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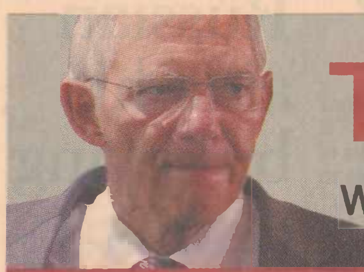
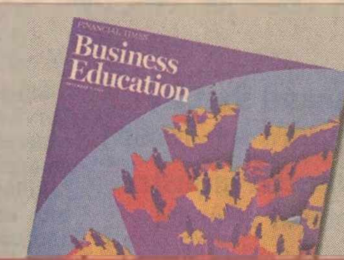


The troubleshooter

Wolfgang Schäuble, Europe's finance minister of the year, Page 14

European business schools ranking 2010

Separate magazine



World Business Newspaper

28

News Briefing

Tough bail-out terms set out for Irish banks
Ireland will have to accelerate the shrinking of banks' balance sheets in return for gaining continued access to emergency European funding. **Page 21; Editorial Comment, Page 16; Failings of Nama Page 23; www.ft.com/ireland**

Expert probes rise
The City watchdog is forcing a record number of financial services groups to hire outside experts to investigate their inner workings, prompting complaints over the rising costs of regulation. **Page 2**

£2.2bn Rio approach
Rio Tinto Group made an initial A\$3.5bn (£2.2bn) takeover proposal for Riversdale Mining, which is developing coal mines in Africa, Sydney-based Riversdale said today. **www.ft.com/mining**

Move on tax loopholes
Anti-avoidance measures expected to raise more than £2bn over five years are to be revealed, as the Treasury seeks to show its commitment to tackling tax dodging. **Page 3**

Aide faces deportation
A Russian woman working for a Liberal Democrat MP in the House of Commons is set to be deported amid indications that she is being detained on suspicion of espionage. **Page 2**

Concorde judgment
A French court will today deliver its judgment in the trial over the crash 10 years ago of an Air France Concorde that killed 113 people and speeded up the end of commercial supersonic travel. **Page 25**

Broadband upgrade bid
Local authorities may be invited to bid for public funds to upgrade broadband infrastructure, according to plans expected today. **Page 4**

Spanish flights resume
Air transport in Spain is returning to normal after a strike by air traffic controllers paralysed most of its airports for 24 hours. **Page 6**

Tehran nuclear talks
Iran today resumes talks on its nuclear programme for the first time in over a year, giving the US and allies a chance to gauge whether Tehran will make concessions. **Page 12**

Netanyahu criticised
The government of Benjamin Netanyahu faces criticism for its handling of Israel's most devastating forest fires. **Page 8**

Uranium shift
A Russian state-owned group is set to control up to a half of the US's uranium output by the middle of the decade, after US authorities backed the partial takeover of Canada's Uranium One by ARMZ. **Page 21**

Ivory Coast divisions
Former South African president Thabo Mbeki has been called to mediate in Ivory Coast, which now has two rival presidents after recent elections. **Page 8; Editorial Comment, Page 16**

Bank fees clarity urged
The Obama administration's consumer financial protection supremo is working on a deal with banks that would lead to more transparent products but could end free bank accounts. **Page 7; www.ft.com/usbusreg**

Separate section

FTfm
Fund management update

Europe's leaders at odds over bond plan

Fresh splits loom over turmoil in eurozone

Vast joint debt market proposed

By Ralph Atkins in Frankfurt and Quentin Peel in Berlin and Josh Chaffin in Brussels

Europe's leaders face fresh splits over how to tackle the eurozone's escalating crisis after being urged to create as rapidly as possible a vast market for joint European government bonds, a move almost certain to be blocked by Germany.

Jean-Claude Juncker, Luxembourg's prime minister who also chairs meetings of eurozone finance ministers, and Giulio Tremonti, Italy's finance minister, argue in today's Financial Times that the launch of "E-bonds" would send a clear message to financial markets and European citizens about the "the irreversibility of the euro".

They say the market for such bonds should become the most important in Europe, and as liquid as that for US Treasuries.

However, Germany's Wolfgang Schäuble – today named as the FT's European finance minister of the year – said in a video interview that jointly-guaranteed bonds would require "fundamental changes" in European treaties. He added that it was also key that governments had incentives to maintain discipline over finances – and faced sanctions when they did not. "Otherwise the euro would fail," he warned. Germany also fears the issuance of joint bonds would raise its borrowing costs.

The contrasting views of Mr Schäuble, and Mr Juncker and Mr Tremonti, will fuel the debate about what radical steps are needed to restore investor confidence in Europe's 12-year-old monetary union.

The European Central Bank was last week forced to step up substantially its purchases of eurozone governments' bonds to prevent the crisis spinning out of control – but Jean-Claude Trichet, its president, made clear the initiative for its long-term resolution lay with politicians.

Mr Juncker and Mr Tremonti outline institutional arrangements for E-bonds that they say would impose market discipline on governments without them being exposed to "speculative attacks", while at the same time fostering Europe's financial and economic integration.

Among other ideas, which could be discussed when finance ministers meet in Brussels on Monday evening, is an increase in the European Union rescue fund.

Such a move was backed at the weekend by Didier Reynders, Belgian finance minister – and has also been implicitly endorsed by Mr Trichet.

Top EU officials met on Sunday to discuss the crisis. Attendees were to include José Manuel Barroso, European Commission president, Mr Juncker, Herman Van Rompuy, European Council president, Olli Rehn, economics commissioner, and Mr Trichet, according to a person familiar with the plans.

Schäuble interview, Page 6
The vex factor, Page 14
Jean-Claude Juncker and Giulio Tremonti, Page 17
Video at www.ft.com/finmins

Liberal Democrats poised for three-way split over tuition fees

Students in Bristol took to the streets on Sunday before another week of national demonstrations over the planned tuition-fees rise Getty Images

By George Parker, Political Editor

The Liberal Democrats are expected to split three ways this week after Nick Clegg acknowledged he could not hold his traumatised party together before Thursday's Commons vote on the raising of university tuition fees.

Mr Clegg and Vince Cable, business secretary, are now expected to vote for the policy – reversing a high-profile election pledge to oppose tuition-fee rises – while some Lib Dem MPs could abstain and up to a dozen may vote against.

The party's discomfort will intensify before the vote when students stage what are expected to be mass protests in London and across the country.

After weeks of agonising internal party debate, the deputy prime minister has rejected the compromise favoured by Simon Hughes, his deputy, who hoped a policy of mass abstention would allow the party to unite by sitting on the fence.

Mr Cable has been mocked by Labour for indicating he was prepared to abstain in the interests of party unity, then suggesting he would vote for the policy, before saying last Friday he had yet to make up his mind.

Mr Clegg spent Sunday on the phone to his MPs urging them to support the lifting of the fees cap, but his aides admit unity now looks impossible. Charles Kennedy, the former leader, is among those MPs apparently determined to oppose a policy to allow tuition fees to almost treble to a maximum £9,000 a year.

'Nick Clegg really believes in this policy. The direction of travel is now obvious – he has always wanted to vote for it'

"Mass abstention is not tenable," said one aide to Mr Clegg. "Nick Clegg really believes in this policy. The direction of travel is now obvious – he has always wanted to vote for it."

The coalition looks certain to win Thursday's vote, which will allow universities to charge students up to an initial cap of £6,000; those charging a maximum £9,000 would have to make special arrangements to help poorer students.

Mr Clegg is now shifting his focus from managing his bitterly divided party – a final decision on voting tactics will be taken at a meeting on Tuesday – to try to sell to the public a policy he believes to be genuinely "progressive".

Mr Clegg told the Independent on Sunday that a £150m scholarship fund would give up to two years' free tuition to 18,000 students who receive free school meals.

But John Denham, shadow business secretary, claimed the scholarship scheme undermined Mr Clegg's claim that the new tuition fees arrangement would not deter poorer students from going to university.

Mr Clegg hopes university vice-chancellors will come out in favour of the plan in the coming days, on the basis that the funding settlement will provide stability in the years ahead.

But some vice-chancellors have expressed reluctance to enter such a politically charged environment, not least when their students are about to take to the streets in another week of national demonstrations.

A pledge too far, Page 3
www.ft.com/ukeducation

De La Rue wooed

DeLaRue

Crisis-hit printer of banknotes De La Rue has received a takeover approach from Oberthur, a French secure printing group, say people with knowledge of the matter. The FTSE 250 group, which prints notes for more than 150 currencies, is expected to reject an all-cash approach made in recent weeks valuing it at more than £750m. Oberthur is unlikely to offer more until it gauges the reaction of De La Rue's shareholders to its approach.

Report, Page 21

Flowers gets cold feet over move into Spanish savings banks

Blow as first potential foreign investor retreats

By Martin Arnold and Patrick Jenkins

Christopher Flowers, the US private equity investor, is backing away from completing the first foreign investment in a caja, dealing a blow to Spain's troubled savings banks, which trumpeted his arrival as a vote of confidence.

JC Flowers, the US financier's private equity vehicle, agreed in principle in July to buy €450m of convertible bonds in Banca Cívica, just hours before it became one of five cajas to fail European bank stress tests.

Mr Flowers said: "We entered into a non-binding letter of intent with Banca Cívica in Spain. That has never been superseded by a formal agreement. Consequently we have not made any investment in Spain and are not committed to do so."

Stressing that he was highly unlikely to acquire a bank in any country facing concerns over its own sovereign credit risk, Mr Flowers said that the Banca Cívica deal was not expected to be completed until Spain restored faith in its finances. Banca Cívica is in talks to merge with CajaSol. Mr Flowers said that he would decide whether an "investment in Banca Cívica makes sense after [its] merger discussions are complete".

Though Mr Flowers said that any investor would be "pretty brave" to move into Spain or Ireland, he is clearly intrigued by the potential opportunities.

Mr Flowers, who once predicted that "low-life gravedancers like me will make a fortune" from the crisis, is looking at three possible ways to invest in Ireland. The idea of buying stakes now in one of the "big two" – Allied Irish Banks or Bank of Ireland – or in EBS, the building society, would be attractive as long as government guarantees on legacy toxic assets are sufficient, he believes.

More appealing in the short term could be the purchase of asset portfolios at knock-down prices, again with government support.

A longer-term option is to buy the banks, or bits of them, once the government begins re-privatising them. Mr Flowers believes the UK is the most attractive market in which to pick up financial assets.

He recently bought a near-50 per cent stake in Kent Reliance as the platform to acquire other banking operations. That followed several years of attempts to break into the UK banking market by JC Flowers, which made failed bids for Northern Rock and Friends Provident.

Caution the watchword, Page 24

World Markets

STOCK MARKETS

	Dec 3	Nov 26	Wk's chg%
S&P 500	1224.71	1189.4	2.97
Nasdaq Comp	2591.46	2534.56	2.24
Dow Jones Ind	11382.09	11092.0	2.62
FTSEurofirst 300	1103.97	1086.65	1.59
DJ Euro Stoxx 50	2782.39	2736.96	1.66
FTSE 100	5745.32	5668.7	1.35
FTSE All-Share UK	2974.74	2930.78	1.50
CAC 40	3750.55	3728.65	0.59
Xetra Dax	6947.72	6848.98	1.44
Nikkei	10178.32	10039.56	1.38
Hang Seng	23320.52	22877.25	1.94
FTSE All World \$	212.2	205.7	3.16

CURRENCIES

	Dec 3	Nov 26		Dec 3	Nov 26
\$ per €	1.338	1.322	€ per \$	0.747	0.757
\$ per £	1.572	1.561	£ per \$	0.636	0.641
£ per €	0.851	0.846	€ per £	1.175	1.181
¥ per \$	82.66	84.04	¥ per €	110.6	111.1
¥ per £	129.9	131.2	£ index	80.60	80.90
\$ index	80.80	82.00	€ index	94.36	94.30
SFr per €	1.306	1.326	SFr per £	1.535	1.567

COMMODITIES

	Dec 3	Nov 26	Wk's chg
Oil WTI \$ Jan	89.19	83.76	5.43
Oil Brent \$ Jan	91.42	85.58	5.84
Gold \$	1,385.15	1,374.62	10.53

INTEREST RATES

	price	yield	Wk's chg
US Gov 10 yr	96.66	3.02	0.15
UK Gov 10 yr	110.47	3.42	0.08
Ger Gov 10 yr	96.93	2.85	0.11
Jpn Gov 10 yr	99.92	1.21	0.02
US Gov 30 yr	98.91	4.32	0.10
Ger Gov 2 yr	100.28	0.86	-0.07

	Dec 3	Nov 26	Wk's chg
Fed Funds Eff	0.19	0.20	-0.01
US 3m Bills	0.14	0.15	-0.01
Euro Libor 3m	0.97	0.97	0.00
UK 3m	0.66	0.66	

Inside today

Doing Business in Hungary

Reform is the route to tackle uncertainty

Separate section

No: 37,485 ★ ★ ★

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National news

FSA forces rise in probes by experts

Demand for City inquiries sets record

Financial industry protests at costs

By Brooke Masters and Megan Murphy

The City watchdog is forcing a record number of financial services companies to hire outside experts to investigate their inner workings, prompting complaints over the rising costs of regulation.

Since April, the Financial Services Authority has ordered 90 companies to commission and pay for "skilled persons reports" into areas such as capital adequacy, governance and complaint handling.

That is more than the 88 reports the FSA required during the entire 2009-10 fiscal year and triple the total for 2007-08, according to data obtained by the Financial Times through a freedom of information request.

The average cost of a report jumped by more than 50 per cent between 2007-08 and 2009-10 to £128,000, while the cost of the most expensive probe quadrupled from £1.1m to £4.4m, the data show.

The increase is a direct consequence of the FSA's tougher stance and its willingness to second-guess the executives who lead London's banks, insurance companies and brokers.

When regulatory supervisors uncover a rule violation or are worried that a company may have a problem, they are now far more likely to use their powers under Section 166 of the Financial Services and Markets Act to call in experts.

These investigations have underpinned some of the FSA's most prominent enforcement cases – against improper trading in client accounts at UBS and flawed client money handling at JPMorgan, among others.

Companies ranging from the interdealer broker Icap to the small mortgage broker Ash are among those told to pay for one. The most common issues are systems and controls, but governance-related reports are increasing rapidly, the FOI data show.

FSA officials say these "Section 166" reports are a smart way to husband its resources because they tap experts at the target's expense – freeing up the regulator's staff to focus on day-to-day supervision.

"It is a direct reflection of our desire to be more intrusive. I don't want to tie up huge swaths of supervisors doing detailed work on one firm," said Jon Pain, FSA managing director of supervision. "It's effective because the firm pays for it rather than the costs being spread across all firms."

Some lawyers and consultants agree, and point out that the Bank of England used to ask routinely for reports on topics of concern before the FSA's creation. "It is a much more front foot, proactive response," said Kari Hale, a former FSA official who is now a Deloitte partner and has performed two 166 reports so far this year.

But bankers and other lawyers argue that it amounts to an abdication of the FSA's responsibilities in favour of the "Big Four" accountants. There are not enough skilled consultants to do them, they say, and the costs can be prohibitive for smaller firms.

"There just isn't the infrastructure in place for conducting 100 of these reports a year," said a senior executive at a global bank, adding that the intrusiveness was making London less attractive.

MP's Russian aide hit by spying claims

By James Blitz

A Russian woman working for a Liberal Democrat MP in the House of Commons is set to be deported amid strong indications that she is being detained by MI5, the Security Service, on suspicion of espionage.

In an incident that could strain relations between London and Moscow, Mike Hancock, the Liberal Democrat MP for Portsmouth South, said on Sunday that Katia Zatuliveter, 25, his research assistant, had been subjected to a deportation order last Thursday.

The Home Office and officials at other government departments refused to comment on whether Miss Zatuliveter was being deported, saying they never discuss individual cases with the media.

However, government sources contacted by the Financial Times refused to deny newspaper claims that Ms Zatuliveter had been detained for espionage. They said the SVR, Russia's foreign intelligence service, is making a sustained attempt to gain information from political and business figures in the UK, and that there is no reason to think this threat is subsiding.

Ms Zatuliveter had been working for Mr Hancock, who sits on the Commons defence select committee, which examines defence policy but has no access to secret material.

The alleged arrest comes as David Cameron's government tries to mend relations with Russia ahead of a planned visit by the prime minister to Moscow next year. However, UK claims that Russia runs a significant spying operation in London remain an irritant.

The FT reported this summer that Russia's spy chiefs deploy between 30 and 35 intelligence officers at the country's official missions in London, operating an espionage effort of the same intensity as the one conducted by the KGB at the end of the cold war.

Mr Hancock denied that his assistant had done anything wrong. "She is not a Russian spy. I know nothing about espionage but she has been subjected to a deportation order," he said in a statement, adding that he would appeal against moves to deport her.

"No one has ever said to me under any circumstances whatsoever that she has been involved in anything like that. It is now in the hands of her lawyers. I am sure that in the end she will be proved to be right."

A security source told The Sunday Times that Ms Zatuliveter's presence was not "conducive to national security", and the intention was to "show her the door".

The newspaper said it was the first time since the end of the cold war that someone working in parliament had been accused of spying for the Russians.

Rule of law, Page 17

Osborne resists higher bank levies

By George Parker, Political Editor

George Osborne is resisting pressure for a new tax on bank bonuses or an increase in the revenue raised by the planned £2.5bn bank levy as he seeks to normalise relations between the government and the City.

Liberal Democrats including Vince Cable, business secretary, want to leave open the option of a new tax on bonuses if bank chiefs fail to show restraint when payments are made in February and March.

Meanwhile Mr Osborne has faced Labour calls for an increase in the money raised from the levy, details of which will be published by the Treasury before Christmas.

But the chancellor believes there is enough uncertainty hanging over the City at present, and David Cameron, prime minister, has told colleagues: "It's time for us to stop beating up on the banks."

Bank leaders are expected to announce their side of a "peace pact" soon, and are considering commitments to lend £180bn each year to British companies and £1.5bn to Mr Cameron's "Big Society Bank", and a broad cut in bonus levels.

Mr Osborne believes Sir John Vickers' report on the future of banking poses enough quandaries for the City without what Treasury officials call "knee-jerk" threats to raise new taxes on the banks. Although Mr Osborne does not expect Sir John's team to recommend a complete separation of investment and retail banking operations, the report may call for some banks to be broken up to foster competition.

The Treasury dismissed a report on Sunday that it was eyeing an early sale of the public's stake in RBS and Lloyds Banking Group, arguing that no such sale would be possible until after the conclusion of the Vickers review.

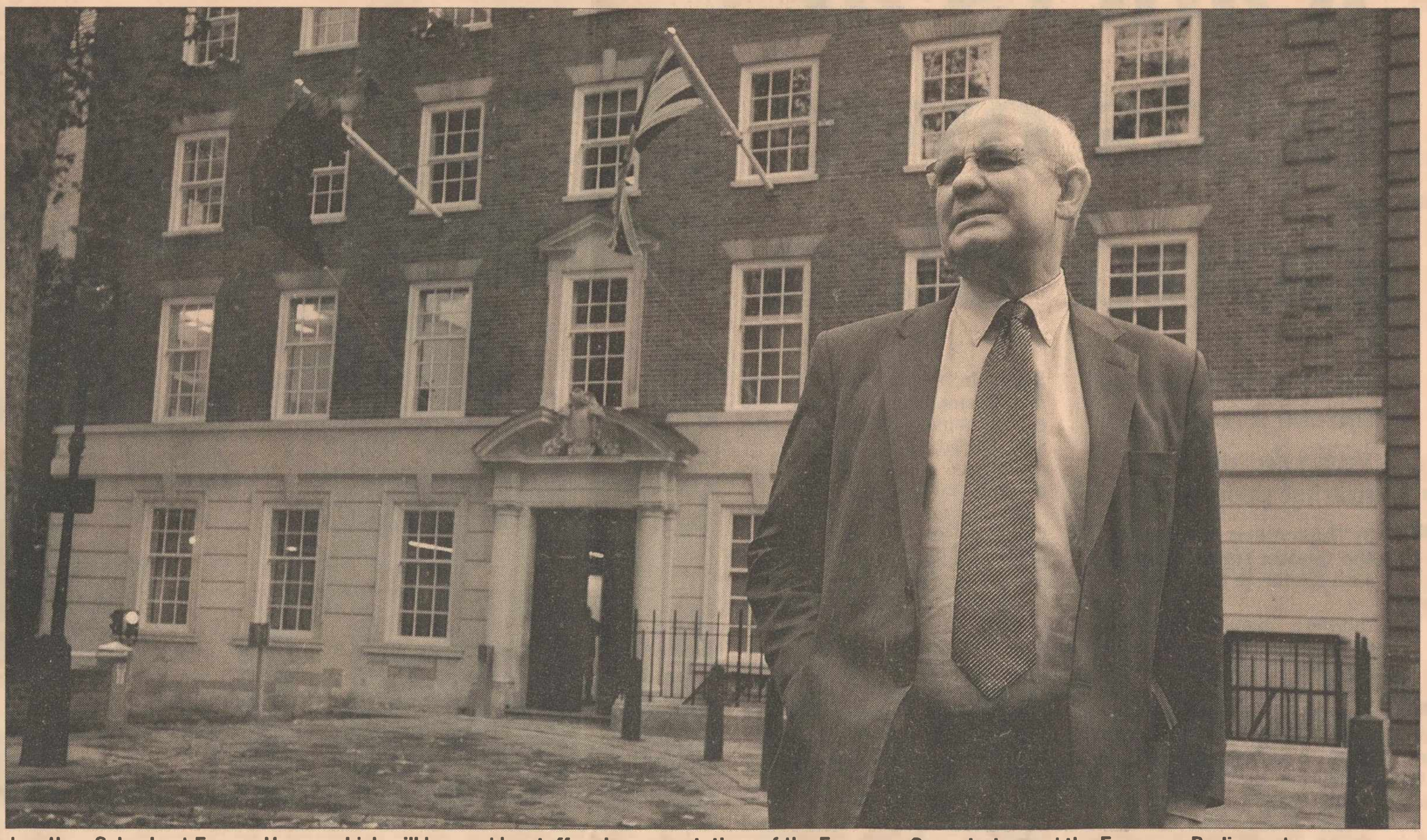
Mr Osborne's team also discounted reports he was eyeing a new bank bonus tax, pointing out that the last Labour government's bonus levy had done little to change bank behaviour – even if it did raise substantial sums for the exchequer.

The chancellor will announce soon the details for the implementation of a separate bank levy, to be imposed on balance sheets, with a view to raising £1.2bn in the next financial year and about £2.5bn in subsequent years.

"We are targeting the revenue here and will set the rate accordingly," a Treasury spokesman said. "We judge £2.5bn to be the maximum sustainable revenue."

But Chuka Umunna, Labour member of the Treasury select committee, said: "They could certainly pay a whole lot more. When I meet senior bankers, they are very completely relaxed about the levy. If they are not complaining, you are probably not setting the rate high enough."

More news, comment and analysis on bonuses at www.ft.com/bonuses



Jonathan Scheele at Europe House, which will be used by staff and representatives of the European Commission and the European Parliament Daniel Lynch

Brussels breaches Thatcher's stronghold

Europe House

The Tories' former HQ officially opens today as a home for two European bodies at a cost of £30m, says **George Parker**

Margaret Thatcher's citadel at 32 Smith Square – backdrop to her three election victories – will today fall into the hands of her oldest foes, when the old Conservative Central Office is officially reincarnated as Europe House.

As if the sight of the blue, star-spangled European Union flag flying outside her old HQ was not enough, Lady Thatcher is unlikely to be impressed by the fact that the EU has spent more than £30m buying and refurbishing the building.

Europe House is presided over by Jonathan Scheele, a British "lifer" on the Brussels scene, who admits he is "sensitive" to the idea of opening these new offices at a time of austerity.

But he argues Europe House replaces two separate EU buildings at Westminster, housing staff and representatives of the European Commission and the European Parliament, and it will save money in the long term. Not only is it at the cutting edge of green technology, there will be public spaces for people to come and talk about European issues.

"We are not talking about one-sided propaganda," he says.

Champagne is banned at tonight's reception but, even so, there are whispers in Brussels that some feel uneasy about attending the opening of a building that cost £26m to purchase and £4m to refurbish in these straitened times.

Lady Ashton, the EU foreign affairs head, was originally down as a guest, but is instead meeting Iranians in Geneva. José Manuel Barroso, European Commission president, is another guest of honour unable to attend.

Mr Scheele, 62, admits he has "a tough job" being the EC's head of representation in his home country, trying to explain the EU's purpose to a country that is probably the most Eurosceptic in the union.

He knows something about difficult sales pitches. Before moving to Brussels in 1974, he worked for British Leyland. Nick, his brother, is the former president of Ford.

Jonathan Scheele sees his job as having two main purposes. The first is "to explain the EU" to the media, MPs, lobby groups and to individuals. "We get some pretty rude e-mails," he says with a smile.

The second is to explain Britain to Brussels, especially in areas such as financial services regulation.

"The City is not just an asset to Britain," he says. "It's an asset to the EU as a whole. On this and other issues, the Commission is concerned that we don't walk into elephant traps before we make proposals."

Mr Scheele accepts that the crisis in the eurozone, the prospect of a German-inspired treaty revision and an ongoing battle about the EU budget, has stirred anti-European passions that have been dormant at Westminster for some time.

"Clearly the Conservative Eurosceptics will use the opportunities that arise," he says, adding: "From the point of view of the government, radio silence from Brussels would be no bad thing."

However, he says the coalition government has been "quite proactive and constructive" in its relations with the EU, often finding itself on the same side as the Commission in areas such as free trade, enlargement, climate change and the growth agenda.

He concedes there have been differences on EU budgetary matters, and Britain will want to get a grip on shortcomings in the management regional structural funds, exposed by the Financial Times last week.

"People are perfectly entitled to be sceptical," he says. "But I want that to be for the right reasons and not because they have a false understanding of what we are doing."

Opening ode

While Britain's relationship with the European Union is usually written in prose – often expressed in blunt Anglo-Saxon language – the opening of these new offices proves that some are still stirred to poetry by the European project, **writes George Parker.**

George Szirtes, a Hungarian-born British poet, has composed a verse on the opening of Europe House:

Here histories, manners,
speech, vision, dance,
Commerce and custom,
constitution, chance
And strategy, seek
concord and a voice.
Open the door. The
house is yours.
Rejoice.

Poll victory: Margaret Thatcher at Central Office in 1987 PA

Panel set up to drive property savings

Government seeks advice on real estate

By Daniel Thomas and Elizabeth Rigby

Top property professionals have been approached by the government to advise on a strategy to drive cost savings across its £370bn real estate portfolio.

Leading real estate bankers and advisers have been invited to sit on a panel of experts to help the Cabinet Office gain efficiencies across the government estate. The government is the largest owner of property and land in the country, ranging from hospitals and police stations to offices, embassies and army barracks.

The panel will add to the recommendations of Sir Philip Green, who had been asked by the coalition government to look at cost-cutting more broadly across departments. Some of the easiest savings are seen to be in its use of property, with the government spending £25bn annually on running its wholly owned estate and on covering the cost of its lease liabilities.

One senior banker who was asked to sit on the panel said property cuts were an "easy win" for the government as they did not have the same emotional effect as cuts in other areas.

The Cabinet Office confirmed that it was in discussions with property experts and said an announcement would be made in "due course".

"This government is committed to its efficiency and reform agenda and to driving through savings across government. As part of this process the Cabinet Office is in the process of setting up a panel of property experts from the private sector to provide advice on the government's strategy to drive efficiencies throughout its estate."

The government has begun making improvements to the running of its estate, including a moratorium on signing leases and a policy to agree new terms only at less than the market value by using the state's strong covenant. This has already saved £24m.

The government has created a property unit within the Cabinet Office headed by John McCready, which will work with the advisory panel. Mr McCready is head of the property unit at the Shareholder Executive, which manages taxpayer-owned assets.

The government is focused on reducing the £25bn annual cost of running its estate using a national control strategy aimed at making the government's occupation of property more efficient. It is also creating vehicles for the central ownership of public property, with pilots being rolled out in London and Bristol.

It is expected that these vehicles will be able to form joint ventures with private sector partners to increase revenues and improve efficiency across the government estate.

The large sale of property from the government's £370bn estate as a means of raising money to reduce the deficit has been played down by Mr McCready in the past, however.

In November, he said that where possible the government should try to retain ownership of its estate because this gave it the greatest flexibility and meant it could not be held to ransom by landlords.

The property market outside London was also too weak to support extensive sales, he said.

> One banker said property cuts were less emotive, and so an 'easy win' for the government

Reports and analysis, www.ft.com/property

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World news

Financial markets 'do not understand the euro'

Interview

Wolfgang Schäuble
German finance minister

The link between opportunity and risk is spelled out to **Quentin Peel** and **Ralph Atkins**

European monetary union is a new form of governance for the 21st century, but international financial markets do not really understand how it works, according to Wolfgang Schäuble, German finance minister.

"We need new forms of international governance, global governance and European governance," he said in an interview with the Financial Times.

"The international markets do not really understand the very specific construction of the euro. We have a common monetary union, but we don't have a common fiscal policy. [We need] to convince the international public and international markets that this is a new form, very specific to meeting the demands of the 21st century."

Mr Schäuble warned that if private bondholders did not bear some risk, as well as the reward, of investing, it could destroy the legitimacy of the market economy and even of "our political order".

He ruled out the use of jointly guaranteed eurobonds to finance borrowing by eurozone members as a move requiring "fundamental changes in the European treaty". But he did express optimism that, in the long run, eurozone member states, including Germany, would be prepared to give up more of their national budgetary authority.

Speaking as winner of the FT competition for European finance minister of the year, Mr Schäuble spelt out his belief in shared national sovereignty in the European Union. "If you want to build European integration, you don't have to harmonise everything," he said. "The model of European integration is very modern, and there is a lot of interest [in it] in Asia.

"There is a lot of scepticism in North America, I know, but there is a lot of interest in Asia, and I think we should work to improve the European model and to get the UK as much engaged inside the European model."

It was based on a concept of the "limited sovereignty" of member states. "That is a demand of all people in Europe. This does not mean [it is necessary] to harmonise every part of national sovereignty, but to find beyond national sovereignty some parts which have to be decided in a new way – a totally different way to the 20th century."

That was why the EU needed rules such as the stability and growth pact to underpin monetary union with guidelines for budgetary and fiscal policy, including limits on the indebtedness of eurozone member states. "We need rules like the stability and growth pact and, of course, we need incentives and sanctions," Mr Schäuble said. Such sanctions included interest rate spreads to reflect the different risks involved in government borrowing between different eurozone members, according to their public debt burden.

It was one reason why private creditors should be required to participate in any bail-out scheme. "If you have the risk it must not only [be borne by] taxpayers," he said.

"In any market economy there has to be a relationship between risk and opportunity, otherwise it would fail and we would lose any support for the legitimacy of our economic and, in the end, of our political order."

Mr Schäuble said raising jointly guaranteed eurobonds to finance government debt in the eurozone would not be possible "without fundamental changes" in the European framework.

"As long as we have a national competence for fiscal policy, we cannot give up the instruments for incentives and sanctions for members of the eurozone, [to ensure] discipline in their national budget policies," he said.

If the German parliament were asked for a vote today on giving up national budgetary authority, "you would not get a Yes vote", he added. But "if you would give us some months to work on this, and if you give us the hope that other member states will agree as well, I would see a chance".

He said that, given their history after 1945, "for Germans it is relatively easy to understand that national sovereignty alone is not the instrument for the 21st century. It is more difficult for other countries".

It was "absolutely unavoidable" for the big economies to reduce their deficits, "not only in Europe, but in the US as well". "In principle, we all have too-high deficits, and deficits were one of the main reasons for the crisis," he said.

"I know the difficulties in the US but, when we discussed an exit strategy in the first months of the year, in Europe, the G7 and the G20, everyone agreed, even the IMF, we have to find a balanced exit strategy."

Every country needed a different strategy to fit its own situation, he added, and Germany was "on the right track".

He was "quite sure" that domestic demand in Germany would increase, but it depended on investors and consumers regaining confidence, not on government action. "Confidence is a precondition in Germany for increasing internal demand."

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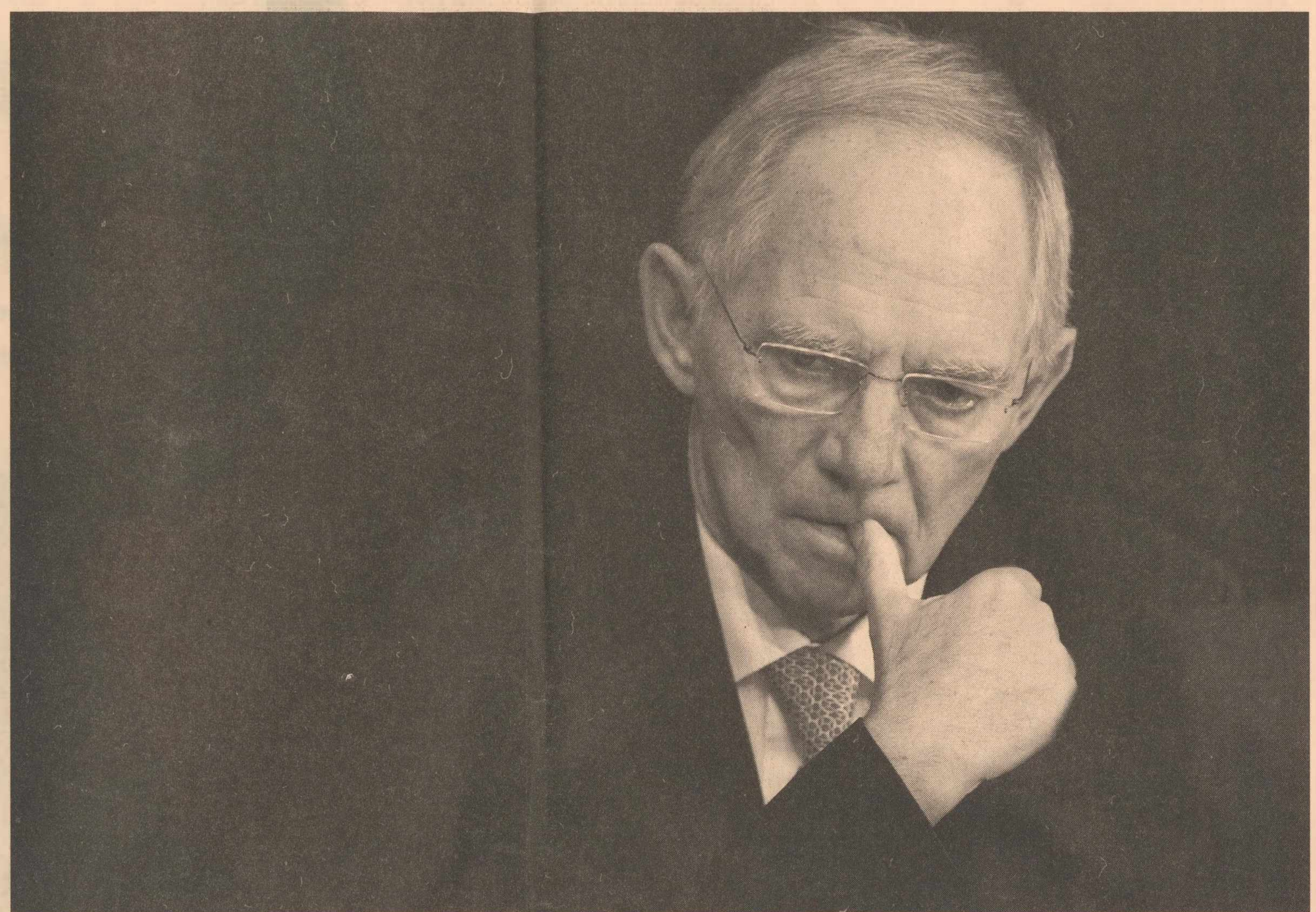
VIDEO ON FT.COM

Wolfgang Schäuble, the FT's European finance minister of the year, talks to Quentin Peel about the future of the eurozone
www.ft.com/schauble



Food for thought: Wolfgang Schäuble, German finance minister, has said Berlin may be prepared to relinquish more national budgetary authority EPA

Europe puts final touches to crisis regime

By Ben Hall in Paris

Eurozone finance ministers are putting the finishing touches to a regime for managing future debt crises involving private creditors, but French officials say it is highly unlikely a government will ever be pushed into restructuring its debt.

"The markets have got this wrong," said an official. "Insolvency is just not politically acceptable."

In a deal later endorsed by other eurozone governments, France and Germany agreed on November 28 to set up a permanent European stability mechanism with two stages. Countries with liquidity problems would get access to emergency aid as they do now from the €440bn European financial stabilisation facility.

A eurozone member that is later deemed insolvent would have to restructure its debt. While Berlin depicted the deal as a breakthrough that would ensure bondholders shared the cost of lending to ill-disciplined governments, Paris took a different view.

French officials see it as nothing new. "We have made the choice of an absence of originality," said a senior Elysée adviser.

While the markets focused on the nature of private sector involvement in potential debt restructuring, the Elysée believes the achievement was the extension of the EFSF.

In May, France and other eurozone governments fought to get Berlin to agree to a temporary bail-out facility. Six months later Germany agreed to make it permanent. Now the onus is on ensuring the fund is large enough to contain the crisis.

As for the debt restructuring, French officials say it replicates IMF procedures for dealing with sovereign debt crises.

This view is shared by Jean-Claude Trichet, president of the European Central Bank. In Paris on Friday Mr Trichet said: "What I took from this declaration [of November 28] and what is essential in my mind is that European governments are making it very clear that they are not introducing a different doctrine.

"In the case of European adjustment packages with IMF support that may be triggered in Europe, there is no different doctrine from the international doctrine."

Need for bonds, Page 17

Spain forecasts speedy recovery for air travel after strike

By Mark Mulligan in Madrid

Air transport in Spain was returning to normal late on Sunday after a wildcat strike by air traffic controllers paralysed most of the country's airports for 24 hours and prompted the government to declare a state of emergency.

Aena, the airports authority, said on Sunday evening that about 2,000 of the 4,080 flights scheduled for Sunday had taken off or landed. It forecast a return to near normal service for today.

With order set to return after the weekend chaos, travel operators and government officials began calculating the economic cost of the stoppage on Spain's embattled economy.

One industry association estimated the direct loss for airlines at €60m-€80m ($81m-$107m), while others put the damage to the entire tourist sector, which accounts for about 11 per cent of gross domestic product, at several hundred million euros.

Meanwhile, the socialist government of José Luis Rodríguez Zapatero, the premier, was careful to assure foreign investors spooked by the eurozone crisis that it had regained control.

Alfredo Pérez Rubalcaba, deputy prime minister, said: "We will not allow a repeat of a situation like this . . . This strike was extremely serious and had very damaging consequences."

Madrid's tough line against the air traffic controllers, which could now include disciplinary and judicial action, dismissals and penalties, looks likely to provide a needed boost to Mr Zapatero's government.

The 2,300 air traffic controllers say understaffing forces them to exceed the 1,200 work hours a year considered safe. However, they are seen as overpaid, privileged and disruptive.

The government, under pressure to cut public sector costs and prepare Aena for partial privatisation, has been fuelling this perception for at least a year.

José Blanco, the combative development minister, has partially blamed the controllers for Aena's high operating costs relative to the rest of Europe, and its heavy debt load.

In January, while seeking parliamentary support for reforms to the way Spanish airspace is administered, he revealed that at least one air traffic controller made €900,000 in a year, after adding overtime to the €140,000 salary.

The government soon after slapped a limit on allowable overtime, raised the ceiling on normal working hours, cut basic pay and widened Aena's powers over air traffic controllers.

Until Friday's wildcat stoppage, the controllers' response had been restrained to work-to-rule orders, overtime bans and regular absences on health grounds. This has caused frequent flight delays at Madrid's Barajas airport and other large airports in the country.

The shutdown of airspace over Madrid and the Canary Islands on Friday night, and most of the rest of the country on Saturday, caused chaos, with hundreds of thousands of Spanish and foreign travellers stranded at airports or stuck at home or in hotels as flights were cancelled.

The government called in the army to take over control towers and patrol airports as it declared a state of emergency.

Mr Blanco said Aena had initiated 440 disciplinary proceedings against the air traffic controllers.

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Comment

Saving the eurozone : The FT airs ways to staunch the crisis and halt contagion in the continent's national markets for sovereign debt

Euro-wide bonds would help to end the crisis

Jean-Claude Juncker and Giulio Tremonti

In spite of recent decisions by European fiscal and monetary authorities, sovereign debt markets continue to experience considerable stress. Europe must formulate a strong and systemic response to the crisis, to send a clear message to global markets and European citizens of our political commitment to economic and monetary union, and the irreversibility of the euro.

This can be achieved by launching E-bonds, or European sovereign bonds, issued by a European Debt Agency (EDA) as successor to the current European Financial Stability Facility. Time is of the essence. The European Council could move as early as this month to create such an agency, with a mandate gradually to reach an amount of outstanding paper equivalent to 40 per cent of the gross domestic product of the European Union and of each member state.

That would bring sufficient size for it to become the most important bond market in Europe, progressively reaching a liquidity comparable to that of US Treasuries. But to ensure this happens, two further steps must be taken. First, the EDA should finance up to 50 per cent of issuances by EU members, to create a deep and liquid market. In exceptional circumstances, for member states whose access to debt markets is impaired, up to 100 per cent could be financed in this way. Second,the EDA should offer a switch between E-bonds and existing national bonds.

The conversion rate would be at par but the switch would be made through a discount option, where the discount is likely to be higher the more a bond is undergoing market stress. Knowing in advance the evolution of such spreads, member states would have a strong incentive to reduce their deficits. E-bonds would halt the disruption of sovereign bond markets and stop negative spillovers across national markets.

In the absence of well-functioning secondary markets, investors are weary of being forced to hold their bonds to maturity, and therefore ask for increasing prices when underwriting primary issuances. So far the EU has addressed this problem in an ad hoc fashion, issuing bonds on behalf of member states only when theiraccess has been seriously disrupted. This week the European Central Bank took further steps to stabilise the secondary market. With a single European market, primary market disruptions are in effect precluded, reducing the necessity for emergency interventions in the secondary market.

A new market in E-bonds would halt the disruption of sovereign bond markets and stop negative spillovers

A new market would also ensure that private bondholders bore the risk and responsibility for their investment decisions. In this way, the E-bond proposal usefully complements recent decisions aimed at providing clarity about a permanent mechanism to deal with debt restructuring. It would help to restore confidence, allowing markets to expose losses and ensuringmarket discipline. Allowing investors to switch national bonds to E-bonds, which might enjoy a higher status as collateral for the ECB, would help to achieve this. Bonds of member states with weaker public finances could be converted at a discount, implying that banks and other private bondholders immediately incurred the related losses, thus ensuring transparency about their solvency and capital adequacy.

An E-bond market would also assist member states in difficulty, without leading to moral hazard. Governments would be granted access to sufficient resources, at the EDA's interest rate, to consolidate public finances without being exposed to short-term speculative attacks. This would require them to honour obligations in full, while they would still want to avoid excessive interest rates on borrowing that is not covered via E-bonds. The benefits from cheaper, more secure funding should be considerable.

A liquid global market for European bonds would follow. This would not only insulate countries from speculation but would also help to keep existing capital and attract new flows into Europe. It should also foster the integration of European financial markets, favouring investment and thus contributing to growth.

Ultimately the EU would benefit too. Profits from conversions would accrue to the EDA, reducing effective E-bond interest rates. As a result EU taxpayers, and those member states currently under attack, would not have to foot the bill. All these benefits could be extended to member states that remain outside the eurozone.

We believe this proposal provides a strong, credible and timely response to the ongoing sovereign debt crisis. It would endow the EU with a robust and comprehensive framework that not only addressed the issue of crisis resolution but also contributed to the prevention of future crises by fostering fiscal discipline, supporting economic growth and deepening European integration.

The writers are prime minister and treasury minister of Luxembourg and Italy's minister of economy and finance

A Europe doomed by design flaws

Wolfgang Münchau

Usually I stay clear of connotation-rich German words that have no real equivalent in other languages. Their purpose is to obfuscate. But there is one that describes the eurozone's crisis management rather well. It is *überfordert*. The nearest English translation is "overwhelmed", or "not on top of something", but those are not quite the same. You can be overwhelmed one day, and on top the next. *Überfordert* is as hopeless as Dante's hell. It has an intellectual and an emotional component. If you are it today, you are it tomorrow.

I am not saying that every policymaker in the eurozone is hopeless. There are a few exceptions. My point is that the system is *überfordert*, unable to cope. This inability has several dimensions. I have identified six.

The first, and most important, is a tendency to repeat the same mistakes. The biggest of these is the repeated attempt to address solvency problems through liquidity policies. It happened in October 2008 with bank guarantees. The European Central Bank's never-ending liquidity support is another example. So is the Greek bail-out. And so is the European Financial Stability Facility, the €440bn ($588bn) bail-out fund. Set up in May as a mechanism to resolve financial crises, it became a cause of the Irish crisis in November. What triggered last week's panic was the sudden realisation by investors that, with an interest rate of 6 per cent and an ongoing no-default guarantee to bank bondholders, Ireland is insolvent.

The second is a lack of political coordination. All the decisions taken have one thing in common: no one takes political ownership of the whole system. Everybody inside the system is optimising their corner. International investors, by contrast, are looking at the system as a whole and cannot make sense of the cacophony. Germany's motivation in the debate on the European Stability Mechanism (ESM), the anti-crisis mechanism from 2013, was to safeguard its financial interest. That is legitimate, but the way it is done offers no solution feasible for the eurozone as a whole.

The third is a breakdown of communication. The EU has a tendency to hype whatever it agrees. The markets first react with euphoria to the announcement, then with disappointment once they have read the small print. When Germany raised the issue of a permanent anti-crisis mechanism, it gave few details. The markets were spooked. When news came out that Germany had climbed down over the question of automatic bondholder haircuts, the markets were euphoric. Details that have come out since are again more alarming. The way the ESM is constructed will make a debt default in the eurozone dramatically more probable. There is a good case to be made for limiting taxpayers' liability. But the scope and the details must be conveyed much more clearly.

A fourth aspect is a tendency by governments to blame investors when something goes wrong, rather than solve the problem. The prevailing view in Paris and Berlin is that last week's crisis was the work of nasty speculators. It is not the first time. Remember the ban on short-selling of equities? Or the "locust" debate about private equity a few years back? The point is that this time there is no George Soros-like speculator attacking the system.

The EU hypes whatever it agrees. The markets first react with euphoria to the announcement, then with disappointment

These are fairly normal investors who are pulling out, or regrouping. They have lost confidence in the eurozone's crisis management.

Fifth is the tendency to blame each other. In the spring, the Germans had a go at the Greeks. Now the Spanish and the Irish blame the Germans. Readers of this column know that I have been a frequent critic of German policy, but I think it unjustified to blame Berlin for causing the current problems. The cause of the crisis in the European periphery was the bursting of a credit bubble, and that bubble was not the work of the German government. The blame game is not a constructive way out of this crisis.

Finally, a sixth aspect is the tendency to appeal to a *deus ex machina* when all else fails. That would be the European Central Bank. Last week, several European politicians beseeched the ECB to act as defender of last resort. Market commentators raised expectations that the existing securities market programme would be extended from a volume of close to €70bn to €1,000bn or even €2,000bn.

It did not happen. Or did it? It is hard to say. Jean-Claude Trichet, president of the ECB, said little, but the ECB nevertheless bought hundreds of millions of euros worth of Irish and Portuguese debt that day. Mr Trichet knows that he can prevent contagion but also that he cannot save the eurozone alone.

I do not want to play down the ECB's role. Its liquidity policies prevented a calamity in August 2007, and later in the autumn of 2008. But it also delayed a resolution to the political crisis. Europe's bank resolution policy is the ECB, and only the ECB. That is why this crisis is lasting so long.

The euro is currently on an unsustainable trajectory. The political choice is either to retreat into a corner, and hope for some miracle, or to agree a big political gesture, such as a common European bond. What I hear is that such a gesture will not happen, for a very large number of very small reasons. The system is genuinely *überfordert*.

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Obama must force the parties to co-operate

Clive Crook

In January a new Republican majority takes charge in the US House of Representatives. The balance of political power is about to shift decisively – yet the result is not pre-ordained. Can a bitterly divided government get things done, or must the country prepare for two years of quarrelsome stagnation?

In the last frantic days of the current session of Congress, the government's authority to spend, the fate of George W. Bush's tax cuts, the possible extension of unemployment benefits and ratification of the Start nuclear arms accord are all in the balance – and politically interconnected. The deals struck, or not struck, in the dying days of this Congress could set a pattern for the remainder of Barack Obama's first presidential term. The signs so far are mixed, but hint at some interesting possibilities.

At first sight, the usual post-election promises of co-operation and bipartisanship clash with the reality of bitter political division. On both sides, the prevailing sentiment is "no surrender". The parties have mutually irreconcilable visions of the country's future and are reluctant to give an inch. As the pendulum swings, each in turn interprets electoral success, however tentative, as a mandate for radical change, and electoral defeat, however crushing, as only a temporary setback.

As a result, both sides are less interested in the next two years than in the elections of 2012. The prize that matters is undivided power: control of the White House, the Senate and the House of Representatives. Even with that, as Mr Obama and the Democrats found, you cannot always do as you wish. Without it, the system is capable only of compromise or paralysis – and given this choice the true believer prefers paralysis.

This is the logic that somehow must be broken. Most Republicans think Mr Obama is beatable in 2012. Until then, meeting him halfway might improve his prospects, so they are doubly reluctant to do it. Many Democrats, on the other hand, believe their best hope of regaining undivided power is to cut no deals and stand on their principles. Ridiculous as this seems, they think they were pounded in last month's midterm elections because the administration has been too timid.

Both sides, therefore, are alarmed by the possibility that Mr Obama might move to the centre and "triangulate" in the style of Bill Clinton. Historically, the combination of a president willing to compromise and defectors in Congress willing to work across the aisle has been able to break the impasse, and to good effect. Arguably, divided government has produced better results.

The problem is that even if Mr Obama wanted to play this role, there are fewer possible defectors in Congress than in the past, and there will be fewer still next year. Moderate "blue dog" Democrats, typically elected in closely contested districts, did especially badly in November. Many Republican newcomers, meanwhile, speak with Tea Party accents. Congress will be more angrily divided than ever.

CLIVE CROOK'S BLOG

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Yet the picture is not all bad. Note, first, that Mr Obama has reason to be sincere when he calls for new efforts to co-operate. For the next two years, without Republican support he can get nothing done.

He has struck a conciliatory tone in recent days, calling Republican leaders over for a chat and going so far – almost – as to apologise for his earlier failure to engage with their side. He has signalled a readiness to compromise on extending the Bush tax cuts next year for all Americans, to the dismay of most Democrats in Congress and all of the party's most fervent supporters.

Consider, too, the response to the report of the president's deficit-cutting commission last week. The panel called for a far-reaching mixture of tax and spending reform, aiming to reduce public debt to 40 per cent of gross domestic product by 2035. The proposals, which I praised when an earlier version was released a few weeks ago, offend both parties. Republicans object to the tax increases and Democrats to the cuts in Social Security (pensions) and other programmes.

The initial response from zealots on both sides was predictably vitriolic. However, 11 of the 18 commissioners ended up voting for the plan – more than expected. Also, this majority included both conservative Republicans such as Tom Coburn, senator for Oklahoma, and liberal Democrats, such as Richard Durbin, senator for Illinois.

House members, as you might expect, showed less flexibility. All three House Republicans on the commission and two of the three House Democrats voted against the report (though some of the naysayers found good things to say about it). A majority of 14 was needed to trigger a congressional vote: formally, therefore, the plan goes nowhere.

Nonetheless the report has had an impact. Co-operation on fiscal reform might not be a lost cause, after all. An upper house capable of doing business would give Mr Obama an opening. He should seize it.

Indeed, behind the posturing, a deal linking Start ratification, the extension of unemployment benefits and the temporary extension of the Bush tax cuts for all could be in the offing. It will not happen by itself: Mr Obama will have to press. But if a bargain could be struck, it would be a good beginning – especially if it encouraged the president to explore what a more forceful triangulation strategy might achieve from now on. And I am not just talking about re-election in 2012.

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How the rule of law may come eventually to Russia

Anatol Lieven

Russia is not exactly the criminal state imagined by the US officials quoted in last week's WikiLeaks cable dump – it is a different kind of criminal state. The national government is not chiefly responsible for directing political violence. Instead, most is the work of local bosses and other criminals, tolerated by those at the top.

Democracy in itself is not the answer to Russia's problems. In many countries, forms of democracy co-exist with domination by corrupt and brutal oligarchies. One example is the Philippines, where the death rate of journalists is even higher.

But while democracy is not essential to social and economic progress, the rule of law is. The present Russian set-up, in which the rule of law is widely flouted by the state itself, makes the government incapable of taking action against corruption and the violence this corruption breeds – because any effective anti-corruption campaign would risk bringing the fragile existing order down in ruins.

Much of the country's political and judicial system is riddled with corruption, links to organised crime and the use of violence against critics and opponents. The world's media now worry about how this might affect the 2018 football World Cup, which Russia is to host. Less coverage is given to ongoing physical attacks on journalists, only the latest of which have come against writers who had condemned plans to build a road through Khimki Forest near Moscow. These attacks are more likely to be the work of those close to local officials and building contractors.

Judges and public prosecutors who go after local political bosses and organised criminals are also being killed in considerable numbers. Thus while some attacks, such as the murder of the journalist Anna Politkovskaya in 2006, may have taken place on Kremlin orders or with its acquiescence, these have been the minority. From this point of view, Russia is closer to a grimmer version of Italy than it is to an updated Stalinism.

Mr Putin's order has outlived its usefulness – though how to reform it without bringing down the state is difficult

The present situation began with the collapse of state power in the 1990s, in which organised criminal groups shot their way into control of massive amounts of property, or were adopted as allies and gunmen by business and political figures. The result was an explosion of assassinations that claimed the lives of officials, businessmen and journalists on a near-daily basis. The undermining of the state system by armed oligarchs led, among other things, to a collapse of the state's revenue raising capacity and therefore of public services.

The great achievement of Vladimir Putin, president and now prime minister, was to bring a measure of order to this chaos. Given the power and ruthlessness of the oligarchs and the organised criminal groups, it was inevitable that the security services would play a big part in this struggle. In the process, however, they themselves become a property-owning elite, less anarchic than their predecessors in the 1990s but equally dependent on corruption and concealment in the state apparatus. To defend their position they sometimes employ violence, but more often the state's control of the media is used to stifle criticism – as highlighted in a courageous speech last week by Leonid Parfyonov, a television journalist.

The order fostered by Mr Putin has therefore now outlived its usefulness – though how to reform it without bringing down the state itself is a horribly difficult question. The government has not been able to bring to justice many of those who have committed political murders, or to clean up the incompetent and corrupt police. The disastrous results of all this for economic development have been highlighted by numerous western investors, as well as by honest Russian businessmen who require a reasonably untainted and predictable legal order in which to operate.

What is essential, in Russia and elsewhere, is a stronger sense of the rule of law, both in the state system and in society as a whole. For this, new middle classes would have to develop to replace the existing oligarchy – classes that would be the bearers not just of a new political ideology but a new morality.

This will not happen any time soon, but it is not an impossibility. For to see themselves as a colder version of the Philippines is hardly compatible with Russians' sense of their country's historical greatness.

The writer is a professor at King's College London. His next book, Pakistan: A Hard Country, will be published in April 2011