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FINANCIAL TIMES

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Banks sign up to code

Banks operating in Britain have met a Treasury deadline for a code of conduct designed to curb tax avoidance. **Page 2**

Scottish budget boost

Scotland will see the largest transfer of fiscal power from London since the creation of the union, according to Michael Moore, Scottish secretary. **Page 4**

Tax break attacked

George Osborne's decision to go ahead with a £1.1bn tax break for patent income has been criticised by the Institute for Fiscal Studies. **Page 4**

Shell in Gazprom tie-up

Gazprom and Royal Dutch Shell have formed an alliance paving the way for two of the world's biggest gas groups to deepen co-operation. **Page 21**

IMF bail-out concerns

The International Monetary Fund has played the role in the Irish bail-out allotted to it, but some experts worry about the threat to its reputation if the programmes go off track. **Page 8**

India rates pressure

India's economy grew close to 9 per cent in the three months to September, putting pressure on the central bank to continue its campaign of raising interest rates. **Page 5; Lex, Page 20**

Ukraine dispute settled

Russia and Ukraine have settled a natural gas dispute, bringing a controversial trader back into the centre of the supply trade to Ukraine. **Page 10**

US budget vote delay

Leaders of the commission to shrink US budget deficits have delayed a final vote on their contentious plan until Friday, as the hunt for a political ...nsensus goes down to the ... **Page 6; Lex, Page 20**

Italy's debt market fear

Italy's centre-right government expressed worries over debt market turmoil as new data showed unemployment rising and protesting students paralysed central Rome. **Page 9; Lex, Page 20; www.ft.com/lexvideo**

Medvedev woos voters

The Russian president, Dmitry Medvedev, used his annual state of the nation address to campaign for a second term as president in 2012. **Page 10**

EU funding curbs urged

European parliamentarians have called on the European Commission to cut structural funding to regions that ...misspend the money. **Page 12**

Trichet hints at ECB bond rethink

Purchase programme could be expanded

Move aimed at driving down borrowing costs

By Ralph Atkins in Frankfurt, and Richard Milne and David Oakley in London

Markets should not underestimate Europe's determination to resolve the escalating eurozone crisis, Jean-Claude Trichet, European Central Bank president, has warned as he left open the possibility of the bank significantly expanding its government bond purchases to drive down surging borrowing costs.

The hint that the ECB could recalibrate its response to the unfolding crisis came as the premiums that Italy and Spain paid over German benchmark interest rates hit fresh highs since the launch of the euro. The currency's monetary guardian had already stepped up purchases of Portuguese bonds, traders said.

The euro sank below $1.30 on Tuesday, to its lowest level for 11 weeks, hit by risk aversion.

The ECB's bond purchase programme has been controversial within its governing council since its launch in May, with Axel Weber, president of Germany's Bundesbank, voicing his opposition publicly. But the pace at which the crisis has spread has altered the debate in the ECB, which could justify stepping up its intervention by arguing that governments' borrowing costs were far out of line with fundamentals, signalling dysfunctional markets.

Speaking in the European parliament on Tuesday, Mr Trichet would not comment "at this stage" on the bond programme "in the light of the current situation". But the programme was "ongoing" and decisions on its future would be taken by the 22-strong governing council, which next meets on Thursday. He refused to rule out the possibility of eurozone governments issuing joint bonds, although the ECB was not endorsing this.

Since May, the ECB has spent just €67bn (£56bn) under its bond purchase programme. Financial markets, however, increasingly see the bank as the only institution with pockets deep enough to ease the crisis.

The ECB thinks financial markets are badly mispricing risk; eurozone growth was surprisingly strong and Ireland's bail-out had shown the EU was capable of responding to crisis. "I don't think that financial stability in the eurozone, given what I know, could really be called into question," Mr Trichet said.

Willem Buiter, chief economist at Citigroup, said: "The involvement of the ECB is likely to rise, despite its statements – and probably wishes – to the contrary." He has said that the ECB backed by governments could give the European bail-out fund a €2,000bn loan. Gary Jenkins, head of fixed income at Evolution Securities, argued the ECB could create an immediate "firebreak" through purchases of €1,000bn-€2,000bn of bonds.

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Penned it like Beckham World Cup tactics

England's David Beckham signs an autograph in Zurich. He is in a three-man attack in Switzerland for Fifa's vote on who will host the 2018 football World Cup **Report, Page 4; Editorial Comment, Page 16** AP

Charges in UK-US insider deals case

By Brooke Masters, Chief Regulation Correspondent

A former Deloitte partner and his wife face civil charges in the US for insider trading over allegations that they tipped off her relatives in London about seven mergers planned by his clients.

The Securities and Exchange Commission alleged in a court filing in California that Arnold McClellan and his wife, Annabel, leaked confidential information to her sister, Miranda Sanders, and her husband, James, between 2006 and 2008.

The SEC complaint alleges that the Sanders reaped $3m in profits from trading in advance of the mergers and that half the money was supposed to be funnelled back to the McClellans.

The Sanders and three others associated with Blue Index – the brokerage firm Mr Sanders co-founded – were charged last week by the Financial Services Authority with criminal insider dealing. The SEC alleged his friends and clients reaped $20m in profits from his tips.

This is one of the first cross-border cases where the FSA has taken the lead.

Lawyers for Mr McClellan said he denied the SEC's claims and would vigorously contest them. "He did not trade on insider information, and there will be no evidence that he passed along any confidential information to anyone. He had no financial incentive to commit the actions alleged," they said.

A lawyer for the Sanders said that his clients denied any wrongdoing and would fight the FSA charges.

A spokesman for Deloitte said the company was "shocked and saddened by these allegations" which, if proved to be true, "would represent serious violations of our strict ... confidentiality policies". He added that Deloitte had co-operated fully with the SEC and stressed that the regulator had not alleged "any wrongdoing by Deloitte in this unfortunate matter".

Mrs McClellan's lawyer said she would fight the charges.

Off message

Intercepted audio recordings of phone calls involving Niira Radia, above, a powerful corporate lobbyist in India, have revealed an unattractive side to the country's journalistic scene, with media personalities acting as power-brokers in their own right. The leaked recordings of the lobbyist, who represented two of India's most powerful business tycoons, Ratan Tata and Mukesh Ambani, have gripped and dismayed a public that still had faith in the media.

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EU launches formal probe into Google's dominant position

Claims of abuse on web search rankings

By Nikki Tait in Brussels, Mary Watkins in London and Richard Waters in San Francisco

Google will come under intense scrutiny from antitrust authorities in Brussels who announced a full probe into allegations that it had abused its dominant position in the online search market and breached European competition rules.

The investigation, which follows eight months of more informal inquiries by competition officials, will centre on claims that the US search company gave preferential treatment to its own services when ranking search results, and discriminated against competitors.

It will also probe the contractual relationship which Google has with advertisers. In particular, it will explore allegations that Google imposes exclusivity obligations and restricts advertisers from moving their data to competing platforms.

There is no time limit for European Commission inquiries of this type, but they typically take many months, if not years.

Google said it had "worked hard to do the right thing by our users and our industry". It said it had tried to ensure that adverts were "always clearly marked, making it easy for users and advertisers to take their data with them when they switched services, and investing heavily in open-source projects".

The US company also challenged the claim that it was dominant in the online search market in spite of its very high market share, pointing out that users do go to more specialised search sites directly.

Lawyers believe that allegations related to Google's search system are potentially the most damaging.

"This strikes at the heart of how internet search is conducted. Google's natural search results are based on its proprietary algorithms," said Kenneth Mullen, technology specialist at the Withers law firm. "These are Google's crown jewels and how its search ranking works is still largely a secret."

The Commission's initial inquiries followed complaints from three internet services – one owned by arch-rival Microsoft and another a member of a trade group in which Microsoft has a strong hand.

If Google was found to have breached competition rules, it could be forced to change business practices and face heavy fines. In theory, these could amount to up to 10 per cent of global annual revenues, or about $2.4bn based on current levels.

Brussels lifts lid, Page 26
www.ft.com/googlevideo

World Markets

STOCK MARKETS

	Nov 30	prev	%chg
S&P 500	1180.55	1187.76	-0.61
Nasdaq Comp	2498.23	2525.22	-1.07
Dow Jones Ind	11006.02	11052.49	-0.42
FTSEurofirst 300	1067.22	1069.24	-0.19
DJ Euro Stoxx 50	2650.99	2669.96	-0.71
FTSE 100	5528.27	5550.95	-0.41
FTSE All-Share UK	2861.61	2874.78	-0.46
CAC 40	3610.44	3636.96	-0.73
Xetra Dax	6688.49	6697.97	-0.14
Nikkei	9937.04	10125.99	-1.87
Hang Seng	23007.99	23166.22	-0.68
FTSE All World $	203.09	204.25	-0.57

CURRENCIES

	Nov 30	prev		Nov 30	prev
$ per €	1.302	1.309	€ per $	0.768	0.764
$ per £	1.557	1.553	£ per $	0.642	0.644
£ per €	0.836	0.843	€ per £	1.196	1.187
¥ per $	83.8	84.4	¥ per €	109.0	110.4
¥ per £	130.5	131.0	£ index	81.4	81.0
$ index	82.5	82.5	€ index	92.92	93.64
SFr per €	1.298	1.311	SFr per £	1.552	1.556

COMMODITIES

	Nov 30	prev	chg
Oil WTI $ Jan	84.11	85.73	-1.62
Oil Brent $ Jan	85.92	87.34	-1.42
Gold $	1,369.20	1,363.73	5.47

INTEREST RATES

	price	yield	chg
US Gov 10 yr	98.44	2.81	-0.02
UK Gov 10 yr	112.13	3.23	-0.12
Ger Gov 10 yr	98.40	2.68	-0.06
Jpn Gov 10 yr	96.52	1.20	0.00
US Gov 30 yr	102.36	4.11	-0.04
Ger Gov 2 yr	100.29	0.86	-0.06
	Nov 30	**prev**	**chg**
Fed Funds Eff	0.20	0.20	
US 3m Bills	0.17	0.16	0.01
Euro Libor 3m	0.97	0.97	
UK 3m	0.66	0.66	

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National news

Health reforms

Letwin scrutinises NHS power shift

Budget plans

Policy fixer to put GP switch to test

Fears finances will run out of control

By Nicholas Timmins and Alex Barker

Oliver Letwin, the Cabinet's policy guru and fixer, has been charged with scrutinising the health department's plans for a shift of power and accountability in the NHS, amid mounting concern at the Treasury and Downing Street over its implementation. Both Number 10 and Andrew Lansley, health secretary, insist there is no significance in publication of the NHS bill being pushed back to January, and that there is no rowing back on plans to hand up to 80 per cent of the NHS budget to GP commissioning consortia.

But after Sir David Nicholson, the NHS chief executive, conceded last week that primary care trusts, which currently control the budget, are "in meltdown" and that "Stalinist" central controls will be needed to keep the NHS finances in place, Number 10 sources say Mr Letwin has been charged with challenging the implementation plans.

The Treasury expressed reservations in July about the shift to GP commissioning. But one senior Treasury official said: "We have now got to get a grip on this," amid fears that the NHS could lose financial control in the run-up to the changes.

One Number 10 insider said: "There is no change in the policy. But Oliver is starting to ask all the important questions that need answers."

Another added: "Andrew [Lansley] has all the answers when he is asked the questions about how the implementation of all this will work. We are just not sure they are the right ones."

A senior Lib Dem source in the coalition said: "It is only right that we have a second pair of eyes looking at all this. We can't afford to get this wrong."

Aides to Mr Lansley are adamant there is no rowing back and that "David Cameron is 100 per cent behind all this".

Mr Lansley insisted on Tuesday there was no re-think under way, and said a response to the consultation on the white paper will emerge before Christmas. But he added: "It does not mean that we will do everything in the way that we first suggested in the white paper. This is a major reform.

"There are aspects of implementation of the reform that people have made comments on, and we will take them on board."

The prime minister has made much virtue of acting as "chairman" and not "chief operating officer" of the government, trusting policy lieutenants such as Michael Gove at education, Iain Duncan Smith on welfare and Mr Lansley to get on with reforms they conceived in opposition.

But partly as a result, both Downing Street insiders and outsiders say Number 10 lacks the subject specialists such as Andrew Adonis, Paul Corrigan and Simon Stevens in education, health and elsewhere who inhabited Labour's policy and delivery units.

"There just isn't anyone in Downing Street with the expertise to challenge Andrew's assertions," one insider said.

Jonathan Powell, Tony Blair's former chief of staff, said the coalition sees Labour's approach as having been too target and command and control-driven. "There is some truth in that. But you do need expertise in Downing Street to keep an eye on strategy and implementation, otherwise departments can just go off and do things that don't work, and you have no oversight. It was not just command control freakery on our part."

From the outside, he said, implementation oversight in Number 10 "looks weak".

Sir David appeared to hint last week that clusters of primary care trusts might survive the switch to GP commissioning in 2013, saying that was a matter for the NHS commissioning board, due to start operating in 2012.

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cables publishe
WikiLeaks reveal.

Mr King also said th
Conservative leader an
then shadow chance
operated too much withi
narrow circle and seem
resistant to reaching ou
beyond their small inne
group, according to the
dispatch sent in February.
The Bank governor also raised concerns that the pair only thought about issues "in terms of politics, and how they might affect Tory electorability".

Revelations that the governor had pressed the pair on their deficit reduction plans lend weight to the claims that Mr King was key in persuading the coalition to endorse a radical programme to cut the deficit.

Some senior bank officials have expressed concern about Mr King's "excessively political" support for the coalition government's fiscal austerity programme.

The cables reveal that Michael Fallon, now Conservative deputy chairman, also aired doubts about the leadership to US diplomats. A cable sent in October 2008 said the Tories response to the economic crisis had been "regrettably tepid".

Meanwhile, another leaked cable revealed on Tuesday that the British government had promised to protect US interests during the Chilcot inquiry on the Iraq war.

Jon Day, then director-general at the Ministry of Defence and a key political adviser to the Labour government, told Ellen Tauscher, US undersecretary of state, that the UK had "put measures in place to protect your interests", as he warned that there would be "a feeding frenzy" around the issue "when the inquiry takes off".

The admission came in a cable sent on September 2009, which recorded a series of meetings between Ms Tauscher and UK officials.

The revelation threatens to undermine the inquiry, launched by Gordon Brow former prime minister, identify lessons that ca be learnt from the Iraq conflict".

It is due to deliver its findings early next year.

Councils given £4bn to promote wellness

Public funding

By Nicholas Timmins

Some £4bn of NHS money is to be set aside for preventing ill-health and promoting wellness, with a good chunk of it handed over to English local authorities.

The radical shift in funding from 2013 will provide a ring-fenced budget for public health for the first time since councils lost their health functions 40 years ago in the 1974 reorganisation of the NHS.

However, while providing a significant boost for prevention and health promotion – which could save money in the long run by reducing rates of obesity, heart disease, cancer and other ills – the ring-fencing of the cash, just under 4 per cent of the NHS's budget, is likely to put added pressure on the remainder of the NHS budget.

It is more or less frozen in real terms to 2014, and Tuesday's public health white paper admits that "public health funds have too often been raided [in the past] at times of pressure in acute NHS services". Historically "money for public health has disappeared into other services", the health department said, but the new flow of cash "will change that".

Under the new arrangements, the Health Protection Agency and the substance misuse agency will lose their independence and be merged into the health department as Public Health England, which will deal with emergencies and national level protection.

The planned NHS commissioning board will buy in screening and some immunisation services from GP consortia, while an as yet undefined part of the budget will be devolved to local authorities to spend on ill-health prevention and health promotion.

> Andrew Lansley wants 'nudge' techniques to get people to look after their health better

Those that do well will receive a "health premium", taken from within the overall budget. However, an area that makes no progress "might receive no growth in funding", the white paper says – a move that would appear to penalise local populations for the failures of their local representatives and local public health director.

Only two-thirds of health gain comes directly from health services, said Andrew Lansley, health secretary, and with the new arrangements "we will start seeing significant improvements in the nation's health".

He also wants both business and employers to promote healthy living, with voluntary arrangements with the food and drink industries to tackle labelling and sensible drinking, while employing more "nudge" techniques to try to get people to look after their own health better. He is seeking a new "responsibility deal" with employers to promote healthy lifestyles. "It is simply not possible to promote healthier lifestyles through Whitehall diktat and nannying about the way people should live," Mr Lansley said.

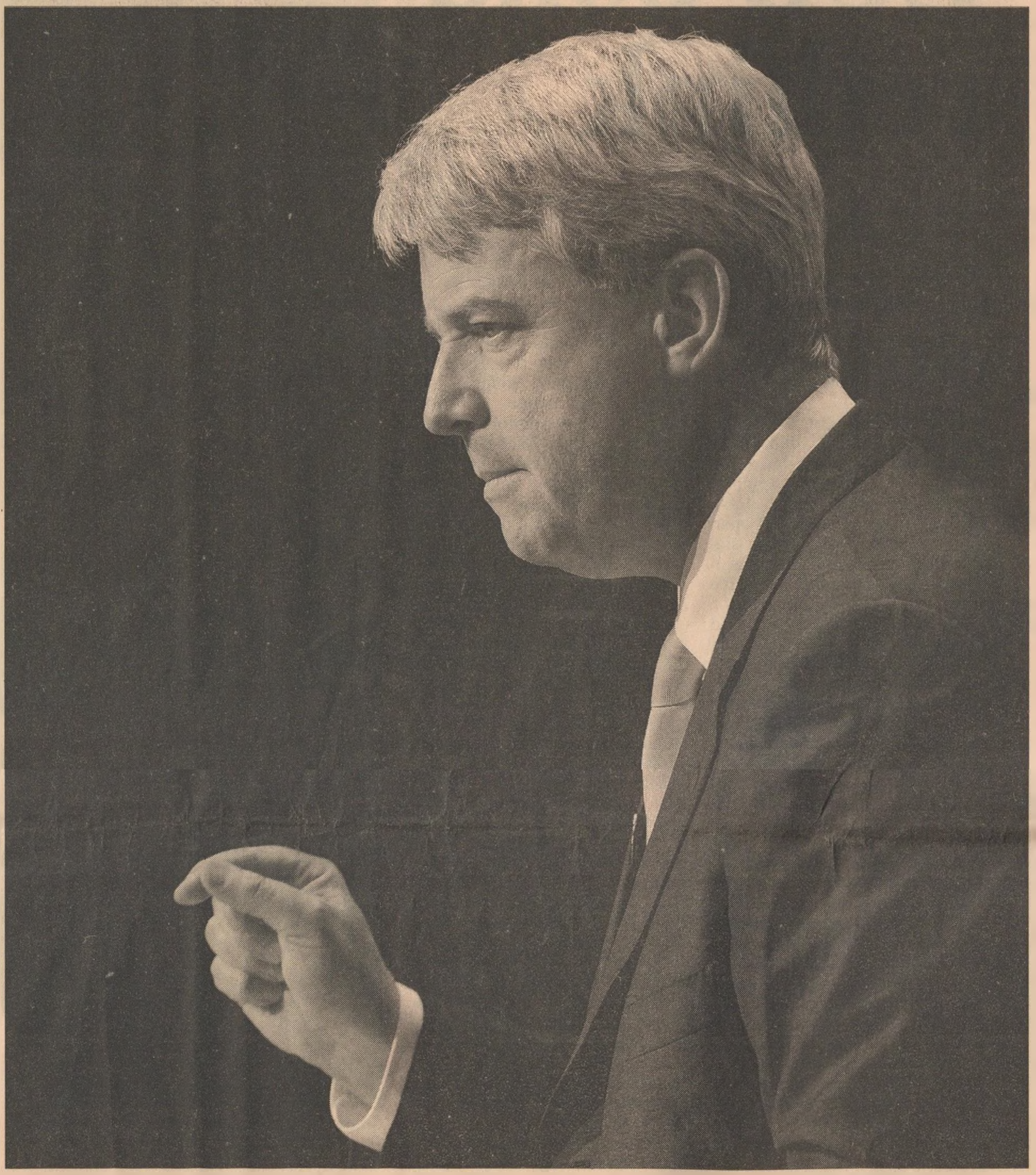
"We need a new approach that empowers individuals to make healthy choices and gives communities the tool to address their own, particular health needs," he added, with that supported by industry and other partners. More detailed papers on tobacco, alcohol, obesity, mental health and other issues will follow.

Public health professionals broadly welcomed the plans for a dedicated service, but John Healey, Labour's health spokesman, was dismissive, saying any good would be "knocked aside" by higher unemployment, increased poverty and cuts to school sport.

Sir Michael Marmot, whose government commissioned review of health inequalities the white paper partly addresses, said "nudge" would only work if combined with regulation and wider social programmes from the outset.

Tim Lang, professor of food policy at City University, said the white paper was "over reliant on corporate responsibility" given that companies profit from driving unhealthy lifestyles.

A wide range of organisations said more detail was needed on how the transfer of power to councils would work in practice.



Cash switch: Andrew Lansley, health secretary, says only two-thirds of health gain comes directly from health services Getty

'Nudging' as government strategy

David Cameron is fascinated by the idea of the state encouraging people to do the right thing and has set up a special "nudge" unit in Downing Street to work on the agenda, **writes George Parker**.

Richard Thaler, co-author of the best-selling book *Nudge*, has been sighted in Number 10 helping to devise a strategy where the state acts as a guiding friend rather than as a nanny, helping people to help themselves.

The public health strategy has been informed by this work, overseen by David Halpern, a veteran of Tony Blair's administration, who has specialised in overseeing a strategy to encourage "wellbeing".

Mr Cameron was attracted by the ideas in *Nudge*, written by Mr Thaler and Cass Sunstein, in opposition. The authors described their ideas as "libertarian paternalism".

The Downing Street unit is looking at issues such as reducing obesity, cutting smoking rates, and even persuading people to pay their taxes by appealing to their better nature.

Super-strength beers face higher tax rate to cut binge drinking

Tax on high-strength beer will rise next year, as part of a drive to tackle alcohol abuse which will also see cuts to duty on weak beer, **writes Vanessa Houlder**.

The new rates for beer containing more than 7.5 per cent alcohol and less than 2.8 per cent alcohol will be set out in the Budget in March.

The tax increase will affect super-strength lagers and some vintage ales, which together account for less than 1 per cent of the beer market.

The British Beer & Pub Association criticised the decision to single out beer for higher tax, leaving duty rates untouched for spirits and wines. Brigid Simmonds, chief executive, said:

> 7.5%
>
> **Alcohol content at which the higher levy will apply**

"Overall, we need a duty system that nudges consumers to choose lower-strength, pub-based drinks such as beer."

A Treasury spokesman said the decision was based on research which found that wine and spirits were generally consumed sensibly. The measures were targeted at binge drinkers, he said.

Don Shenker, chief executive of Alcohol Concern, a campaign group, welcomed the decision to use the tax structure as a lever to tackle alcohol-related problems, but said it was only "tinkering at the edges".

The BBPA welcomed the cut in duty for low-strength beer, which would provide an "incentive for further investment". However, it also said that moving towards duty based solely on alcohol content across all drinks would "significantly penalise responsible drinkers."

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Big banks meet tax code deadline

By Vanessa Houlder, George Parker and Megan Murphy

The biggest banks operating in Britain have met a Treasury deadline to sign up to a code of conduct designed to curb tax avoidance.

The code, which will encourage banks to follow the spirit as well as the letter of the law, was first announced by Alistair Darling last year in an effort to defuse anger over banks' tax planning schemes.

George Osborne, the chancellor, said on Tuesday: "Alongside the bank levy, this shows that the coalition government is taking action to ensure banks pay their fair share – unlike the previous government, which talked tough but failed to deliver."

The announcement that the top 15 banks had signed was made in the Commons by Nick Clegg, deputy prime minister, whose party has been pushing hard for tougher regulation. Mr Clegg has had to swallow a decision by Mr Osborne to shelve plans for full disclosure by British banks of bonuses above £1m, while he searches for European agreement. The Liberal Democrat leader's announcement offered a brief respite from a torrent of Labour criticism in the Commons over his U-turn on university tuition fees.

Mr Osborne last month set a deadline of the end of November for the banks to sign up in a BBC interview.

Only four of the 15 banks on Mr Osborne's list had signed the code at the time, which he described as "unacceptable". Privately, however, bankers said that they had been unaware of any deadline before the chancellor's announcement.

Many banks, particularly US institutions, had been reluctant to sign up to an extra-statutory code because of uncertainty over its implications.

Browne lines up key business figures

King and Cheshire on Whitehall list

By Elizabeth Rigby and Alex Barker

Justin King and Ian Cheshire are among some of the big business names Lord Browne has approached to inject commercial acumen into government as ministers press ahead with plans to shake-up Whitehall boards in spite of resistance from some civil servants.

The chief executives of J Sainsbury and B&Q, the DIY chain, have been quietly tapped up by Lord Browne to be senior non-executives on Whitehall boards, along with other big names thought to include Dick Olver of BAE Systems, Paul Walsh of Diageo, Roger Carr, former chairman of Cadbury, Sir Victor Blank, former chairman of Lloyds TSB, and Andrew Witty of GlaxoSmithKline.

The former chief executive of BP is keen to get some of the City's top talent into government in an effort to inject some commercial savvy into the way departments are run.

He is rounding up about 60 business figures to put on boards as non-executive directors. The first 15 senior non-executives were meant to have been unveiled by the Cabinet Office in November.

However, deadlines have slipped as the government struggles to bring all parties on board. Serious concerns have been raised in Whitehall over the process of appointing candidates and the roles being carved out for the new non-executive directors.

Some senior Whitehall officials are worried that the appointees, brought in by ministers, will have more clout than other non-executives – raising questions over the political impartiality of the boards and the balance of responsibilities of directors.

Meanwhile, some business leaders have needed convincing that the project is worthwhile and that they will be able to effect change.

"Not all secretaries of state or ministers want to do it. Some departments are up for it and others aren't," said one senior businessman. "Getting business involved is a terrific idea, but it's the practicality of it. You can't just fire the 'chief executive'. So the big question is, can you be useful?"

Another wrinkle in the implementation has been conflicts of interest, which have arisen as ministers look for private sector candidates with some experience of the main issues facing the department.

The Cabinet Office said on Tuesday that it was still on track to deliver the non-executives.

"[It is] a vital part of the government's plan to deliver its reform programme, and it is important we take the time to get this right," said a Cabinet Office spokesperson.

The announcement is expected before Christmas.

It is thought that each department will have four non-executives, with Lord Browne taking up the reins as the government's leading efficiency tsar, reporting directly to David Cameron, prime minister.

Notebook, Page 16

Eurozone woes

Berlin tough talk scares investors on future rescues

GLOBAL INSIGHT

Alan Beattie
in Washington

One thing is clear: the e-mail traffic between Angela Merkel, Nicolas Sarkozy and Jean-Claude Trichet concerning the Irish bail-out is going to provide a cracking read on WikiLeaks one day.

The €85bn rescue package for Ireland was agreed with somewhat less chaos than the Greek version earlier this year. The eurozone authorities have meshed their operations much more closely with those of the International Monetary Fund, which on this occasion is providing about a quarter of the money and at least three-quarters of the credibility.

But just as the labyrinthine journey to the Greek bail-out was complicated by talk of a European monetary fund, so the road to the Irish rescue was lengthened by a peculiar discussion about restructuring sovereign debt. Germany convened a seminar on financial architecture in the midst of a raging house fire, advancing the idea future rescues be conditional on private bondholders taking a haircut.

Berlin insisted that any changes would only take place after 2013 and would not apply to the Irish rescue. But despite France and the European Central Bank heading off the threat of a much more coercive debt restructuring mechanism, markets appear to have taken fright at the general idea that default is going to be an early recourse rather than a last resort.

In fact, this looks like another of those messaging blunders in which European leaders have specialised. When details of the proposed "mechanism" finally emerged this weekend, after it was heavily weakened by the ECB and Paris, it was not particularly radical. Its main element was a commitment to make it easier to corral recalcitrant investors during a restructuring by adding so-called "collective action clauses" (CACs) to bonds, which will merely bring eurozone debt into line with practice elsewhere.

More concerning is the suggestion that the restructuring of debt held by private investors could precede official assistance. The plan states: "If debt sustainability can be reached through these measures, the [mechanism] may provide liquidity assistance."

In practice, the two must proceed at least simultaneously, if not with public money taking the lead. Without knowing how much liquidity support from the IMF or the eurozone will be on offer to support growth – and hence tax receipts – bankrupt sovereigns will have to impose much bigger writedowns on private creditors in order to regain public solvency.

> Markets appear to have taken fright at the idea that default is going to be an early recourse

If eurozone authorities mean these to happen simultaneously, they need to say so publicly. There is widespread confusion among market participants and experts on the issue.

The supreme irony is that this discussion comes at a time when eurozone authorities, including Berlin, have shied away from demanding a debt writedown – in this case on the senior bonds of Irish banks – in return for a bail-out. A cent of action is worth a euro of posturing. If Berlin really wants to signal it is getting tough with private creditors, it should force a restructuring of bank debt and deal with the impact on German holders of Irish bonds itself, if necessary, rather than bailing them out at one remove.

By talking tough without thinking through the consequences, Berlin has scared investors about the prospects for future defaults while lacking the courage to insist on restructuring this time. All that seems to have been injected into the debate is more uncertainty about what eurozone authorities actually want and whether they have the political will and unity to achieve it.

Though the apparatus of decision-making has run much more smoothly for Ireland than for Greece, the verdict about inept economic management in the eurozone must still stand. This remains a hell of a way to run a bail-out.

Wall of opposition: hoardings covered in graffiti in Dublin yesterday. Many observers see the Ireland rescue programme as a risky exposure for the fund PA

IMF stance on Irish bail-out questioned

Reputation risk

By Alan Beattie

The International Monetary Fund has played the role in the Irish bail-out increasingly allotted to it: contributing a minority of the money, a lot of the technical capability and almost none of the public comment.

But while most experts think that the fund's presence is highly valuable, the comfortable majority who think that the Greek and Irish programmes are unsustainable without a writedown of debt to foreign investors are concerned about the threat to its reputation if the programmes go off track.

"Ireland is a risky exposure for the fund," says Arvind Subramanian, fellow at the Peterson Institute of International Economics in Washington.

"Most people believe that without some kind of debt writedown it will not work, but once again the bail-out is proceeding nonetheless."

The fund itself refuses to discuss why a writedown of senior bank debt is not included in Ireland's rescue programme, saying merely that the conditions address only lower quality "subordinated" debt.

Some observers familiar with IMF thinking say that given the possibility for financial contagion within the eurozone, there was only limited enthusiasm among fund staff for a restructuring and it was overwhelmed by fierce opposition from the European Central Bank and eurozone governments.

Eswar Prasad, a former senior IMF official now at Cornell University, says: "The fund does not appear to be pushing very hard for a restructuring now because it is worried about the knock-on effect on other European economies".

But he adds: "Everyone knows a restructuring is coming – it is just a question of when."

Prof Prasad says the function of the Greek and Irish programmes may simply be to cushion the blow of restructuring on the European banks that hold their debt, allowing them to build up bigger capital cushions or offload the bonds on to other investors gradually by deferring restructuring for a year or two.

The attempt to return Greece and Ireland to solvency is complicated by the overall cost of borrowing, which is higher than for a typical IMF-only programme. While the fund's contribution to the rescue is at just over 3 per cent interest, lending from the European financial stability mechanism and bilateral loans from the UK and others are at much higher rates.

Ireland's calculation that it faces an average interest rate of 5.8 per cent for the entire package also makes allowance for the cost of swapping the IMF's debt, which is denominated in a basket of currencies at a floating rate, into fixed-rate euro-denominated debt.

But since the 5.8 per cent rate is above most estimates of Ireland's trend economic growth in nominal terms, the rescue loans will take a long time to pay off compared with an IMF-only rescue.

The IMF's loan is under its "extended fund facility", which allows drawn-out repayment schedules. It runs counter to the development of IMF lending during much of the past decade, which, ironically bowing to pressure from European shareholders and particularly Germany, tried to emphasise limited short-term crisis lending rather than large open-ended financing.

"The arithmetic doesn't add up," says Prof Prasad.

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Fears over sovereignty stir deep emotions

Portugal

Public debate has progressed beyond the 'if and when' of a rescue to question what it would mean, writes Peter Wise

Pedro Passos Coelho, leader of Portugal's opposition Social Democrats (PSD), has been vilified by opponents this week for breaking the "ultimate taboo" of his political class: admitting the possibility that the country might have to seek a Greek and Irish-style bail-out.

"Shameful capitulation", "indescribable opportunism", said Jerónimo de Sousa, the Communist party leader. A man "prepared to pay any price to gain office", commented Augusto Santos Silva, defence minister in the Socialist government.

An international financial rescue, seen by many economists and investors as an increasing likelihood for Portugal, remains an unmentionable "elephant in the room" for most Lisbon policymakers, despite government borrowing costs repeatedly hitting new euro-era highs.

But outside Lisbon politics, where the idea of a bail-out by the European Union and the International Monetary Fund remains so sensitive, a public debate has moved beyond the "if and when" of a rescue to question what it would mean for the country.

"Only the IMF can do what our governments have shown themselves incapable of doing," Henrique Medina Carreira, a former finance minister, said in a heated television discussion on Monday night, referring to unsuccessful efforts to discipline the country's debt-burdened public finances.

"Letting the IMF in," countered Daniel Oliveira, a leftwing politician and journalist, "would be to hand over our sovereignty".

In internet blogs, newspaper columns, radio forums, workplaces and cafés across the country, similar debates are being waged over what the "coming of the IMF" – popular shorthand for a financial rescue – would mean for Portugal, the poorest of the peripheral eurozone countries swept up in the sovereign debt crisis.

"In a country where the average wage is only €800 [$1,043] month, it pains me to keep hearing that we are living above our means," said Mr Oliveira in the television debate. Mr Medina Carreira held up a chart showing a sharp dip in public deficits during the 48 years of the Salazar-Caetano dictatorship, which ended in 1974, describing it as an uncomfortable truth.

In the same way that sovereignty over economic policy is a burning issue for Ireland after centuries of British rule, the idea of tough austerity measures being imposed "anti-democratically" by the EU and IMF stirs deep emotions in Portugal.

Joining the European Community in 1986 and becoming a founder member of the euro in 1998 were seen as steps away from relative poverty and a return to the democratic fold. Despite a "lost decade" of low growth and months of an impending debt crisis, a majority of Portuguese, shown by polls to be among the most enthusiastic Europeans, continue to embrace the euro.

For many in Portugal's governing and professional classes, seeking an EU and IMF bail-out would be an admission of failure that could damage the country's international credibility for years.

Portugal did draw on the IMF's support in the 1970s and 1980s, and this has not been forgotten. "In the same way our creditors will remember our current failure of budgetary policy," Luís Campos e Cunha, a former finance minister, wrote in a newspaper column.

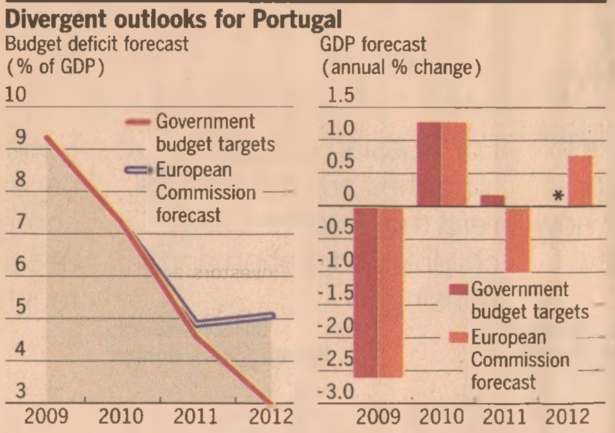
Nicolau Santos, an economics commentator, argues that it is a myth to believe that the IMF would succeed in pushing through difficult reforms where Portuguese governments have failed. "The IMF recommends cuts in public sector pay and welfare benefits and social security reforms – all measures which Portugal has taken. It also wants to liberalise individual dismissals, but that would make no sense for an economy like ours."

In the eyes of his critics, the cardinal sin of Mr Passos Coelho was to admit that he would be prepared to work with the IMF "if that would help the country", stressing that he neither wanted nor saw the need for a bail-out.

As José Sócrates, the prime minister, continues to resist such a possibility as unthinkable, the Portuguese public has already passionately engaged in weighing up its pros and cons.

A shop window with the words 'Crisis 2010 -20%' is seen in Porto's Baixa shopping district AP

Divergent outlooks for Portugal



*No government forecast

Source: European Commission, Portugal Ministry of Finance

Italy admits to concerns on contagion risk

Debt markets

By Guy Dinmore in Rome

Italy's centre-right government on Tuesday expressed worries over turmoil on international debt markets, as new data showed unemployment rising and thousands of protesting students paralysed central Rome.

Silvio Berlusconi, prime minister, told cabinet colleagues the spread between Italian 10-year bonds and the German equivalent had risen to a record 210 percentage points.

Gianni Letta, cabinet undersecretary, said he was worried that markets were trying to "spread the contagion from Ireland to more solid countries like Spain and Portugal, and maybe even Italy".

He did not know how much longer the government, facing a confidence vote in parliament on December 14, would last.

The comments from Mr Letta – sometimes named in the media as a possible caretaker successor to Mr Berlusconi – amounted to the first official admission in public that Italy was at risk of contagion.

It was the first time the cost of Italian borrowing had risen more than 2 percentage points over Germany's since 1997.

The ABI banking group blamed market speculation, arguing the public finances and banks were solid. Luigi Casero, Treasury undersecretary, also sought to calm markets, saying Italy did not need further austerity measures to meet budget deficit targets.

His comments followed a European Commission forecast that Italy's budget deficit would fall to 4.3 per cent in 2011 against a government target of 3.9 per cent in 2011 and 5 per cent at end-2010.

In spite of government assurances that Italy is emerging from its worst postwar recession, figures released on Tuesday show that the jobless rate rose to 8.6 per cent from 8.3 per cent a month earlier.

Giorgio Squinzi, of the Confindustria business group, said the fall of the government would not have a significant impact on Italy's finances.

Oliviero Roggi, professor of corporate finance at the University of Florence, believes markets have discounted political instability, but fears that market speculation will intensify, driving up Italy's borrowing costs.

"Like the big banks, Spain and Italy are too big to fail," he said.

"If they come under speculative attack, then probably the euro is over," he added.

The opposition has promised to see the 2011 budget through parliament before the confidence vote.

Adding to the sense of disarray, thousands of students protesting at planned education cuts brought central Rome to a standstill, throwing eggs and flour at riot police at parliament.

Mr Berlusconi was quoted as telling the students to go and study but they went on to block Rome's main railway station instead.

4.3%
European Commission forecast for Italy's budget deficit in 2011

3.9%
Italian government's target for budget deficit in 2011

World news

Medvedev seeks to woo voters with education

Russian president focuses on children

Warning of arms race with west

By Charles Clover in Moscow

Dmitry Medvedev, Russia's president, yesterday used his annual state of the nation address to campaign for a second term in 2012, slamming corruption in law enforcement, and focusing on themes that poll well among Russia's voters, such as children and education.

He also warned of a new arms race between Russia and the west should negotiations on a common strategy on missile defence in Europe – begun at a Nato summit last month – fail. "If we do not succeed in entering into a constructive understanding, there will begin a new arms race," he told a joint sitting of both houses of parliament.

His most important speech of the year was picked apart by experts eager to learn what it signalled for the future of Russia's "tandem", the political partnership between Mr Medvedev and former president, now prime minister Vladimir Putin. Mr Medvedev would clearly like a second term, while Mr Putin has not ruled out coming back to power himself. Most experts believe the prime minister, considered the stronger of the two, will have the final say, and Mr Medvedev's strategy has been to portray himself as an alternative while steering clear of any conflict with his mentor.

While some analysts found Mr Medvedev's speech wanting for lack of anything specific on political and economic reforms, Gleb Pavlovsky, head of the Foundation for Effective Politics, who works for the Kremlin as a "spin-doctor", said that focusing on themes such as children and education sent a clear signal to the elites that this was a campaign speech.

"For voters, priorities are not political reforms. Priorities are children, education and housing," he said. For instance, he praised a plan to offer free plots of land to families with three or more children.

RUSSIA IN-DEPTH

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But Masha Lipman, analyst at the Moscow Carnegie Center, a think-tank, said the speech was weak and hesitating. "He was not speaking as a leader with a vision or as a leader who knew how to implement his policy priorities," she said.

She said that Russia's elite still considered Mr Putin to be the paramount leader, though they are reading the signals emanating from the Kremlin for any indication that they should switch their loyalties to Mr Medvedev. "I certainly don't think this speech sent that kind of signal," she said.

Lacking in the speech was any elaboration on comments Mr Medvedev had made last week on his video blog indirectly criticising Russia's ruling United Russia party, headed by Mr Putin. He had said that rule by a single party would lead to political "stagnation".

With a bored looking Mr Putin sitting in the audience, Mr Medvedev glossed over the topic of political liberalisation and touched on police corruption, decrying "lack of discipline in law enforcement and other power structures, even to the extent of uniting with criminal elements".

Mr Medvedev earlier this year fired 15 police generals, after the death in prison of lawyer Sergei Magnitsky in November 2009. But many anti-corruption initiatives and other political reforms have been stymied.

Sergei Markov, a deputy in United Russia, said he believed that Mr Putin was disappointed with Mr Medvedev "not because he competes with him, but because he is not energetic enough, not tough enough".

However, Mr Putin has also thwarted many of Mr Medvedev's efforts to promote reform.

"Putin is utterly contradictory, its true. He wants Medvedev to be tough, but not to touch this or that. It's the normal behaviour of a retired manager," said Mr Markov.

In the spotlight: Dmitry Medvedev delivers his state of the nation speech in the Kremlin in Moscow yesterday AFP

What the critics said . . .

'He was not speaking as a leader with a vision or as a leader who knew how to implement his policy priorities'
Masha Lipman, Moscow Carnegie Centre

For Russian voters, the 'priorities are not political reforms. Priorities are children, education and housing'
Gleb Pavlovsky, Kremlin 'spin-doctor'

Putin is disappointed 'not because [Medvedev] competes with him, but because he is . . . not tough enough'
Sergei Markov, United Russia deputy

News digest

Jobless rise hits eurozone hopes

Eurozone unemployment rose in October, dashing policymakers' hopes of an improvement in the labour market before austerity measures take hold across the currency bloc.

The jobless rate reached a record 10.1 per cent, up 0.1 percentage point on revised September figures, according to Eurostat, the European Commission's statistical arm.

Stanley Pignal, Brussels
In full: www.ft.com/europe

Poland lifted by domestic demand

Poland's economy grew at an unexpectedly strong annual rate of 4.2 per cent in the third quarter, higher than the 3.6 per cent expected by analysts, mainly on the strength of rising domestic demand, the country's statistical agency said on Tuesday.

The economy expanded by an annual 3.5 per cent in the second quarter.

The data confirm Poland as one of the fastest growing economies in the European Union.

Jan Cienski, Warsaw
www.ft.com/europe

Oil spat delays Iraq census

Iraq's cabinet decided on Tuesday to postpone the nation's first full census in more than two decades as it struggles to end a dispute between majority Arabs and minority Kurds over land and oil.

No new date was set for the census, which is keenly awaited because it will answer questions important to the future of northern oilfields – areas in Kirkuk and Nineveh provinces disputed by Arabs and Kurds.

Reuters, Baghdad

Japan considers raiding pensions

Japan may have to dip into pension reserves to cover a funding shortfall in the next fiscal year, a stark illustration of the fiscal pressures it faces.

"It will be extremely difficult to secure the Y2,500bn [$30bn] financing needed to meet the treasury's obligation," said Yoshihiko Noda, finance minister.

Lindsay Whipp, Tokyo
www.ft.com/asia

Rail plan stokes CDU vote tensions

The German state of Baden-Württemberg, heartland of chancellor Angela Merkel's Christian Democrats, is braced for a raucous ride to regional elections in March after a highly divisive railway project was given the green light.

Arbitrator Heiner Geissler said stopping the €4.1bn project to part-demolish Stuttgart's historic rail terminus and replace it with an underground station would cost €1bn-€1.5bn in damages and fines.

Gerrit Wiesmann, Berlin
More: www.ft.com/europe

Kiev and Moscow reach gas deal

By Roman Olearchyk in Kiev

Russia and Ukraine have reached a settlement over a dispute involving billions of dollars' worth of natural gas, bringing a controversial gas trader back into the centre of the supply chain to Ukraine and possibly other European markets.

According to the agreement unveiled late on Monday, Naftogaz, the Ukrainian state energy company, will transfer 12bn cubic metres of gas from its underground storage facilities to Switzerland registered RosUkrEnergo. RosUkrEnergo this year won an international arbitration case ruling that the gas had been illegally expropriated from it after being transferred to Naftogaz as part of a deal to resolve the 2009 Russia-Ukraine gas crisis that disrupted supplies to Europe. The gas trader is jointly controlled by Gazprom, the Russian natural gas monopoly, and business people close to the inner circle of Viktor Yanukovich, Ukraine's president. In turn, RosUkrEnergo is to pay Naftogaz $1.7bn, nearly half the current market value of the gas, and Gazprom $800m.

The settlement – which Kiev-based analysts called a big blow for cash-strapped Naftogaz – brings to an end nearly two years of attempts by RosUkrEnergo to reclaim the disputed gas. Russia cut gas supplies to Ukraine – affecting supplies through the Russian export pipeline that runs across Ukraine to European markets – in a dispute in January 2009. In an agreement between Vladimir Putin, Russia's prime minister, and Yulia Tymoshenko, Kiev's premier at the time, RosUkrEnergo lost its previous intermediary position as monopoly supplier of Russian gas to Ukraine and exporter to Europe.

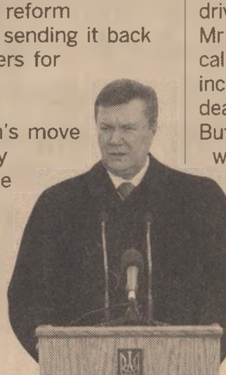
From the agreement reached this week, it remains unclear if RosUkrEnergo – which has been largely dormant in the past two years – will sell the gas only on the Ukrainian market or also to markets further west.

Tom Mayne, of London-based transparency watchdog Global Witness, said: "It would be a big step backward if RosUkrEnergo was to return. The case has never been made for why a structure such as RosUkrEnergo was needed in the first place. For the EU to secure its energy supply, there has to be predictability and transparency."

Yanukovich vetoes tax reforms

Ukraine's president has bowed to the demands of small businesses and vetoed tax reform legislation, sending it back to lawmakers for revision.

Viktor Yanukovich's move on Tuesday came in the wake of recent massive protests by people representing small and medium enterprises, who said the changes would drive them out of business. Mr Yanukovich (pictured) called for revisions to increase taxpayer rights in dealing with tax authorities. But he left it unclear whether tax privileges for small businesses would be preserved or adjusted.



For full story, go to: www.ft.com/europe

Strauss-Kahn pressed over his French political plans

Royal breaks ranks in Socialist race

By Ben Hall in Paris

Dominique Strauss-Kahn is under growing pressure to declare whether he will give up his job as managing director of the International Monetary Fund and run for the French presidency after one of his leading rivals broke ranks and entered the race for the Socialist party nomination.

Ségolène Royal, who lost to Nicolas Sarkozy in 2007 after a shambolic campaign, took her colleagues by surprise when she said on Tuesday she would seek the Socialist nomination for the presidential election in 2012.

Ms Royal's declaration ended a brief non-aggression pact that she had struck with Mr Strauss-Kahn and Martine Aubry, the Socialist party leader.

The three leading contenders had originally agreed to wait until June 2011 to decide which of them was best placed to beat Mr Sarkozy, who is already gearing up for the campaign following a reshuffle of his government in November.

Ms Royal insisted on Tuesday that "if [Mr Strauss-Kahn] comes back, we will see what is the best winning team".

However, she made her own evaluation very clear, lauding the IMF chief's economic competence but describing him as "the best prime minister that France could have" rather than as a potential head of state.

An opinion poll published on November 23 indicated Mr Strauss-Kahn would trounce Mr Sarkozy by 59 per cent to 41 per cent in a second round of the presidential election.

The former Socialist finance minister has yet to decide whether to run. He is in no hurry to leave his powerful IMF job to join a long and unpredictable US-style primary contest next year to secure his party's nomination.

The eurozone debt crisis argues in favour of Mr Strauss-Kahn's staying at the IMF for as long as possible, but he risks losing ground to rivals in France.

Ms Royal intends to use the next six months to build up momentum and present herself as the alternative to Mr Sarkozy.

In so doing, she will raise the pressure on Ms Aubry to enter the race.

More on this story at www.ft.com/europe