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Two arrested over iPad hacking case

BUSINESS & FINANCE 19

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BUSINESS & FINANCE 18

THE WALL STREET JOURNAL.

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Suitable for winter?

European Pressphoto Agency

A model takes to the catwalk in a creation by Giorgio Armani at the Milan Men's Fashion Week, in which designers presented collections for fall-winter 2011-12. 'Men look all the same. They need to rediscover their personality,' Mr. Armani told reporters. **More photos at WSJ.com/Fashion.**

U.S. factories reverse trend, add more jobs

By James R. Hagerty

U.S. manufacturing, viewed as a lost cause by many Americans, has begun creating more jobs than it eliminates for the first time in more than a decade.

As the economy recovered and big companies began upgrading old factories or building new ones, the number of manufacturing jobs in the U.S. last year grew 1.2%, the first increase since 1997, government data show. That total will grow again this year, according to economists at IHS Global Insight and Moody's Analytics.

Among others, major auto makers—both domestic and transplants—are hiring. Ford announced last week it planned to add 7,000 workers this year and next year.

The economists' projections for this year—calling for a gain of about 330,000 manufacturing jobs—won't come close to making up for the nearly six million lost since 1997. But manufacturing should be at least a modest contributor to total U.S. employment in the next couple of years, these economists say.

After a steep slump during the recession, manufacturing is "the shining star of this recovery," says Thomas Runiewicz, an economist at IHS. He expects total U.S. manufacturing jobs this year to rise by about 2.5%, to about 12 million. Currently, manufacturing jobs account for about 9% of all U.S. nonfarm jobs; the average pay for those jobs is roughly $22 an hour, or nearly twice the average for service jobs, according to government data.

Despite the upbeat forecasts, job growth may remain modest because many companies are finding ways to increase production through greater efficiency and automation, without adding many workers. In the third quarter, U.S. manufacturing productivity increased as output rose 7.1% from a year earlier and hours worked grew just 3%. Conrad Winkler, a vice president at the consulting firm **Booz & Co.** who focuses on manufacturing, says manufacturers are being very cautious in their hiring, partly to avoid the risk of having to lay off people later on.

"Manufacturing is going to be a significant source of job growth over the next decade," says Mark Zandi, chief economist at Moody's Analytics. He says U.S. manufacturers that survived the brutal 2008-09 recession are now very com-

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The Quirk

Buffalo booze—Poland's national drink is finally ready to roam in U.S. **Page 29**

World Watch

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Editorial & Opinion

President Obama: The U.S. needs regulatory reform. **Page 13**

U.K. inflation puts pressure on BOE

By Natasha Brereton

LONDON—U.K. consumer-price inflation accelerated sharply in December, underscoring the view that the Bank of England's most likely next move will be to tighten policy, but the economy's fragility suggests that action is a while off yet.

Data from the Office for National Statistics Tuesday showed annual inflation jumped to 3.7% last month from 3.3% in November, well above expectations as economists polled by Dow Jones Newswires had forecast a figure of 3.4%.

The latest figures amplify the dilemma faced by officials on the BOE's Monetary Policy Committee, who must tread a difficult path between fostering economic recovery and keeping public inflation expectations under control.

"With the bulk of the government's public spending cuts yet to be fully felt, many on the MPC will no doubt argue that more time is needed to assess the impact on the economy, before responding to high current inflation," said Rob Carnell, an economist at ING Bank. The U.K. government has promised £111 billion ($176.32 billion) of fiscal tightening by 2015. "Nonetheless, pressure on the doves to change their views is building."

The CPI annual rate has now been at least a percentage point above the BOE's 2%

Please turn to page 5

PAGE TWO

Germany won't fancy the pain game

[Agenda]

By Alen Mattich

It looks like the European Union is settling on a strategy to save the euro. It's called extend, pretend…and pray.

Negotiations are under way to make permanent the European Financial Stability Facility, the bailout fund launched last year as a temporary backstop to deal with sovereign-debt crises ripping through the euro zone.

Not only that, but there is talk of increasing the quantity of funds the EFSF can lend.

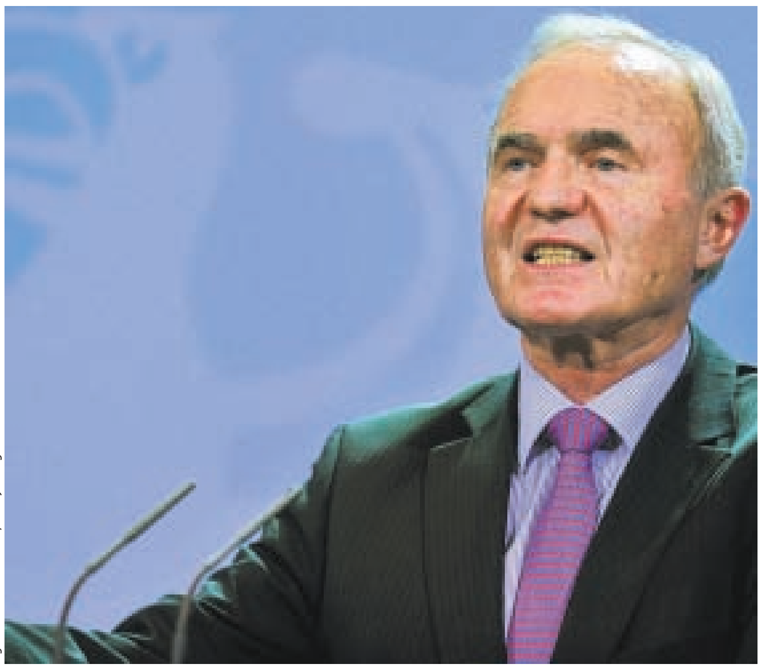
As it stands, the EFSF is funded to the tune of €440 billion ($588 billion), but credit guarantees imposed on it mean that only about €250 billion can be disbursed. Some EU members are looking at ways of making the full €440 billion available, unless, that is, the fund can be boosted even further. They are also hoping it will be used to buy government debt from fragile sovereigns.

The markets like what they're hearing. But the optimism is overdone.

The EU is hoping fresh loans at cheaper rates may keep these crippled countries afloat for a few more years, until domestic growth starts to take off and they can once again manage to meet their obligations. Until then, the answer to their problems is more lending and more austerity.

But the premise hinges on peripheral Europe's eventual ability to pay back the huge amounts of public and private sector debt it already owes. That's improbable.

High interest rates and rising amounts of debt mean that, for instance, Spanish interest payments will rise from 1.8% of GDP in 2009 to 4.5% in 2016, while for Ireland that burden will rise from 2.2% to 5.4%, according to Citigroup estimates. The Greeks are likely to hemorrhage even more of their income, something north of 6% of GDP to foreign creditors, according to other estimates. When set against real GDP growth expectations of less than 2% for the coming five years across most of peripheral Europe (although Ireland is likely to average about 3%) these sort of debt repayments will be politically crippling.


Agence France-Presse/Getty Images

Otmar Issing, former chief economist at the European Central Bank.

For peripheral Europe to avoid another more severe debt crisis down the line, one that would likely prove fatal to their euro membership, these countries need to be able to shake off the bulk of their debt burdens and at the same time be allowed to nurse their economies back to health.

> The richer countries would have to forgive a hefty amount of peripheral Europe's debt.

But the only way this will happen is for core Europe, particularly Germany, to share substantially in the periphery's pain.

The richer countries would have to forgive a hefty amount of peripheral Europe's debt or, alternatively make them equally large transfer payments. And at the same time, Germany would have to accept significantly higher than hitherto acceptable inflation rates in order to spare countries struggling with austerity from having to deflate their way to competitiveness.

To be sure, the new European rescue fund may be able to replace expensive funding at a more reasonable rate. For instance, Ireland and Greece are paying an interest rate of about 5.2% on the emergency finance they have been given by the International Monetary Fund and the European Union under its EFSF and EFSM programs, well below what the market demands.

But the rescue fund is also presented with a tricky balancing act. The interest rates it demands of borrowing countries need to be low enough to give them financial relief, but without inducing wholesale abandonment of the market.

It's doubtful the fund is big enough for a large country like Spain to tap it, as currently projected. And if Belgium and Italy, which are overloaded with sovereign debt, follow suit there definitely won't be enough money in the kitty.

But ultimately, even on easier terms, many of these countries will have to default on their debt. It's not something Germany will like—large German banks are exposed to some €210 billion of peripheral European debt, the equivalent to about 13% of Germany's GDP. A default with a 50% recovery would be very, very painful for the German taxpayers backstopping German banks. The alternative of equally massive direct transfer payments from the core to the periphery is likely to be even less palatable to Germans, according to a recent paper by Otmar Issing, formerly the European Central Bank's chief economist.

Nor is this the only price Germany would likely have to pay to rescue the euro. Wages have been deflating in the euro zone's periphery as these countries struggle to regain competitiveness now that they can't devalue. It would help if Germany were willing to allow domestic inflation, and with it domestic wages, to rise substantially. That, though, isn't happening. Germany's inflation rate is lower than those across much of peripheral Europe. Nor is it likely to happen in the future. Germans are allergic to inflation.

The message from Germany about doing anything more than backing a permanent fund is nein, nein and nein. Germans, the Dutch and the Finns expect peripheral Europe to take ever bigger doses of austerity in order to qualify for bailouts.

For peripheral Europeans, that means big drops in living standards. Ireland's GDP per capita was 69% of Germany's in 1989. By 2009 it was 112%. This gain in relative wealth is now fast reversing. As people across the periphery start to feel substantially less well off, their resentment against Germany and other core states will only rise. Eventually, they'll ask what exactly they're getting for all the pain they're taking.

If the answer is "poorer," the urge to default will be hard to resist. Even if it means withdrawal from the euro.

What's News

■ **UBS will hire staff** faster in Asia than elsewhere, CEO Grübel said, predicting that the region could benefit in the long run from taking a less stringent stance on bank capital and compensation than Europe and U.S. **17**

■ **Citigroup swung** to a fourth-quarter profit as lending strengthened outside the U.S., but the result disappointed investors. **17**

■ **Boeing pushed back** delivery of its 787 Dreamliner again, to the third quarter. Airbus is raising the average price of its aircraft by 4.4% to offset higher costs. **21**

■ **Police in the U.K.** and Russia are investigating allegations of corruption against Russia's top appointee to the EBRD and three others. **6**

■ **One of the three Renault** managers accused of selling company secrets sued the auto maker for defamation, raising the stakes in the case involving electric vehicles. **18**

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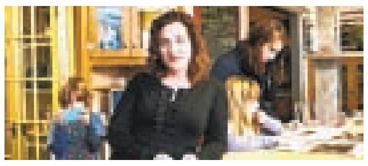

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'They may not love each other any more but divorce would be ruinous.'

David Cottle on why the European monetary union resembles a sham marriage

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China puts its image on Times Square

By Loretta Chao

BEIJING—When many Americans think of China, they think of a rising rival accused of manipulating its currency and siphoning U.S. jobs. China's government wants them to think of sports stars, Internet entrepreneurs, and astronauts.

As President Hu Jintao begins his visit to the U.S. this week, China is blitzing America with a flashy television ad that mixes images of ordinary Chinese citizens with celebrities like NBA star Yao Ming, Web tycoon Jack Ma, and a quartet of fashion models. The minute-long video is scheduled to run on CNN and to be shown 300 times a day—once every four minutes during peak periods—on the giant display in New York's Times Square from now until Feb. 14.

The ad is part of China's broader push to use its culture and people to ease global fears about its rise. That use of "soft power"—as scholars describe it, in contrast to the hard power afforded by economic, geopolitical and military clout—will also be highlighted during Mr. Hu's trip by his visit to a Chinese government-sponsored language-learning center at a Chicago high school—part of a global network of so-called Confucius Institutes designed to spread the use of Mandarin.

China's government was long neglectful of its image overseas, but in recent years it has invested billions of dollars to promote its viewpoints and polish its reputation. In addition to the new commercial and increasing numbers of Confucius Institutes, Chinese state-run media companies are expanding overseas as well. China Daily, the government English-language newspaper, launched a U.S. edition in 2009. Xinhua news agency started an English-language TV news service last year, and state broadcaster China Central Television recently announced a new English-language documentary channel that will showcase films about China for foreign audiences.

The efforts come as China's policies and actions are coming under increasing international scrutiny and criticism, from its military advances to its exchange-rate policies to its handling of deadly antigovernment riots in Tibet in 2008 and the 11-year prison sentence it gave dissident Liu Xiaobo, who as awarded the 2010 Nobel Peace Prize in absentia at a December ceremony.

Zuma Press

Footage promoting China is shown on the screens at New York's Times Square on Monday.

The image push has expanded enormously in just the five years since Mr. Hu last visited the U.S., in April 2006. To use one measure: China had fewer than 10 Confucius Institutes in the U.S. that year. Today, there are more than 100 institutes and similar Confucius Classrooms in the U.S.—and hundreds more in other countries. The institutes are sponsored, and partly funded, by an arm of China's Ministry of Education called the Hanban, which cooperates with schools and universities around the world.

But like so much in China, the soft-power push is led by the government, and it is unclear how much impact it is having wooing U.S. hearts and minds. A survey of 1,503 Americans by the Pew Research Center for the People & the Press found that 58% want to build a stronger relationship with China, but 65% see China as either an "adversary" or a "serious problem."

Marketing experts say the state-led approach has limits. While Beijing clearly recognizes the value of soft power, it should promote things "which are happening culturally and spontaneously" within the country, such as its vibrant art scene, says Ogilvy & Mather Worldwide Chief Executive Miles Young. He says other nations like South Korea and Japan have gained global cultural influence by embracing contemporary, ground-up cultural developments in addition to government-led initiatives.

The Times Square ad was ordered up by China's State Council Information Office and produced by a Chinese agency, **Shanghai Lintas Advertising**. Chinese officials couldn't be reached and Lintas Advertising declined to comment.

The ad appears designed to put a human face on relations with China, quite literally, scrolling through a series of still images of Chinese people—China's first astronaut in space, a pair of film directors, a state-owned enterprise executive—under titles like "Cutting-Edge Chinese Agriculture" and "Award-Winning Chinese talent." "Chinese friendship," the screen says as it ends.

Initial reviews of the ad are mixed. Tom Doctoroff, director of the north Asia area for WPP Group's JWT ad agency, said the commercial ad is "a good first step." "China is demonstrating an awareness that it needs to forge a more trustful relationship with other countries and cultures," he said. But the spot a more effective message for China to present would have been one about how it can integrate with the rest of the world. "The question on people's minds is how do we form a harmonious 21st century with China standing side-by-side the West, each complementing one another?"

It's "a perfect example of saying what you want to say rather than saying what the audience needs to hear," said David Wolf, chief executive of Wolf Group Asia, a Beijing-based marketing firm. He said the ad misfires by calling attention to some of the very aspects of modern China that put Americans on edge. He added, "Instead of saying, 'we are your friends,' the ads are saying 'Hello, America. Be very afraid.' "

—Juliet Ye in Shanghai and Yoli Zhang in Beijing contributed to this article.

U.S. firms complain of China's heavy hand

By James T. Areddy

SHANGHAI—Almost one half of all U.S. businesses surveyed in Shanghai complain of discrimination by domestic regulators, contradicting an assertion by Chinese President Hu Jintao that the playing field is level.

The issue of alleged bias against U.S. companies is likely to be a major point of contention during Mr. Hu's visit to the U.S., which began Tuesday. The U.S. is expected to push for greater market access to help narrow a huge trade imbalance in China's favor.

An annual survey by the American Chamber of Commerce in Shanghai, China's main commercial hub, found that 47.7% of 346 respondents said they face regulators who show a preference for domestic companies. The survey, of chamber members, found that 31.3% said treatment is balanced.

Respondents by a two-to-one margin said Beijing's efforts to address intellectual-property theft is stagnant at best.

But the survey, published Wednesday and conducted in November and December, found that nearly 80% of those surveyed said their China operations were profitable last year. Most executives said China is among their companies' top three global priorities.

Still, the survey reflected the frustrations of growing numbers of American businesses operating in China, even as companies in such industries as cars, cellphones and high-speed trains are forced to relocate operations to the country or risk losing global scale and competitiveness. A major complaint by chamber members is that companies are losing out on big government-procurement contracts in a bidding process rigged in favor of Chinese rivals. About 72% of respondents said they experienced rising competition from local companies.

A key objective of President Hu's U.S. trip, will be to assure American corporations about equal treatment. U.S. officials are expected to push for guarantees on the issue.

Mr. Hu said China doesn't distinguish between foreign and Chinese companies. "All foreign companies registered in China are Chinese enterprises," he said in a written response to questions.

Just a decade ago, China was viewed as a long-term play by American businesses that simply wanted a foothold in the populous nation. In 1999, 58% of Shanghai chamber members said their profit margins in China were below world-wide levels. Last year 78% said China results at least matched global levels. Almost half said China was more profitable than most markets and 73% said it was growing faster. Nearly 36% said more than 10% of their global revenue comes from China.

But respondents said last year's earnings in China were generated amid an increasingly tough competitive and regulatory environment. Only a fifth of respondents said they consider regulations transparent, while 63.1% said regulatory conditions are either staying the same or getting worse. That compares with 36.9% who said they have seen improvement.

Beijing wants a deeper commitment from its foreign investors, including greater access to technology. But while that might earn a foreign company short-term profit, it could come at the cost of losing commercial secrets and foster Chinese competition.

One area in which chamber members share interests with Chinese companies is foreign-exchange rates. Just over 50% of respondents said their business would be harmed with a 10% increase in the Chinese currency's value.

Bloomberg News

Prime Minister Brian Cowen will lead his Fianna Fail party into the next election after winning a confidence vote with Finance Minister Brian Lenihan's backing.

Irish leader wins party vote

By Quentin Fottrell

DUBLIN—Ireland's embattled Prime Minister Brian Cowen won a vote of confidence in his leadership on Tuesday, clearing the way for him to lead his fractured Fianna Fail party into the next general election.

Mr. Cowen proposed the secret ballot in his own leadership of the ruling right-of-center political party in an attempt to end persistent questions over his leadership skills and handling of the economic crisis.

His chances received a significant boost earlier Tuesday from Finance Minister Brian Lenihan, who said, "He is the best person to lead us into the next election....He will lead us into the general election as a collective team."

The finance minister said there was no point in electing another leader before the March election who doesn't support government policy.

"We have to take responsibility for our part in the current difficulties," he said.

Mr. Lenihan acknowledged that with around 14% support among the electorate, Fianna Fail lawmakers are worried about the very survival of the party, which has been in power for nearly 54 years of its 85-year history.

Although Mr. Cowen was expected to win the vote, the prime minister's supporters took no chances: Minister for Justice Dermot Ahern cast his vote for Mr. Cowen from his hospital bed after an operation.

Earlier, Mr. Lenihan denied he was preparing to take over as party leader himself.

"I didn't have the luxury of indulging my ambitions on this particular matter....I haven't had time to organize a coup or a challenge in the last year," he said.

However, Fianna Fail lawmaker John McGuinness said Mr. Lenihan had wanted the leadership of the party: "He did encourage dissent, he did encourage us to look at the numbers" to launch a no-confidence motion.

Mr. Cowen said he sees a general election taking place in the spring.

Also Tuesday, Mr. Lenihan also said the 5.8% average interest rate for the European Union-International Monetary Fund's €67.5 billion ($90 billion) rescue package is set and can't be renegotiated "unilaterally" by Ireland.

Musical chairs for ECB's leadership

[ECB Watch]

By Brian Blackstone

Let the game of musical ECB chairs begin.

Two candidates have officially been put forth to succeed Austria's Gertrude Tumpel-Gugerell when her eight-year term on the ECB's executive board expires May 31: Peter Praet, executive director of the National Bank of Belgium; and Elena Kohutikova, former member of the Slovak central bank's monetary-policy board.

Ms. Kohutikova may have the early edge, says ING Bank economist Carsten Brzeski, because she would symbolically cement the importance of Eastern Europe to the euro bloc and give a small country, and new euro entrant, greater representation.

Ms. Kohutikova would also help the ECB avoid the potentially embarrassing situation of turning the ECB's 23-member Governing Council into an all-male club when Ms. Tumpel-Gugerell, the only woman on the Governing Council, leaves. The Governing Council includes the six-member executive board and heads of the 17 national central banks that make up the euro. (Ms. Kohutikova's candidacy may be hampered somewhat by Slovakia's early opposition last year to creation of the European fiscal rescue fund).

Comments Tuesday by French Finance Minister Christine Lagarde suggest some momentum for Ms. Kohutikova. "We need the most competent candidate to fill the vacancy," Ms. Lagarde said in Brussels. "My position has always been the same: if we have equal competencies [between] a man and a woman, if I had the choice, I would pick the woman."

Yet equally intriguing to some ECB watchers is what the nominations suggest for the race to succeed Frenchman Jean-Claude Trichet when his eight-year term as ECB president ends this October.

Barring a last-minute entry to replace Ms. Tumpel-Gugerell, France runs the risk of being shut out of the ECB's Frankfurt-based executive board when Mr. Trichet exits later in the year. Unless a Frenchman succeeds Mr. Trichet as ECB president—something analysts say is highly unlikely—France's only hope would be if his successor creates an open slot on the executive board. BNP Paribas economist Ken Wattret explains the musical chairs this way: "The best possible way [for France to maintain its presence in Frankfurt], is for one of the executive board members to go home and head their national central bank."

That leaves Bundesbank President Axel Weber and Bank of Italy Governor Mario Draghi—already considered the front-runners—as practically the only realistic options if France wants to secure its place in Frankfurt, despite chatter among economists late last year that a "compromise" candidate may be in the offing to succeed Mr. Trichet if Messrs. Weber and Draghi aren't able to gain enough backing from governments (no one has officially been put forth yet to succeed Mr. Trichet).

Here's why: Were Mr. Weber to get the nod for ECB president, the presumption is that German ECB board member Jürgen Stark would move over to the Bundesbank, opening up Mr. Stark's post on the executive board. Similarly, if Mr. Draghi gets the top spot, board member Lorenzo Bini Smaghi would be expected to either move to the Bank of Italy or get another top post outside of Frankfurt.

Prominent names mentioned by economists as potential compromise picks—including Luxembourg's central bank governor, Yves Mersch, or Erkki Liikanen, governor of Finland's central bank—wouldn't create new space in Frankfurt, since there isn't currently someone from Luxemburg or Finland on the executive board.

After Mr. Trichet's, the next executive board post doesn't open up until June 2012, leaving France with the prospect of at least a nine-month absence in Frankfurt, something analysts say Paris would be loath to stomach, especially during the debt crisis.

"You cannot see the decision on Tumpel-Gugerell totally isolated with the Trichet succession," explains Mr. Brzeski. With France apparently taking a pass now, "the chances for any compromise candidate have decreased," he says.

German economic sentiment shows jump

By Nina Koeppen

MANNHEIM, Germany—Economic expectations in Germany improved sharply in January, indicating that the euro zone's largest economy is set to continue growing in the months ahead despite the debt crisis in the region, the ZEW think-tank said Tuesday.

ZEW said its closely watched economic-expectations index increased for the third consecutive month, to 15.4 points in January from 4.3 points in December. The index is a measure of financial experts' outlook for the economy over the next six months.

The outcome was above economists' forecasts of 8 points, indicating that Germany's robust economic recovery will continue in the first half of 2011.

German gross domestic product increased 3.6% last year in price-adjusted terms, which marks the strongest increase since pan-German records began in 1992.

"The currently low level of real interest rates should strengthen demand for capital equipment in Germany," said ZEW President Wolfgang Franz, adding that improved labor-market conditions are boosting private consumption.

Analysts may have taken heart from rising stock-market valuations, with the German DAX up more than 3% since the start of the year.

The assessment of current economic conditions was at its highest since July 2007, with the corresponding indicator gaining 0.2 points to be at 82.8 points in January, the ZEW survey of 284 analysts and institutional investors showed.

"The diversified export mix, the labor market and a further strengthening of private consumption should put growth in 2011 on a broad footing," said ING economist Carsten Brzeski.

Separately, the United Nations estimated Tuesday that the German economy will grow 2.2% this year, which would be well above its predictions for the euro zone as a whole. In its annual report on the World Economic Situation and Prospects, the U.N. said the euro-zone economy will grow 1.3% this year, a slower expansion than the 1.6% recorded for 2010.

—Karen Hage in Frankfurt and Paul Hannon in London contributed to this article.

Sharp improvement

The German ZEW economic expectations indicator

Source: ZEW

EUROPE NEWS

CEO ousted over Galileo comments

A Wall Street Journal Roundup

A German company involved in the building of European satellite navigation system Galileo says it has removed its chief executive after he was quoted in a cable obtained by WikiLeaks as describing the project to a U.S. official as “a stupid idea.”

The CEO’s removal came as the European Union revealed Tuesday that Galileo would need an additional €1.9 billion ($2.5 billion) between 2014 and 2020 to complete the project’s infrastructure. That comes on top of €4.5 billion necessary for getting it off the ground between 2007 and 2013, according to the European Commission, the EU’s executive which has been bankrolling the project.

“We intend to go on because we believe in the Galileo project,” said EU Industry and Entrepreneurship Commissioner Antonio Tajani during a press conference in Strasbourg, France. “We are discussing also with the industry ways to reduce the costs.”

OHB-System AG, a unit of **OHB Technology** AG, said late Monday that the supervisory board decided to revoke Berry Smutny’s appointment as CEO. It said the firm “saw no alternative to this decision in order to effectively avert any further damage to the company.”

The company has previously said that Mr. Smutny denied making the statements attributed to him in U.S. diplomatic cables released by WikiLeaks that were published last week in the Norwegian newspaper Aftenposten.

OHB-System last year won a €566 million ($754 million) contract to build the first 14 satellites for Galileo, Europe’s planned rival to the U.S. Global Positioning System, or GPS. Galileo claims it will be technologically superior to the U.S. Global Positioning System because it will provide more accurate locations for cars, ships and people using navigation devices. The EU says the global market for satellite navigation applications will be worth €240 billion by 2020 and that 6% to 7% of the region’s economic output, about €800 billion, depends on satellite navigation.

However, the cable published by Aftenposten quoted Mr. Smutny as saying during a visit to the U.S. Embassy in Berlin: “I think Galileo is a stupid idea that primarily serves French interests.”

In a statement on Friday, OHB-System supervisory board chief Manfred Fuchs said Mr. Smutny “declared in a statutory oath that he did not make the statements attributed to him.” Mr. Fuchs added that the company “expressly repudiates” all the statements attributed to Mr. Smutny and “affirms its full and complete commitment” to Galileo.

The EU’s Mr. Tajani said Mr. Smutny’s removal would not create any problems for the program. “Frankly, I don’t think it will change the stance of the company,” Mr. Tajani said.

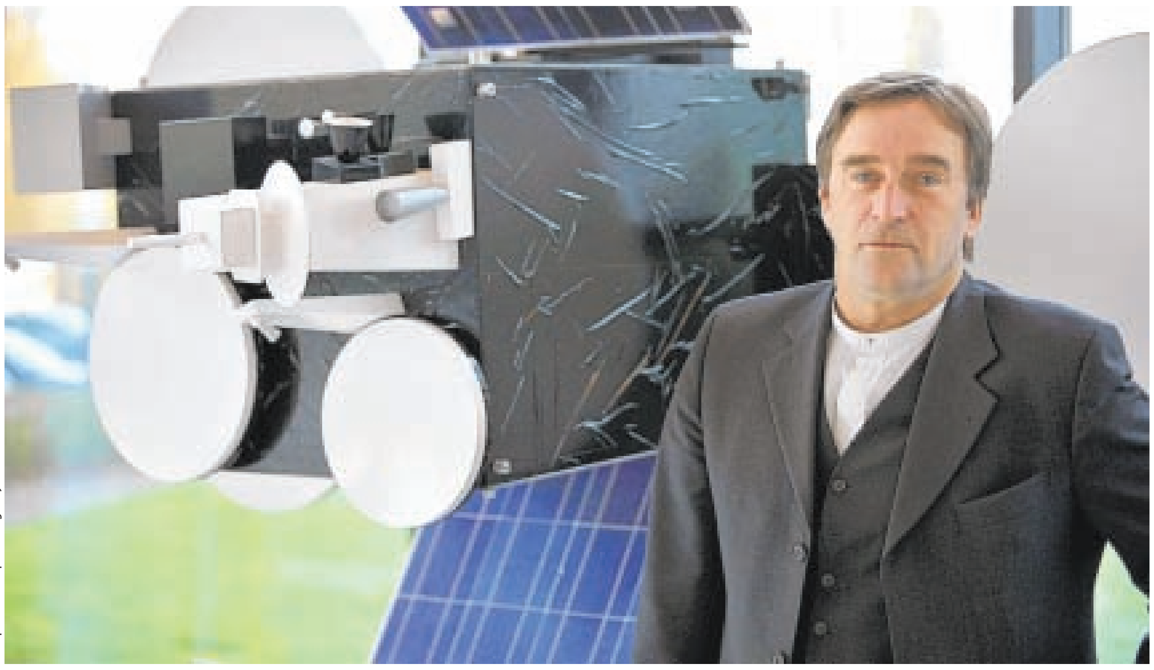
The satellite project has been rattled by delays and cost overruns. In 2008, the Commission had to bail out the project, after a private consortium that was expected to help finance Galileo dropped out. Disputes over funding only ended when the 27-nation EU agreed to invest public money.

Tuesday’s midterm review of Galileo for the first time put an official figure on the expected additional costs. The majority of the €1.9 billion—€1.18 billion—is necessary to construct and launch the remaining satellites, the European Commission said.

The Commission added it also had to cover some financial shortfalls of the European Space Agency-which is co-developing Galileo—including a world-wide increase in launch costs and growing security constraints.

Nevertheless, Mr. Tajani insisted that Galileo makes economic sense. The program will improve citizens’ lives in transport, agriculture, energy and it will help combat illegal immigration, the commissioner said.

Russia already has its own rival to GPS, called GLONASS, and China, Japan and India are also working on their own navigation systems.



European Pressphoto Agency

Berry Smutny said Galileo ‘is a stupid idea,’ according to a WikiLeaks memo published in a newspaper.

U.K. inflation ramps up

Continued from first page

target for a whole year. December’s rate was the joint strongest since November 2008.

In monthly terms, consumer prices rose 1% in December, well above the 0.4% rate in November and the largest increase since records began in 1996. Economists had forecast a 0.7% gain.

The major factors behind December’s inflation pickup were greater transport costs, and the higher weighting of air fares, as well as housing and household services, due to the impact of gas prices on utility bills and liquid fuels prices. Petrol prices rose to a record high of 122 pence a liter in December. Food prices also gained 1.6% on a monthly basis and 5.7% annually.

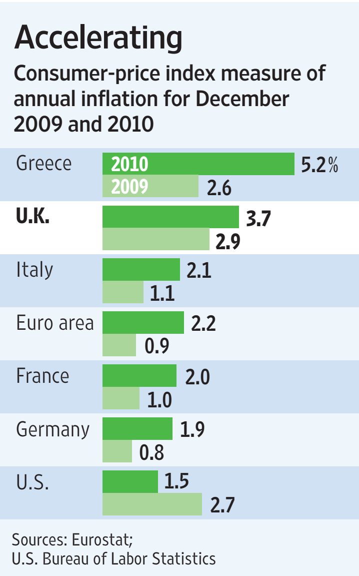
The central bank’s core view is that the spare capacity in the U.K. economy will help drag inflation below target next year as one-off effects—including the rise in sales tax to 20% from 17.5%—subside.

But with inflation having been above the BOE’s target for 41 out of the past 50 months, and expected by many analysts to accelerate above 4% this spring, the concern is whether consumers will continue to believe the central bank when it says price rises are temporary.

The BOE’s Monetary Policy Committee voted this month to keep bond purchases under its quantitative-easing program at £200 billion and maintain its key interest rate at 0.5%.

But opinion has been divided at recent meetings, with MPC member Andrew Sentance calling for an immediate rate rise, and Adam Posen for more bond purchases.

—Ainsley Thomson and Paul Hannon contributed to this article.



EUROPE NEWS

Medvedev meets beaten reporter in Middle East

BY RICHARD BOUDREAUX
AND ALEXANDER KOLYANDR

MOSCOW—Late last year, amid an outcry over the brutal beating of a prominent journalist, Russian President Dmitry Medvedev demanded the capture and punishment of the culprits. Then the crime appeared to drop from the Kremlin's agenda.

No senior Russian official visited Mr. Kashin before he left Moscow to undergo rehabilitation in Israel.

But on Tuesday, during a visit to the Middle East, Mr. Medvedev met for the first time with the victim of the assault, Oleg Kashin, and again voiced interest in the case. Mr. Kashin, who took a break from treatment in Israel to cover the visit, said the Russian leader vowed to "tear the heads off" the unidentified men who broke his hands, jaw and legs.

"He asked me about my health and urged me to stick to my positions," said the 30-year-old journalist, whose articles online and in the mainstream newspaper Kommersant have been critical of Russia's leadership. Mr. Kashin related the meeting in a Twitter message. The Kremlin hasn't commented on the meeting.

The Nov. 6 attack caused an uproar in Russia, highlighting the Kremlin's failure to resolve dozens of murders and other bloody attacks on journalists in recent years. A pro-Kremlin youth group had threatened Mr. Kashin before he was beaten, and Mr. Medvedev's initial call for justice met with skepticism after Prime Minister Vladimir Putin received a youth leader allied with the group. No suspect has been arrested, and no senior Russian official visited Mr. Kashin before he left Moscow early this month to undergo rehabilitation in Israel.

Mr. Medvedev's meeting with the journalist took place in the ancient West Bank city of Jericho. Hobbling on a cane, Mr. Kashin waited along the Russian leader's heavily guarded route and spoke with him briefly outside a Russian-funded museum where Mr. Medvedev was to appear with his host, Palestinian Authority President Mahmoud Abbas.


European Pressphoto Agency
Russian President Dmitry Medvedev, left, speaks with journalist Oleg Kashin in the West Bank town of Jericho Tuesday.

Poland blames air controllers for crash that killed president

BY MARCIN SOBCZYK

WARSAW—Polish officials blamed Russian air-traffic controllers for blunders they say contributed to the plane crash that killed Poland's president in Russia last year, amid an intensifying bout of mutual finger-pointing over who is responsible for the tragedy.

Russian controllers at the airport in Smolensk, the destination of the Polish president's flight, failed to react when they noticed his plane was off course and, under pressure from superiors in Moscow, allowed it to attempt a landing even though visibility at the airport was below the minimum safety threshold, Polish investigators said Tuesday.

At a news conference here, the Poles also said Russian meteorologists gave the Polish air crew misleading weather reports shortly before the April crash, which killed President Lech Kaczynski and the other 95 people on board, plunging Poland into mourning and roiling its politics.

The Polish investigators, who plan to release the findings of their probe into the causes of the crash next month, were reacting to a report published last week by the Moscow-based Interstate Aviation Committee, which blamed the Polish pilots, who it said were pushed to land by dignitaries on the plane.

The Russian report made no mention of actions by controllers that could have contributed to the crash.

The Polish news conference drew an immediate Russian response Tuesday. "The commission analyzed the dispatcher recordings...and the tapes of communications between air-traffic control and the...crew," an investigator with the Interstate Aviation Committee told NTV television.

"We also conducted an independent analysis of how air-traffic control behaved [in the situation]. We found no evidence of any pressure being put on air-traffic control," the investigator said.

Poland's government has come under increasing pressure from the opposition Law and Justice party of the late Mr. Kaczynski for not taking a tough enough line on the crash with Russia. Since 2008, Poland's prime minister, Donald Tusk, has been trying to mend ties between the two historical rivals.

Warsaw has criticized Moscow for failing to share important information about the crash, including recordings of conversations among air-traffic controllers ahead of the disaster. On Tuesday, Polish Interior Minister Jerzy Miller told reporters the country had made "a knockoff copy" of the recordings.

After the Polish news conference in Warsaw, Russian investigators in Moscow said they would release a full transcript of controllers' conversations.

On the tape, Russian controllers can be heard commenting minutes before the crash that a Russian meteorologist was "insane or what" because a weather report said visibility at the heavily fog-shrouded airport was much better than it actually was.


Agence France-Presse/Getty Images
A Russian soldier standing guard near the wreckage of the Polish plane in April.

Ex-Russian EBRD aide faces a corruption probe

Police in the U.K. and Russia are investigating allegations of corruption against Russia's top appointee to the European Bank for Reconstruction and Development and three others in the highest-level probe of suspected criminality at the bank to date, officials said Tuesday.

*By **Paul Hannon** in London and **Alexander Kolyandr** in Moscow*

The Russian government said the top official involved was Elena Kotova, who stepped down as Russia's director at the EBRD in December. The EBRD said Tuesday it had waived diplomatic immunity for four Russian officials appointed to the bank by Moscow in order to allow British and Russian police to investigate them. Tuesday's move was the first time the EBRD had lifted immunity for such a senior official and the first public disclosure of the police probes.

"The City of London police is working closely with the EBRD as part of an investigation into allegations of corruption," a police spokesman said.

The EBRD declined to provide details of the investigation. Russia's Interior Ministry confirmed that it is conducting a probe but provided no other information.

Ms. Kotova, who worked at the World Bank and Russian state bank Vneshtorgbank before taking the EBRD post in 2005, couldn't be reached to comment.

The other three people involved weren't identified. The EBRD said they all either work or have worked at the bank as representatives of the Russian government, which is one of the EBRD's shareholders, as well as a country in which it invests.

Such officials don't work for the development bank, but represent the interests of its 61 government shareholders and oversee management of the bank. Ms. Kotova also represented the governments of Tajikistan and Belarus.

The EBRD said it had conducted an internal investigation into the activities of the four officials last year, and had shared its findings with the Russian authorities. It said it will share those findings with the U.K. police.

Early last year, the EBRD said British police questioned a bank employee in connection with suspected criminal activity involving its investments. The employee was never identified. A person familiar with the case said that probe is related to the Kotova case.

The Russian Economy Ministry said it had decided to relieve Ms. Kotova of her duties at the EBRD following the bank's investigation, which found that she and three other officials had violated its code of conduct.

The ministry said it had asked the EBRD to waive diplomatic immunity for the four. A similar request was separately made by U.K. police through the Foreign and Commonwealth Office.

The EBRD was established in 1991 to help countries in Eastern Europe and the former Soviet Union make the transition from centrally planned to market economies.

Obama orders review of regulations

BY ELIZABETH WILLIAMSON

WASHINGTON—President Barack Obama ordered a government-wide review of federal regulations, aiming to eliminate rules that stymie economic growth.

In an article published in the opinion pages of The Wall Street Journal, Mr. Obama said he would issue an executive order initiating a review to "make sure we avoid excessive, inconsistent and redundant regulation," focusing on rules that "stifle job creation and make our economy less competitive." He also suggested future regulations must do their job "while promoting economic growth."

The order, which was issued Tuesday, was the latest effort by the White House to repair relations with corporate America, hoping to spur investment by the nation's largest multinationals and reduce unemployment.

Business leaders say an explosion in new regulations stemming from the president's health-care and financial regulatory overhauls has, along with the sluggish economy, made them reluctant to spend on expanding and hiring. Companies are sitting on nearly $2 trillion in cash and liquid assets, the most since World War II.

In recent weeks, the administration has made new efforts to push stalled free-trade agreements with Korea and others through Congress, and signaled its eagerness to consider an overhaul of the U.S. corporate tax code. The president invited chief executives to the White House last month, where they formed task forces to work on specific issues, including export growth and taxes.

United Press International

President Barack Obama spoke Jan. 12 at a service for shooting victims in Tucson, Ariz., including Rep. Gabrielle Giffords.

On Feb. 7, Mr. Obama will visit the U.S. Chamber of Commerce—a chief opponent to his administration's regulatory approach—for a discussion on how the White House can work with the group to create jobs. The efforts are designed to give companies more confidence in the president's stewardship of the economy, and bolster his re-election prospects among a wealthy constituency not traditionally allied with Democrats.

In Tuesday's article, Mr. Obama defended his administration's efforts to strike "the proper balance" between protecting the public and not interfering with economic growth.

The president said the government sometimes failed to meet its "basic responsibility to protect the public interest," citing the run-up to the financial crisis. He also acknowledged the cost of regulation and said that sometimes "rules have gotten out of balance, placing unreasonable burdens on business—burdens that have stifled innovation and have had a chilling effect on growth and jobs."

He also said: "Where necessary, we won't shy away from addressing obvious gaps: new safety rules for infant formula; procedures to stop preventable infections in hospitals; efforts to target chronic violators of workplace safety laws. But we are also making it our mission to root out regulations that conflict, that are not worth the cost, or that are just plain dumb."

For nearly a year, the White House has been asking leading business groups in the capital to identify regulations they believe are obstacles to job-creating private investment. But these efforts are being dwarfed by complaints about the administration's unfriendly rhetoric toward the financial industry and large corporations, and regulations stemming from its legislative agenda.

Even some of the president's corporate allies have joined criticism of the White House's regulatory and tax policies. The Business Roundtable, an association of chief executives of many of the largest U.S. corporations, last year compiled a 54-page report that includes proposals to streamline rules proposed by the Environmental Protection Agency and the Federal Communications Commission, among scores of others. It was accompanied by public criticism from the Roundtable, whose members have frequently advised the White House on the economy.

At the same time, the administration faces pressure from the left not to appear to be too close to Wall Street and corporate interests. Liberals were irked most recently when Mr. Obama tapped political veteran and J. P. Morgan Chase & Co. executive William Daley as his chief of staff.

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U.S. manufacturing reverses jobs trend

Continued from first page

petitive, with much lower labor costs and debt burdens, and so can afford to expand. While they will keep building factories overseas to address demand in emerging markets, they also will invest in U.S. plants, Mr. Zandi says. He expects manufacturing job growth to average about 2% a year through 2015.

The job growth is expected as companies replace aging equipment, take advantage of government incentives, seek energy savings and rediscover that it makes sense to produce some products, such as ovens and construction machinery, at home rather than shipping them long distances. A new tax break, approved by Congress in December, is expected to further stimulate investment by letting companies deduct from taxable income 100% of certain types of investments in 2011.

Whirlpool Corp., which has 39 factories world-wide, including nine in the U.S., had a tough decision to make last year. Parts of its oven and cooktop factory complex in Cleveland, Tenn., are more than 100 years old. The labyrinthine layout of the plant, built on a slope and cobbled together over the past century, requires a fleet of more than 100 forklifts to shuttle products along ramps connecting 13 different levels. Temperatures sometimes top 38 degrees Celsius inside the plant, which has no air conditioning. Alan Holaday, who heads North American manufacturing for Whirlpool, calls the plant "an industrial museum."

One obvious option was to move production of the cooking appliances to Mexico, where Whirlpool already has several factories and where its South Korean rivals make some of their cooking products. But, after months of study, Whirlpool decided in mid-2010 to spend $120 million on a new plant in Cleveland, a few miles from the old one, in what will be the company's first new U.S. factory since the mid-1990s. Whirlpool projects that its work force in Cleveland will grow to 1,630 within about two years from 1,500 now as production increases.

Although labor costs would be lower in Mexico, Whirlpool found lots of reasons to stay in the Cleveland area. It already had a trained work force there and wouldn't need to pay severance costs. Freight costs would be lower since most of the plant's products are sold in the U.S. Tennessee also looked safer than Mexico, which has been beset with drug-related violence. And state and local governments were willing to kick in about $30 million of incentives—including grants and property tax breaks—if Whirlpool stayed in the area. Most of the new jobs at the Whirlpool plant will be for assemblers, a spokeswoman said.

Bloomberg News

The number of U.S manufacturing jobs has grown for the first time since 1997.

Caterpillar is building a $120 million plant to make excavator machines in Victoria, Texas. The plant will produce some machines that currently were being shipped from a Caterpillar plant in Japan to North American customers. That means the North American customers will get faster deliveries, and the Japan plant can devote more capacity to the booming Asian market. In return for creating 500 jobs in Texas, Caterpillar also got incentives from state and local authorities, including tax breaks and 320 acres of free land. Those jobs will include assemblers, engineers and logistics experts.

Dow Chemical Co. is building a 74,000-square-meter plant near its headquarters in Midland, Mich., to design and make batteries for hybrid and electric vehicles. In addition, Dow aims to expand a pilot project, also in Midland, in which it is making solar roof shingles that generate electricity. Such spending also creates jobs at suppliers. Dow cites estimates that every new job inside a chemical plant creates five jobs at suppliers and other related firms.

All of this doesn't herald a miracle recovery for manufacturing, which accounted for 11% of U.S. economic output in 2009, down from 27% in 1950. In a new book, Dow Chemical CEO Andrew Liveris, argues that U.S. manufacturing faces continued decline unless the government comes up with a strategy to boost it, including bigger tax breaks and government support for R&D.

Another risk is that manufacturing jobs will start to vanish again if the U.S. economy can't sustain its current recovery and slips back into recession. Still, rising industrial production and capital investments are signs that manufacturing will remain a significant part of the U.S. economy at least in the near term.

Home builders start new year in dour mood

BY TOM BARKLEY
AND JEFFREY SPARSHOTT

Builders remained pessimistic about the outlook for U.S. new-home construction in the first month of 2011 despite signs of improvement elsewhere in the economy.

The National Association of Home Builders said Tuesday its housing-market index remained flat at 16 in January. Although companies are adding jobs and economic growth appears to be speeding up, improvement in the construction industry has lagged behind.

The seasonally adjusted index, based on a survey of 420 builders, has held at 16 for three consecutive months. Numbers above 50 mean more builders view conditions as good than as poor. The last time the home builders' confidence gauge was above 50 was April 2006.

Builders are competing with demand for previously owned homes and have been struggling to get credit to start projects.

"Unfortunately, a severe lack of construction financing and widespread difficulties in obtaining accurate appraisal values continue to limit builders' ability to prepare for anticipated improvements in buyer demand in 2011," Bob Nielsen, the NAHB's 2011 chairman and a builder from Reno, Nev., said in a statement.

On a positive note, Tuesday's report showed the subindex for traffic of prospective buyers edged up a point to 12 in January.

WORLD NEWS

Brazil faces dilemma on rates

By Paulo Prada

President Dilma Rousseff faces difficulties in bringing rates down to levels more in line with those of developed markets.

SÃO PAULO, Brazil—This week's expected increase in Brazil's already towering interest rates highlights inflation concerns in Latin America's biggest economy and the difficulty President Dilma Rousseff faces in trying to reduce rates to levels more in line with those of developed markets.

Shortly after her election in October, Ms. Rousseff said she saw no reason why Brazilian rates, the highest of any major economy, couldn't "converge" with rates in the developed world.

But creeping inflation, fueled by a fast-growing economy and huge increases in government spending in recent years, leaves Brazil's central bank with little choice but to keep pushing rates higher, economists say.

Analysts expect policy makers, after a two-day meeting ending Wednesday, to push the benchmark rate to 11.25%, up from the current 10.75%.

Further rate increases could follow as the central bank, which enjoys de facto autonomy from the administration, gauges inflationary pressure later in the year.

The dilemma for Ms. Rousseff hinges on what economists, investors, and the local business community have long criticized as a handicap in Brazil's economic-policy mix.

By relying too heavily on the central bank to control inflation—through interest rates and other measures to stem private spending—Brazil's government gives itself an excuse to spend more than it otherwise could.

"There must be a shift away from relying so much on monetary policy," said Neil Shearing, an economist at London-based Capital Economics, a research firm. "At some point, there needs to be a move toward fiscal discipline."

Ms. Rousseff, who took office Jan. 1, in recent weeks said her government will take steps to slow spending. Her administration, however, has yet to say how or by how much.

Spending by the federal government more than doubled in Brazil over the eight-year administration of Luiz Inácio Lula da Silva, Ms. Rousseff's predecessor and mentor, reaching almost 20% of the overall economy.

Although the spending helped Brazil weather the global downturn, as public outlays spurred private economic activity, the government continued the increases even after the country had resumed growth.

The government was particularly criticized by economists for high spending in 2010, an election year.

Now, reining in spending is considered vital to slow an economy that is expected to have grown nearly 8% last year.

Big price increases came with the growth, especially for food, energy, and other staples. Inflation by year-end reached almost 6%—well beyond the government target of 4.5%.

While rate increases are a proven way to cool inflation, some policy makers argue that spending cuts would be a more effective measure. In a central bank study released in December, officials said a reduction in public spending equivalent to 1% of Brazil's economy would have the same effect against inflation as a rate increase of 1.25%.

Lower spending would also give the central bank room to make future rate cuts, a move that would likely soothe another growing concern—soaring interest in the real, Brazil's currency. Rapid appreciation of the real against the dollar and other major currencies over the past year has hobbled the country's exporters and made imports more competitive against home-grown goods.

Despite Ms. Rousseff's vow to cut back, economists are urging the government to act quickly and more aggressively. Of particular concern to some critics is that many of Ms. Rousseff's economic advisers, including Finance Minister Guido Mantega, come from Mr. da Silva's administration.

Japan seeks consumption-tax rise

By Takashi Nakamichi

TOKYO—Japanese Prime Minister Naoto Kan's new cabinet is emphasizing its commitment to raising the nation's consumption tax in an effort to restore Japan's tattered finances, a stance that has led to electoral defeats for prior governments.

Underscoring this drive, Finance Minister Yoshihiko Noda said Tuesday that the government would live up to a legislative promise—originally made by a rival party—that requires a tax overhaul be in place by the end of the year ending March 2012. The provision was in legislation approved by parliament when the now-opposition Liberal Democratic Party was in power in 2009.

"The provision requires us to make a decision by March 2012, so I think we will deal with the matter within that realm," Mr. Noda said at a news conference.

The statement is seen as an attempt to put pressure on the opposition to live up to its own previous commitment. Mr. Kan's administration has already promised a tax-overhaul proposal by the end of June to address the problem.

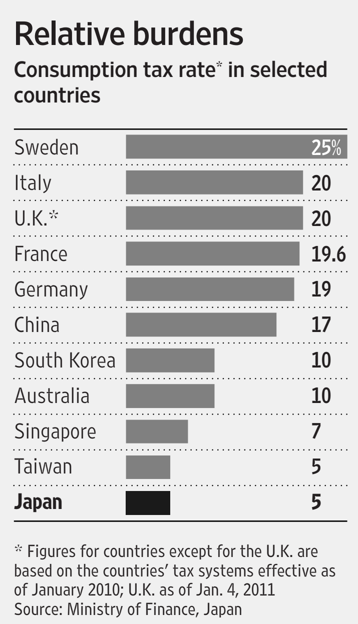
On Monday, Hirohisa Fujii, the new deputy chief cabinet secretary and a former finance minister, said lawmakers of all political parties should stick to the 2009 promise.

Mr. Fujii is part of a new team brought in by Mr. Kan on Friday that is looking to overhaul the nation's tax system by raising the consumption tax to support growing retirement and health-care spending, while cutting corporate taxes to spur job growth.

Mr. Kan had toned down his calls for a sales-tax increase after a major defeat in upper-chamber elections last summer. But he has resuscitated the campaign after going through the budget process over the past few months, when he saw the difficulty of reconciling Japan's shortage of tax revenue with its growing social-security expenses and debt-servicing costs.

An equivalent of Europe's value-added tax, the consumption tax was introduced in Japan at a rate of 3% in 1989 and raised to the current 5% in 1997. Imposed on almost everything consumers buy in Japan, the tax has weighed on economic growth and has been unpopular among Japanese voters, who punished those lawmakers who launched and increased the levy.

But the government hopes the steadily worsening fiscal state will make voters realize that the time has come for a tax increase. The view seems to be gaining traction: A nationwide poll conducted last weekend by the Kyodo news agency found that 54.3% of respondents supported a consumption-tax rise, compared with 43.3% who were opposed.



Experts see a consumption-tax rise as one of the best tools for Mr. Kan's government to meet its promised fiscal-overhaul goals, including balancing the combined main budget of the national and local governments by March 2021.

That is a tall order, given that for the new fiscal year, borrowing makes up 48% of the revenue needed to finance outlays in the national budget.

While Mr. Kan's Democratic Party of Japan dominates the lower chamber, it needs backing from the opposition-controlled upper chamber to pass most legislation, including changes to the tax code. The LDP is the largest opposition party and has been growing increasingly uncooperative as the prime minister's public support remains at low levels, currently around 30%.

Doubts remain over whether the strategy will work. Few opposition parties have so far signaled willingness to work with the government on tax changes, and even some lawmakers within the ruling party oppose higher sales taxes.

In addition, while the 2009 tax law says the tax system must be overhauled, there is no penalty for failure to do so.

The cabinet has offered few details on when, and by how much, it wants to raise the consumption tax. But economists say the government may need to triple or quadruple the rate to fix public finances.

Haiti police question ex-dictator Duvalier

PORT-AU-PRINCE—Haitian police took Jean-Claude "Baby Doc" Duvalier to be questioned on Tuesday under heavy guard on possible charges of murder, malfeasance and embezzlement, the latest twist in a bizarre odyssey that has kept the country on edge for days.

By Ingrid Arnesen, José de Córdoba and David Gauthier-Villars

It wasn't clear whether Mr. Duvalier, 59 years old, would be arrested on the charges that date to 2008. Opponents and supporters of Mr. Duvalier lined the road, jeering and cheering as the former dictator, dressed in a dark blue suit, was led away in a sport-utility vehicle.

The former dictator's unexpected arrival Sunday after nearly 25 years of exile stunned the nation, and appeared to further enmesh Haiti in the political crisis caused by the country's botched attempt to hold presidential elections in November. Haiti, the poorest country in the Western Hemisphere, is struggling to rebuild the country after an earthquake devastated the capital, and as a cholera epidemic continues to rage through squalid tent camps housing about one million refugees.

The former dictator was taken to be questioned to the public prosecutor's office, and could be placed under house arrest, said a high-ranking Haitian official. Mr. Duvalier ruled Haiti from 1971 to 1986, when he was deposed by mass demonstrations and U.S. pressure. He has been living quietly in France ever since. Haitian officials have accused Mr. Duvalier, and his father, François, known as Papa Doc, who ruled Haiti from 1957 until his death in 1971, of stealing hundreds of millions of dollars from the country. In the past, Mr. Duvalier has denied the charges.

Mr. Duvalier is also battling a Swiss effort to confiscate about $5 million that he holds in Swiss bank accounts, and return the funds to Haiti, according to Haitian and Swiss lawyers involved in the case.

A law allowing Swiss authorities to seize funds deemed to be of illicit origin is set to come into force on Feb. 1. From that date, Swiss authorities will have the power to initiate a case against Mr. Duvalier, a spokesman for the Swiss Foreign Ministry said Tuesday. Pending possible legal actions against Mr. Duvalier, Swiss authorities have frozen the funds. Mr. Duvalier has challenged that decision through Switzerland's Federal Administrative Court.

A lawyer for Mr. Duvalier said the Haitian government had no reason to question Mr. Duvalier. "It's scandalous, it's a political attempt to humiliate the former president," said Gervais Charles.

Mr. Duvalier appears to have little political support. But officials fear that Mr. Duvalier's return will anger supporters of Mr. Duvalier's political foe, former President Jean-Bertrand Aristide, a divisive figure who still commands much popular support, and who now will increase demands that Mr. Aristide return as well. Deposed in 2004, Mr. Aristide lives in exile in South Africa.

WORLD NEWS

Ministers quit new cabinet in Tunis

TUNIS—Tunisia faced renewed instability as three ministers in the new caretaker government resigned under pressure from the country's powerful labor union, illustrating the myriad new forces struggling for influence following last week's ouster of the country's authoritarian president.

*By **Margaret Coker** in Tunis, Tunisia and **David Gauthier-Villars** in Paris*

The move by the General Union of Tunisian Workers, a key organizer of the anti-regime protests that helped force President Zine al-Abidine Ben Ali from power, reflected widespread public anger about the inclusion of Mr. Ben Ali's longtime ruling party in the transitional government.

The resignations weren't expected to stop the new government from functioning, but they appeared to quickly influence political decisions among the country's new leaders. Within hours, Prime Minister Mohammed Ghannouchi and Interior Minister Foued Mbazza—both stalwarts of the old regime—canceled their membership in the Constitutional Democratic Rally, known in English as the RCD.

At least one other minister resigned from the government, according to state media. The minister, a leader of one of Tunisia's few registered opposition parties, was considered close to the trade-union movement.

The developments represent how intensely the nation's new political actors—from trade unions, fledgling green parties and exiled Islamic groups—are jockeying for power to shape the pace and face of reform here.

Mr. Ghannouchi cobbled together a coalition government over the weekend following Mr. Ben Ali's surprising departure from power last Friday following 23 years in power. But what he presented as an inclusive body filled with technocrats, fresh independent faces and "clean" holdovers from the last government hasn't met demands of key opposition factions here.

Agence France-Presse/Getty Images

Protesters clashed Tuesday with security personnel in Tunis, angry that the new government included members of the old.

The trade union, one of the country's largest membership organizations in what has been a tightly controlled police state, announced Tuesday morning it was withdrawing its support for the new coalition, said Sami Tahrir, a member of the executive committee. The decision was made during an emergency meeting of union members who voted to overturn their leaders' weekend decision to join the coalition, he said.

"We won't join the government until the RCD is abolished," said Mr. Tahrir, referring to the ruling party. "There is too much corruption and we have to have a fresh start," he told a cheering crowd of union members gathered in the center of the capital.

In rolling demonstrations in Tunis's central square throughout the day, protesters called for more ministers to join the government boycott, saying they didn't trust the former ruling party to institutionalize the democratic freedoms promised by the prime minister.

So far, Islamic organizations have been noticeably absent from the political scene. Religious slogans haven't been in evidence amid the protest movement of the last month and largely leftist trade unions have taken the lead in the demonstrations, drawing on Tunisia's educated middle class.

The country's first president, Habib Bouguiba, instituted a strict secularization program during the 1960s.

The exiled Ennahdha party, the best-known of the Islamic movements in Tunisia, says it was surprised by the intensity of the internal protest movement that started in December, according to Samir Dilou, who spoke on Ennahdha's behalf from Tunis.

"No need to hide it—we were caught off guard by the popular uprising," said Mr. Dilou. "It means we have to be self-critical, take a good look at ourselves and see what we can propose for Tunisia."

Rachid Ghannouchi, the 69-year-old founder of the party, was sentenced in absentia on charges of plotting to overthrow Mr. Ben Ali's government. Mr. Ghannouchi, who has lived in exile in London since 1993, denies those charges. Ennahdha members said Mr. Ghannouchi bore no relation to the prime minister of the same name.

Mr. Dilou said Mr. Ghannouchi would like to return to Tunisia, but that he was waiting for the caretaker government to lift penalties against him. He said Ennahdha may participate in upcoming parliamentary elections, adding that the party was committed to non-violence and religious moderation.

The appeal of Mr. Ghannouchi's movement, which was never registered inside Tunisia and has no formal structure, remains unclear among Tunisians.

Current and former diplomats in Tunisia say Mr. Ghannouchi represents a moderate Islamic voice who has long espoused democracy and pluralism. "He's not violent and he's fairly progressive. This is not by any stretch an al Qaeda-style individual," says Mona Yacoubian, a retired State Department analyst specializing in North Africa who is currently a special adviser at the U.S. Institute of Peace's Center for Conflict.

Meanwhile, the streets of Tunis were filled with people eager to benefit from the new freedoms of speech and assembly. Despite a state of emergency declared last week, security police and anti-riot units positioned through downtown streets allowed groups of hundreds to gather and march down the narrow, winding streets of the city center.

The nature of the demonstrations was amorphous and emotional. Men in business suits stood with handwritten signs saying "No to RCD." Pedestrians joined in small groups to sing the national anthem.

Mohsin Mouttoug, a physics lecturer, illustrated the exuberance of the crowd. He said he had completed registration of a new pro-environment party earlier Tuesday morning and was walking through downtown to sign up new members.

Mr. Mouttoug, 50 years old, said he supported the right of all political groups, even Islamists, to participate in the new democracy. The only red line that should be drawn, he said, should be against the continued presence of the old ruling party.

"They [the RCD] are the greatest threat to our country. They are the only ones who can steal our freedom. We need fair elections so that everyone can choose what comes next," Mr. Mouttoug said.

Tunisia's events continued to reverberate around the region Tuesday. Two Egyptian men attempted to set themselves on fire Tuesday in downtown Cairo, in apparent imitation of the event that sparked the Tunisian crisis that came a day after another Egyptian man burned himself in front of parliament, the Associated Press reported.

IEA calls for rise in oil output

By James Herron And Benoit Faucon

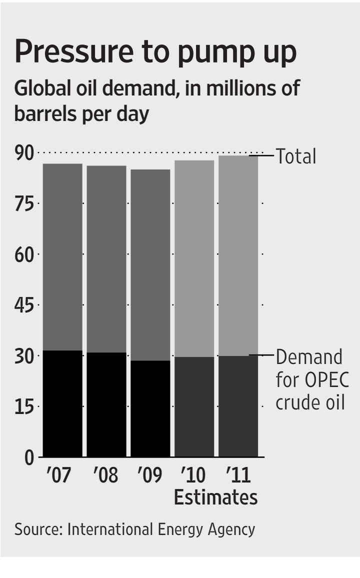
LONDON—The International Energy Agency said the world will need more crude from OPEC amid faster-than-expected oil-demand growth—or risk high prices that damage the economic recovery.

The report by the IEA, which represents major energy-consuming countries, will increase pressure on the Organization of Petroleum Exporting Countries to lift its production ceiling amid a growing debate between the agency and the oil producers' group over the causes and implications of higher crude prices.

The IEA January monthly report boosted demand estimates for 2010 and 2011 by 320,000 barrels a day from its December report.

The agency now sees 2010 oil demand having risen by 2.7 million barrels a day year-to-year to 87.7 million barrels a day, and a subsequent rise in demand of 1.4 million barrels a day in 2011 to 89.1 million barrels a day.

While global oil inventories declined somewhat compared with the IEA's December report, they remain fairly high by historic standards. The overall energy consumption patterns "suggest that the economic recovery has been more pronounced than expected earlier," the IEA said.



The raised IEA demand forecast, which comes on the heels of OPEC's upgrade Monday to its own 2011 global oil demand forecast, was largely due to stronger-than-expected consumption from Organization of Economic Cooperation and Development nations. The report in particular cited euro-zone activity, largely driven by Germany.

The IEA has become vocal in highlighting the threat to the global economy from runaway oil prices. On Monday, IEA's Executive Director Nobuo Tanaka said, "OPEC must continue to be alarmed" over the price rise and suggested that formally increasing its output ceiling could ease oil prices.

But in written remarks to The Wall Street Journal, OPEC secretary general Abdalla Salem El-Badri insisted commercial stocks and the group's spare capacity remained robust. OPEC has repeatedly decided to maintain its production ceiling during recent meetings amid calls by some OPEC members to defend ever-higher prices. "Any assumption that there is tightness in the market ... is incorrect," Mr. El-Badri said. "There is more than enough oil on the market." Mr. El-Badri said the current rise was tied to the weak dollar, speculation and temporary downtime in Alaska and the North Sea.

The IEA didn't respond to a request for comment.

Exiled Islamic leader seeks return to Tunisia

By David Gauthier-Villars

The leader in exile of Tunisia's Islamic movement Ennahdha wants to return home but is waiting for the new government to declare a full amnesty on sentences passed during the rule of recently ousted president Zine al-Abidine Ben Ali, Ennahdha officials said Tuesday.

Ennahdha's founder, Rachid Ghannouchi, "is an ordinary Tunisian citizen who must be allowed to come in and out of Tunisia without restrictions," said Samir Dilou, a lawyer and a senior leader of the movement in Tunisia.

Created in 1981 and formally known as the Movement of the Islamic Trend, Ennahdha wasn't formally authorized in its three-decade existence, its members say.

In 1992, Mr. Ghannouchi was sentenced in absentia to life imprisonment on charges that he had plotted to overthrow Mr. Ben Ali. Mr. Ghannouchi, who lives in London, has denied that he or his party tried to topple Mr. Ben Ali.

Mr. Dilou said that, while waiting for the return of its founder, Ennahdha was considering ways to reshape itself into a political force that could help create a multiparty system in Tunisia. He said that although Mr. Ben Ali had tried to portray Ennahdha as an extremist group and an al Qaeda offshoot, the movement rejects violence and promotes the values of "a moderate Islam."

"We don't need to import solutions from Tora Bora," Mr. Dilou said, in reference to the one-time hideout of Taliban and al Qaeda militants in eastern Afghanistan.

Mr. Dilou said it was too early to say whether the movement would participate in the next elections.

Abdellatif Mekki, another Ennahdha leader in Tunisia, said the movement needs to count its members because many are in exile and some were, until recently, in prison. He said that if it participates in elections, Ennahdha will likely pair up with nonreligious parties to stress that, unlike extremist movements, it supports democracy, a multiparty system and human rights.

WORLD NEWS

Getty Images

An Afghan army recruit waited to conduct drills in Kabul last week.

Allies slow increase of Afghan forces

By Yaroslav Trofimov

KABUL—U.S. allies in Europe and Kabul have questioned the U.S. military's plan to expand Afghan security forces by 72,400 troops, forcing the abrupt postponement of a meeting intended to formally approve the new ceiling.

Concerns from Germany, Italy, France and others, and last-minute objections by Afghan President Hamid Karzai, led to the cancellation of the meeting Tuesday of a committee of the Joint Coordination and Monitoring Board, which includes Afghan, United Nations and coalition member-country representatives.

Representatives of the international community, a Western diplomat said, have largely accepted the case for raising the force ceiling to 378,000, but disagreements remain on how to pay for the increase, and what will be the relative strengths of the army and the police.

Some European diplomats said that the delay is open-ended and that they can't predict when the committee will give the green light to the new ceiling, in part because allied nations have to follow their own budgetary procedures.

Some allies demanded additional commitments from Mr. Karzai on reforming the Afghan police, a force much less professional than the army.

"The feeling was that this was all rushed too quickly, and there was not sufficient time to prepare for such important decisions," one diplomat said.

American officials say they expect disagreements about the increase to be ironed out before the end of the month, in time to secure U.S. congressional approval to pay for the additional recruits.

In recent days, Mr. Karzai wondered whether international funds would be better spent on improving the training and equipment of existing forces, diplomats said.

Mr. Karzai's spokesman, Siamak Herawi, said the Afghan government has welcomed international plans to increase the number of Afghan forces, and declined to comment about the postponement of Tuesday's meeting. Spokesmen for the Afghan ministries of interior and defense said they weren't aware of the planned meeting.

The committee was set to approve a new ceiling of 378,000 Afghan troops by October 2012, up from the current target of 305,600 troops slated for October 2011. There are currently some 150,000 Afghan soldiers and 120,000 police, U.S. officials say.

The new ceiling, U.S.-led coalition officials say, would give the Afghan army and police sufficient strength to assume security responsibility across the entire country by the end of 2014—allowing the bulk of U.S.-led foreign forces to leave.

U.K. official stresses need for U.S. stealth jet

By Enda Curran
And Rachel Pannett

U.K. Secretary for Defense Liam Fox emphasized Tuesday the importance of the next generation U.S. F-35 Joint Strike Fighter to counter China's development of its own stealth jet, after Britain and Australia agreed to strengthen defense cooperation in Asia during talks in Sydney.

"Clearly if we don't have the equipment others have, we would put ourselves at a potential disadvantage," Mr. Fox said. "That's why we are very committed to the Joint Strike Fighter, the F-35, because it does have the sort of fifth-generation stealth technology we are likely to need in the future."

The F-35 program survived a recent U.K. government-defense review intended to help slash military spending as part of a wider effort to cut its deficit.

According to the Royal United Services Institute, a military think tank, the British government is seeking to cut defense outlays by 11% by 2017 as part of £81 billion ($129 billion) of savings in public spending over four years.

As part of these cuts, the U.K. is taking out of service its aging fleet of Harrier jump jets and seeking to sell other unwanted equipment or delay new procurement programs.

New images of China's J-20 fighter have shown that Beijing has made significant progress in developing its own stealth aircraft.