new teaching staff, a revamped curriculum and a $2 million infusion of federal money.

The students and teachers at Marshall—a hulking three-story building on the city's violent West Side known as much for its powerhouse basketball teams as its abysmal test scores—are among millions across the U.S. who will see changes this fall as part of President Barack Obama's push to overhaul public schools.

U.S. Secretary of Education Arne Duncan has used much of his $100 billion budget—almost twice what his recent predecessors had—to lure states into reshaping schools through programs such as Race to the Top and school transformations like the one Marshall is undergoing.

"Mainly, this is a year to lay a foundation for the long-term reforms that will get all students college-ready," said Gene Wilhoit, executive director of the Council of Chief State School Officers, a nonpartisan group of state school chiefs.

Race to the Top, the $4.35 billion competitive grant program at the heart of Mr. Duncan's effort, prodded 11 states to tie teacher pay to student performance, nearly 40 to adopt rigorous common standards in reading and math, and at least another dozen to vow to fix failing schools. Only 11 states and the District of Columbia won money, but new laws in many other states are, nevertheless, taking effect.

Only 11 states and the District of Columbia won money in the Race to the Top program, but new laws in many other states are, nevertheless, taking effect.

As a result, hundreds of school districts and local teacher unions will renegotiate contracts to link teacher evaluations to student achievement. Lesson plans will be rewritten to comply with new standards.

The nation's largest teachers' unions have been skeptical of Mr. Duncan's policies, especially merit pay for teachers and the mass firing of staff at low-performing schools. Some districts have shunned federal money rather than agree to changes that come with it.

Randi Weingarten, president of the American Federation of Teachers, the nation's second-largest teachers' union, said her group didn't support all Mr. Duncan's policies but agreed that academic standards needed to be raised and teacher evaluations overhauled.

"All of these reforms take a huge amount of work to implement and teachers must be supported—instead of demonized—if we want to see any positive changes come from them," she said.

As part of the overhaul at Marshall, where fewer than 3% of students passed the state achievement exams last school year, compared with 59% statewide, the district hired a new principal and replaced nearly 80% of the staff, angering the teachers' union. It added a stricter discipline policy and a literacy program aimed to help students reading below a sixth-grade level—nearly one-third of its students fall into that category. It also hired more social workers.

Daniel Shea for The Wall Street Journal

Marshall High School's new Principal Kenyatta Stansberry, left, speaks to a parent and student. The Chicago school is undergoing an overhaul.

Spurred by Race to the Top, Ohio plans to build a robust database this year that will enable the state to follow students' academic performance from first grade through college. Michigan will open new online schools for high-school students.

State officials in Tennessee created a department to guide school districts as they spend Race to the Top money on training for principals, reading coaches and stronger science and math programs.

"There is an enormous sense of urgency around making sure that our $500 million hasn't gone to waste," said Amanda Maynord Anderson, spokeswoman for the state's education department.

The U.S. has experimented before with large-scale education overhauls, including No Child Left Behind, with limited success.

"Reforms always look good before they are implemented," said Diane Ravitch, a former assistant secretary of education. "I think it is going to be a messy year and low-income and minority children will lose out because we are experimenting on them."

Mr. Duncan said he believed the current overhauls would take hold because state and local education leaders were invested in them, having passed state education reforms. "I could not be more pleased, proud, amazed at the courage and leadership of our state officials," he said in a conference call with reporters last week.

Mr. Duncan doled out $330 million to 44 states to create new standardized math and reading exams and replace the current multiple-choice bubble tests. The states, working together in two groups, are expected to create the exams this year for a 2014 roll out.

Overhauling broken schools is one of the nation's most difficult education puzzles. Few districts have cracked the code and none have done so on a large scale. Chicago's Marshall, for example, already has undergone one failed district makeover. Its next attempt will come through Mr. Duncan's $3.5 billion effort to transform 5,000 low-performing schools.

To get some of the federal dollars, Mr. Duncan insisted that districts take aggressive steps, such as firing principals or eliminating teachers. Chicago Public Schools won about $20 million over three years to revamp four campuses, including Marshall.

The 117-year-old high school has been a source of pride and embarrassment. Its basketball teams have won nearly a dozen women's and men's state titles and produced professional women's all-star player Cappie Pondexter. The school's team was featured in the documentary film, "Hoop Dreams." But Marshall students have a greater than 50% dropout rate and the school has been plagued by violence.

Some challenges were evident last week during school registration. Principal Kenyatta Stansberry, 38 years old, roamed halls lined with freshly painted lockers, welcoming students back. A long line of parents, summoned there by Ms. Stansberry, sat outside the school's main office waiting to talk about their low-achieving or disruptive children.

When one student disobeyed a security guard, Ms. Stansberry marched down the hall shaking her head and wagging her finger. As the young man tried to walk away, she led him by a shoulder into an empty classroom.

"You either roll like we roll or you got to go," she told the boy. "We have a new program here and we won't disrespect you and you won't disrespect us." The boy shrugged and walked away.

"This is not easy," said Ms. Stansberry, who came to Marshall after leading a turnaround at another Chicago high school. "But we've got the right teachers in place to create a culture of high expectations."

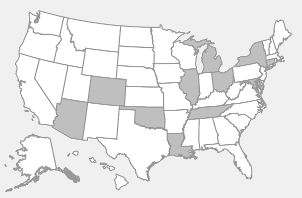
Paquita Johnson, a Marshall senior who maintains a B average, said she was nervous about the new teachers and tougher standards. But she welcomed the challenge. "People ignored us for so long because they think we aren't smart enough to go to college," said Ms. Johnson, who hoped to major in psychology at the University of Central Florida. "It's like someone finally cares."

Fresh starts

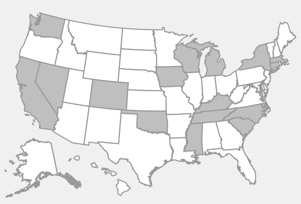
Some state changes spurred by Race to the Top

Expand the number of charter schools allowed

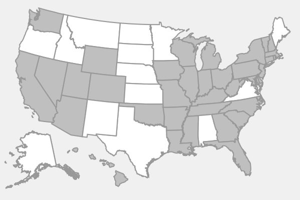
Require student achievement data be used in teacher reviews



Allow districts to overhaul low-achieving schools, including firing teachers and principals



Adopt a common set of math and reading standards for students



Source: U.S. Department of Education

Tax break? Not this one

[Washington Wire]

By Deborah Solomon and Peter Wallsten

The Obama administration has targeted small business with laser-like focus, pushing a $30 billion small-business lending fund in Congress and now rolling out a tax break allowing businesses to deduct 100% of qualified capital investments.

But the chief economist at the National Federation of Independent Businesses said Tuesday that small business didn't need more tax relief. Instead, he said, Washington should aim its firepower at consumers so they begin spending money and creating demand for the products and services small companies provide.

"If you give a small-business guy $20,000 he'll say, 'I could buy a new delivery truck but I have nobody to deliver to,' " said William Dunkelberg, chief economist for NFIB.

Rather than aim more tax relief at business, Mr. Dunkelberg said, Washington should extend the temporary tax cuts passed under the George W. Bush administration for everyone—including those making above $250,000.

"History shows that letting Washington have the money and spend it is very ineffective," he said.

The administration's latest idea, which would allow businesses to temporarily deduct 100% of qualified capital investments, can help "on the margin," Mr. Dunkelberg said. With capital spending by small business at a 35-year low, some firms will take advantage of a temporary tax incentive to replace equipment.

But Mr. Dunkelberg said he thought most small businesses would hold on to their cash until more certain economic times.

Reid's unlikely friends

Senate Majority Leader Harry Reid is one of the country's most unpopular Democrats. He is also widely disliked in his home state of Nevada. But as he revs up his expansive, and expensive, political machinery to try to win re-election against a powerful anti-incumbent wave, Mr. Reid is leveraging his leadership power to win support from unlikely quarters—the Republican Party.

Rusty Tybo, Republican mayor of tiny Wells, Nev., said he was backing Mr. Reid because the senator helped his town secure $680,000 in grants to rebuild from an earthquake two years ago that left the downtown in ruins.

Frank Fahrenkopf, a Reagan-era Republican National Committee chairman, said that his current post as head of the American Gaming Association, whose biggest members are Las Vegas casinos, made it a "no-brainer" to back Mr. Reid.

"My job is to protect the interest of my industry and the state of Nevada," he said. "Do I want to do that with the majority leader or a freshman Republican?"

—More at washwire.com

U.S. NEWS

Petraeus sees gains amid violence

By Julian E. Barnes
And Matthew Rosenberg

KABUL—Gen. David Petraeus, anticipating sustained violence in Afghanistan in the coming months, said in an interview he wants to overhaul how the U.S. measures progress there in the months leading to a crucial Obama administration review of Afghan strategy in December.

Unlike traditional wars in which progress is measured by territory taken and the number of enemy killed, the counterinsurgency campaign being waged by North Atlantic Treaty Organization forces in Afghanistan is focused on lessening violence and restoring confidence in President Hamid Karzai's government.

Such progress is harder to quantify. That leaves Gen. Petraeus, who took over in July as commander of U.S. and allied forces in Afghanistan, in a predicament: Levels of violence, one of the few clear measures of progress, are likely to remain high until the Afghan fighting season concludes toward the end of the year. But he faces a review by the Obama administration of Afghan strategy in December.

Gen. Petraeus talked extensively about his work over the last two months to get a "feel" for the security situation in Afghanistan. He drew comparisons between the current situation in Afghanistan and the situation in Iraq a few months after the 2007 surge began there, before violence began to decline.

The surge forces ordered last year to Afghanistan by U.S. President Barack Obama are now in place. The current strategy, Gen. Petraeus said, revolves around expanding what he calls "security bubbles."

The process has been under way since February, with allied and Afghan offensives in the southern provinces of Helmand and Kandahar, the Taliban's birthplace. The operations in Kandahar are set to intensify in coming weeks with the end of the Muslim holy month of Ramadan.

The security-bubble idea is to create a continuous safe zone in the most populous areas of the south, where the Taliban are strongest, and push violence to rural areas on the fringes. Similar efforts are playing out in northern and eastern Afghanistan, although on a smaller scale.

Once safe zones are established, Gen. Petraeus plans to thin out international forces. Some will be pushed to other hot spots while others can leave in what Mr. Obama has said would be a drawdown of U.S. forces beginning next summer.

At the same time, Gen. Petraeus is trying to thicken forces in trouble spots, especially by using Afghanistan's growing army and police.

Gen. Petraeus attributed the rise in violence seen in the past two years in Afghanistan in part to the massive spike in allied forces. There are now over 95,000 U.S. troops in Afghanistan, fighting alongside an Afghan army that currently numbers more than 136,000 soldiers and growing.

"I can trace the line of the violence, right along the security bubble," Gen. Petraeus said. "When we have an operation going on, people shoot back from their sanctuaries and safe havens."

The data on violence include some measures that indicate a slowly improving security situation, he said.

Insurgents' use of improvised explosive devices, or IEDs, their single deadliest tactic, has generally flattened in the past year, he said.

Shootings, meanwhile, are up, he said. But those incidents tend be less deadly than IED attacks.

Gen. Petraeus compared the situation with what he saw in the months after he took command in Iraq in 2007. By June of that year, even with violence at highs, Gen. Petraeus said he began to see indicators that the surge was beginning to work.

The command in Iraq noticed sectarian violence declining, even as overall violence remained high. They also noticed the number of car bombings fall, as troops began to take apart the networks supplying those bombs.

"Way before I told people, I could sense that things were changing," Gen. Petraeus said. "There were some metrics supported that, others did not. The violence kept going up."

In Afghanistan, the networks that place and plant IEDs are also under pressure, Gen. Petraeus said, pointing to recent interdictions of bombing supplies and the increased tempo of Special Operations Forces raids that have killed or captured scores of midlevel Taliban commanders.

But he said it was still to early conclude those factors were the sole reasons the number of IED attacks had flattened.

Despite his frequent references to Iraq, Gen. Petraeus noted critical differences between the sectarian fight there and the war in Afghanistan. In Afghanistan, the war is against an insurgency drawn almost entirely from Pashtuns, the country's largest and traditionally dominant ethnic group.

Unlike Iraq, where the surge saw sectarian violence decline, the surge in Afghanistan comes at a time of increasing tension between the Pashtuns and the smaller Tajik, Uzbek and Hazara ethnic groups. The growing disenchantment among non-Pashtuns is being driven in large part by the efforts of President Karzai, a Pashtun, to strike up peace talks with the Taliban, say leaders of those ethnic groups.

For now, those tensions haven't resulted in ethnic strife, and the focus of coalition forces remains on expanding their security bubbles.

Before being named the top commander, Gen. Petraeus had never served in Afghanistan. He remains much more of an expert on Iraq. But on his trips around the country, Gen. Petraeus said he is working to get a more "granular" feel for Afghanistan, at the same time as he makes sure his commanders understand the nuances of his strategy.

On Monday at a Marine Corps base in Delaram, in the southwestern province of Nimroz, Gen. Petraeus quizzed commanders on the precise location of their forces, asking questions about the strength of Taliban forces, and areas where residents have returned to their homes.

Reuters

Agence France-Presse/Getty Images

Gen. Petraeus, left, in Kabul, says has been working to get a more 'granular' feel for Afghanistan. A U.S. soldier patrols in Kandahar, above.

Lawsuit seeks to halt suspicionless searches

By Chad Bray

NEW YORK—The U.S. Department of Homeland Security has been sued over its policies that allegedly authorize the search and seizure of laptops, cellphones and other electronic devices without a reasonable suspicion of wrongdoing, the American Civil Liberties Union said Tuesday.

The ACLU claims the policies place no limit on how long Homeland Security can keep a traveler's devices or on the scope of private information that can be searched, copied or detained. There is no provision for judicial approval or supervision, the ACLU said.

"Innocent Americans should not be made to feel like the personal information they store on their laptops and cellphones is vulnerable to searches by government officials any time they travel out of the country," said Catherine Crump, a staff attorney with the ACLU's Speech, Privacy and Technology Project.

The lawsuit was filed on behalf of the National Press Photographers Association, the National Association of Criminal Defense Lawyers and Pascal Abidor, a 26-year-old Brooklyn, N.Y., resident. The complaint was filed in federal court in Brooklyn, the ACLU said.

The ACLU claims Mr. Abidor was detained for several hours without being charged and his laptop was seized for 11 days by U.S. Custom and Border Patrol officers when he returned to New York from Montreal by train in May. Mr. Abidor, a dual French-U.S. citizen, is an Islamic Studies Ph.D. student.

Homeland Security didn't respond to a request for comment.

Quran burning to go forward

Associated Press

GAINESVILLE, Fla.—A Christian minister said Tuesday that he would go ahead with plans to burn copies of the Quran to protest the Sept. 11 terrorist attacks despite warnings from the top U.S. general in Afghanistan and the White House that doing so would endanger U.S. troops.

Pastor Terry Jones of the Dove World Outreach Center said he understood the government's concerns, but planned to go forward with the burning this Saturday, the ninth anniversary of the attacks.

He left the door open to change his mind, however, saying that he is still praying about his decision.

Gen. David Petraeus warned Tuesday in an email to the Associated Press that "images of the burning of a Quran would undoubtedly be used by extremists in Afghanistan—and around the world—to inflame public opinion and incite violence."

State Department spokesman P.J. Crowley echoed that later in the day, calling the plan to burn copies of the Quran "un-American" and saying it did not represent the views of most people in the U.S.

"While it may well be within someone's rights to take this action, we hope cooler heads will prevail," Mr. Crowley said. He said burning copies of the Quran would be "inconsistent with the values of religious tolerance and religious freedom," and potentially puts the lives of U.S. soldiers and diplomats at risk.

Mr. Jones told the AP in a phone interview that he was also concerned, but wondered how many times the U.S. could back down.

"We think it's time to turn the tables, and instead of possibly blaming us for what could happen, we put the blame where it belongs—on the people who would do it," he said. "And maybe instead of addressing us, we should address radical Islam and send a very clear warning that they are not to retaliate in any form."

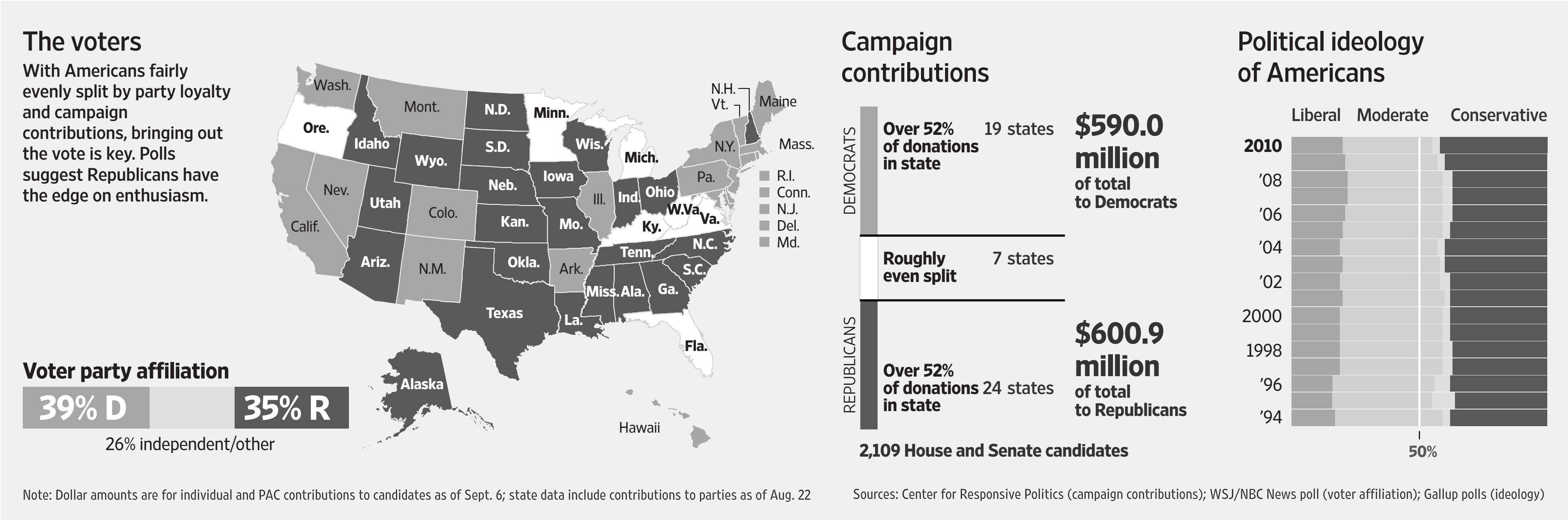
Mr. Jones, who runs the small, evangelical Christian church with an anti-Islam philosophy, said he had received more than 100 death threats and had started wearing a .40-caliber pistol strapped to his hip.

The threats started not long after the 58-year-old minister proclaimed in July that he would stage "International Burn a Quran Day." Supporters have been mailing copies of the Islamic holy text to his Dove World Outreach Center to be incinerated in a bonfire that evening.

The fire department has denied Mr. Jones a required burn permit for Saturday, but he has vowed to go ahead with his event.

He said lawyers have told him his right to burn the Quran was protected by the First Amendment, whether he has permission from the city or not.

U.S. NEWS



Get ready for a big Republican wave

By Gerald F. Seib

This is about the time when Democrats thought—or perhaps hoped—the political clouds that have hung over them all year would begin to lift.

Instead, those clouds may actually be getting darker.

Mounting economic gloom and a controversial agenda are exacting a heavy toll on their prospects for keeping control of Congress in the Nov. 2 elections, according to a new Wall Street Journal/NBC News poll.

The poll, taken to coincide with the traditional Labor Day kickoff of the campaign's home stretch, shows the Democrats' biggest problem is a wide passion gap: Voters angry at Democrats are fired up to vote, while many who like them are yawning over the coming election.

When voters overall are asked whether they prefer that November's vote produce a Congress controlled by Democrats or by Republicans, they split evenly, 43% favoring Democrats and 43% Republicans.

But among those who appear most likely to vote, based on their level of interest in the campaign and their history of voting, the Republicans own a dramatic 49% to 40% advantage. If that kind of lead holds, Republicans would almost certainly take back control of the House.

A tide of national unhappiness and disenchantment with Washington has been building all year and proving a threat to incumbents of both parties, as illustrated by the primary defeats of Republican Sens. Robert Bennett of Utah and Lisa Murkowski of Alaska by upstarts within their own party. But the sour mood is a particular problem for Democrats because they are in control of both the White House and Congress, and the few springtime signs that the economy might have significantly improved by Election Day have been snuffed out.

Indeed, the most striking finding in the new survey is the indication of a deep slide in economic confidence. Only 26% of those surveyed think the economy is going to get better in the next year, down markedly from 47% a year ago.

In the same vein, the share who think the country is generally on the wrong track now stands at 61%, up from 48% a year ago. Perhaps most telling for Democrats, approval of President Barack Obama's handling of the economy has slipped to 39%.

That reading, said Republican pollster William McInturff, who co-directs the Journal/NBC News survey with Democrat Peter Hart, was "a huge danger sign" for Democrats.

GOP Rep. Kevin McCarthy of California, who was in charge of recruiting his party's candidates for House races this year, said he was cautioning his troops "Democrats haven't unleashed their money yet" in many House races and would be using their war chest to attack hard in the two months remaining.

Still, Mr. McCarthy said the favorable winds for the GOP also meant the party should think about the range of seats it has a chance to seize. "Republicans should expand that field and look beyond, and not use past elections as an indicator" of what is possible this year.

Rep. Eric Cantor of Virginia, the second-ranking House Republican, said he was advising candidates "to stay focused on the issue the public is concerned about, and that is the economy."

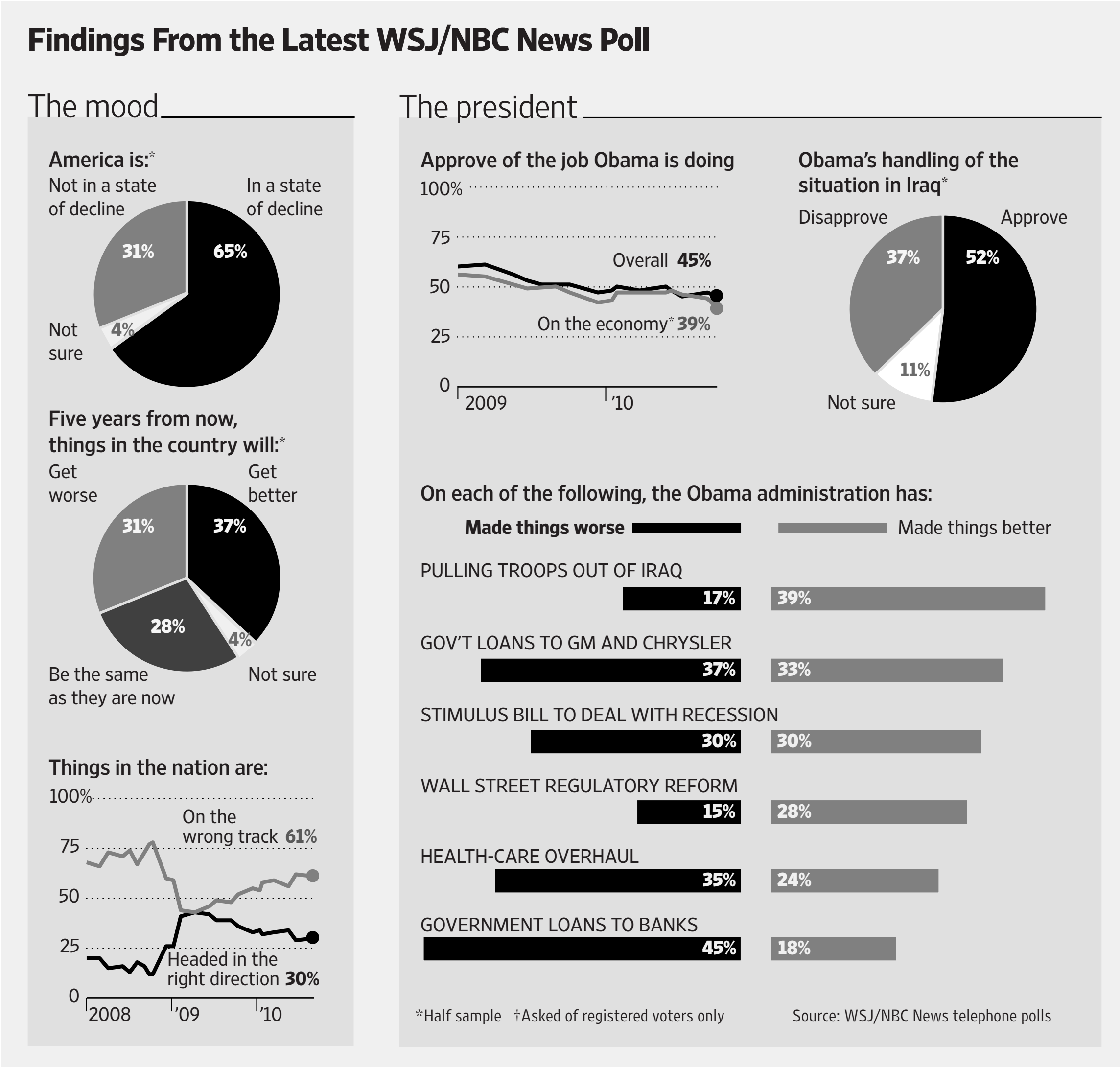
While the survey illustrates Democrats' deep problems, it also suggests the strategy that party leaders are likely to pursue to limit the damage: devoting resources to energize their own voters and focusing attention on a Republican party that isn't particularly popular either, according to the poll.

One hope for Democrats is this: There are enough pro-Democrat, pro-Obama voters available to help the party head off disaster—if they can be persuaded to show up and vote. In the survey, those who expressed the very highest levels of interest in this year's election preferred a GOP Congress by a margin of 53% to 35%. Among all other, less interested voters, Democrats are preferred by a 20-point margin.

So Democrats' most urgent challenge in the next eight weeks is to turn these uninterested voters into interested voters—a difficult task, but one party leaders insist they are tackling.

"We have had a voter contact program that has been going strong for more than a year," said Jennifer Crider, deputy executive director of the Democratic Congressional Campaign Committee.

Recognizing the challenge Democrats face, she says, the national party has helped put a field director and an average of five staff members in place in 75 of the most hotly contested House congressional districts, where they have been building a base of volunteers to turn out the vote. Democratic leaders say the party will be spending at least $50 million for mobilization efforts between now and the election.



The second Democratic tactic suggested by the numbers is to remind voters they aren't fond of the Republican Party either. Amid all its woes, the Democratic Party is viewed positively by 36% of those surveyed, higher than the 30% with a positive view of Republicans. Fully a quarter said they'd vote for an independent or third-party candidate if they had the chance; a similar share said they were interested in voting for someone in the tea-party movement.

That suggests there will be a concerted strategy by Democrats to make the election as much about Republicans who seek control as it is about Democrats now in control.

Still, even Democrats acknowledge they face big problems.

"We all know that there's a hurricane coming for the Democrats," said Mr. Hart, the Democratic pollster. "What we haven't determined at this moment is whether it's going to be a category three or a category five."

Weak approval ratings for Mr. Obama aren't helping. The president's overall job-approval rating now stands at 45%, down from 47% earlier in August, while 49% said they disapproved. His approval rating has declined most noticeably among seniors, suburban women and Midwestern voters.

Mr. Obama is benefiting from his announcement last week that combat operations are ending in Iraq; approval of his handling of the war has risen to 52% from 49% earlier in the month.

But other parts of his agenda haven't gone over so well. One-third of those polled said the big health-care overhaul Mr. Obama championed "made things worse."

Still, Mr. Obama doesn't seem to be the central cause of Democrats' problems. Just 12% of those who said they prefer a Republican-controlled Congress said they wanted to vote that way to protest the performance of the Obama administration, while more than twice as many—28%—said they wanted to protest the performance of Democrats in Congress.

Democrats argue it still will be tough for Republicans to pick up the net total of 39 Democratic-held seats they need for control of the House.

For one thing, Democratic leaders think the nation's general wave of unhappiness may wash away some Republican incumbents, as well. Indeed, 56% of all voters—Democrats, Republicans and independents—said it was time to give a new person a chance in their own congressional district.

As a result, Democrats think they have a chance to take perhaps four or five Republican seats, making the GOP climb to control that much steeper.