30

Central bankers take 2 tacks in debt crisis

E.C.B., FROM PAGE 1

governor of the bank of Italy. Mr. Draghi will take office Nov. 1.

Mr. Draghi brings a similar outlook and background as Mr. Trichet and is not expected to radically alter monetary policy. But he may find it hard to move rapidly at the beginning of his term, given that he may feel it necessary to establish his anti-inflation credentials. He has kept an extraordinarily low profile in the final months of Mr. Trichet's tenure and his intentions are largely a mystery.

The E.C.B. did respond to signs that banks are reluctant to lend to each other because of fears about their exposure to shaky government debt.

Those fears were intensified by the woes of the French-Belgian bank Dexia, which is seeking its second taxpayer-financed bailout in three years and said Thursday that it was close to selling its Luxembourg unit.

The central bank will spend €40 billion, or $53.6 billion, in the coming year buying so-called covered bonds, a form of debt secured by payments received on assets like packages of loans.

Covered bonds are one of the main ways that European banks raise money. The E.C.B. also bought covered bonds in 2009 to alleviate the bank financing squeeze that followed the collapse of the U.S. investment firm Lehman Brothers in 2008.

The E.C.B. measure, however, was dwarfed by the Bank of England's plans to widen its so-called quantitative easing program to £275 billion from £200 billion.

"Vulnerabilities associated with the indebtedness of some euro area sovereigns and banks have resulted in severe strains in bank funding markets and financial markets more generally," the Bank of England's governor, Mervyn A. King, wrote in a letter to the British Treasury explaining the bank's decision.

The E.C.B. does not have the power to save ailing banks like Dexia or address deeper problems in the banking system, officials insist, caused by banks' exposure to sovereign debt and reserves that are too thin to absorb potential losses. That task belongs to governments.

Angela Merkel, the chancellor of Germany, suggested Thursday that Europe was moving closer to a coordinated effort to bolster European banks and address the longer-term problems.

While cautioning that more expert advice was needed, she said, "If the conditions are there we shouldn't hesitate." Mrs. Merkel appeared at a news conference in Berlin that also included Christine Lagarde, president of the International Monetary Fund, and Robert B. Zoellick, president of the World Bank.

Her comments were similar to what she said Wednesday during a visit to Brussels and in line with remarks made Thursday by José Manuel Barroso, president of the European Commission, the executive arm of the European Union.

A coordinated bank recapitalization is "not only obvious but indispensable," Mr. Barroso said in Brussels. "I don't think anyone in Europe is opposed to coordination in such a sensitive area."

But he declined to put any figure on the euro zone's bank recapitalization needs or to say whether he would propose the use of the euro zone's common bailout fund to help with the task.

The E.C.B. also said it would resume offering banks unlimited loans at the benchmark interest rate for about one year. Previously the maximum loan term was six months. Banks must put up collateral like bonds or other securities, but otherwise are allowed to borrow as much as they want.

Mr. Trichet said the E.C.B. would continue the unlimited lending "for as long as needed" and at least through mid-2012.

FABRIZIO BENSCH/REUTERS

Christine Lagarde, left, of the International Monetary Fund, with Chancellor Angela Merkel of Germany in Berlin on Thursday. Mrs. Merkel suggested that Europe was moving closer to a coordinated effort to bolster banks on and to address the longer-term problems.

While calling on European leaders to implement an expanded bailout fund for Greece and other countries with severe debt problems, Mr. Trichet sought to dash hopes that the E.C.B. could be used as a vehicle to leverage borrowing by the fund, and increase its firepower. Analysts like Daniel Gros at the Center for European Policy Studies have suggested that the bailout fund register as a bank so that it could borrow from the E.C.B.

The British move came about a month earlier than some economists had expected but was no surprise.

The Bank of England's rate-setting committee had hinted last month that it might have to inject more money into financial markets to support an increasingly threatened economic recovery.

The decision shows that "they believe an already difficult outlook for the economy has deteriorated," said Howard Archer, chief economist for Britain and the euro zone at IHS Global Insight.

Many economists have argued that the E.C.B. erred when it raised rates twice this year, most recently in July.

A bigger-than-expected drop in German factory orders in August, according to data released Thursday, provided the latest evidence that the euro zone economy is headed for a downturn caused by severe austerity programs in countries like Spain, as well as the uncertainty created by the European government debt crisis.

Recent figures showed inflation in the euro zone rose to an estimated 3 percent in September, well above the E.C.B. target of about 2 percent. Hard liners on the governing council are likely to have argued that the E.C.B. would violate its mandate to preserve price stability if it cut rates now.

The E.C.B. governing council, in one of its occasional forays from Frankfurt, met at the Berlin offices of the Bundesbank, the German central bank, which remains Europe's bastion of price stability.

Finland's prime minister, Jyrki Katainen, who was visiting the European Commission, underlined how such proposals for bank recapitalization are likely to encounter opposition.

The first step, he said, was for national governments to encourage their banks to raise capital from the financial markets. Failing that, "the government is responsible for recapitalization," he added.

The E.C.B. expects "very moderate" growth ahead in "an environment of particularly high uncertainty."

The European Banking Authority, which coordinates national regulators, is reviewing the results of the last banking stress tests, which took place in July, in light of the slump in the value of Greek and other bonds.

The value of the tests has been called into question by Dexia, which passed easily because those tests did not have to take into account the market valuation of holdings of Greek debt. The banking authority underlined in a statement that it had not announced new tests.

So far the E.C.B. has followed a more conservative course than the U.S. Federal Reserve or the Bank of England. The E.C.B. has bought government bonds in an effort to hold down borrowing costs for countries like Spain and Italy, but has avoided the wholesale asset purchases made by its peers.

With governments struggling just to approve a relatively modest aid package for Greece, the E.C.B. may eventually be faced with a choice of letting the country fail — an event that could threaten the whole euro zone — or making huge bond purchases even though such a move would enrage many north Europeans and split the governing council.

Like their European peers, British leaders are under mounting pressure to act amid criticism from some economists and lawmakers for holding on to far-reaching spending cuts that were introduced before the recent economic slowdown.

Prime Minister David Cameron has been adamant that he was sticking to his austerity plan, but he acknowledged Wednesday that the economic slowdown was worse than he had expected. The government suggested this week that it could sell government bonds to finance loans for struggling companies.

The Office for National Statistics said Wednesday that Britain's economic output rose 0.1 percent from the first quarter, half the 0.2 percent it had said earlier. The I.M.F. last month cut its growth forecast for Britain for this year to 1.1 percent from 1.5 percent.

Consumers have started to curb spending, feeling squeezed by rising prices and unchanged salaries.

Julia Werdigier reported from London. Stephen Castle contributed reporting from Brussels.

Netherlands ready to prop up banks

THE HAGUE

REUTERS

The Netherlands wants to play a role in ensuring the survival of the euro and would support the country's banks if necessary, Finance Minister Jan Kees de Jager said Thursday before a vote in Parliament on extending the powers of the euro zone's rescue fund.

Dutch lawmakers were expected to vote late Thursday in favor of widening the role of the European Financial Stability Fund, the euro zone's bailout fund, as agreed upon by European leaders in July. Expanding the fund's capabilities is seen as essential for stabilizing European financial markets.

The minority coalition government, composed of the Liberal and Christian Democrat parties, is expected to secure a majority with the help of the biggest opposition party, Labor, which is also pro-Europe. The government's main ally, Geert Wilders's populist Freedom Party, is firmly opposed to bailouts.

But the vote is being overshadowed by fears of a banking crisis in Europe, stemming from the debt crisis. The French-Belgian lender Dexia has been battered this week because of its exposure to Greece and problems obtaining access to wholesale funds, and requires state support.

Mr. De Jager, questioned by members of Parliament, said he was prepared to support Dutch banks if necessary but added that the Dutch financial sector was in relatively good shape.

"The Dutch banks have, in comparison to Dexia, limited expansion into peripheral member states and that makes a great difference," he said. "Dutch banks are much better capitalized than many other banks in Europe."

Mr. De Jager said he would speed up planned legislation allowing the authorities to intervene in the financial sector.

The Netherlands paid nearly €40 billion, or $53.6 billion, during the 2008 crisis to prop up its financial sector, providing support to the insurers ING and Aegon and nationalizing ABN Amro and the Dutch operations of Fortis.

The bailout of Dexia this week was the first in the euro zone's sovereign debt crisis, sending shock waves through financial markets as investors worried others could follow.

Mr. De Jager began the debate Thursday debate by reiterating that although euro zone members must stick to the budget rules, failing to support Greece could worsen the crisis.

He reiterated the Dutch government's position that Europe needed an authority with the power to kick out those members that do not abide by the rules. "We need to have greater European powers to enforce the budget rules that we have agreed upon and to deal with budget sinners," he said. "It cannot happen again that Greece, Portugal or Ireland spoil it for everyone else."

ONLINE: EUROPEAN DEBT CRISIS TRACKER
An interactive graphic that follows the latest country-by-country developments and coming events: **global.nytimes.com/business**

BBC tightens its belt, cutting 2,000 jobs

LONDON

Broadcaster also lowers spending for sports and plans to air more reruns

BY SARAH LYALL

The British Broadcasting Corp. announced Thursday that it would eliminate 2,000 jobs, cut its sports budget, show more reruns and broadcast fewer talk shows and game shows.

Mark Thompson, the broadcaster's director general, told his staff that the changes — which amount to cuts of £670 million, or about $1 billion a year, a 20 percent reduction in spending over five years — would lead to a "smaller, radically reshaped BBC."

But he said that no television or radio stations would be closed and that some money would be reinvested in new programming and services.

The BBC is financed mostly through a government-approved license fee, paid every year by every household in Britain with a television set. The fee brings in about £3.6 billion a year. In the early part of the last decade, spending increased annually, allowing the broadcaster to expand its services and introduce new channels.

But after a series of embarrassing episodes, including the disclosure of the huge salaries paid to layers of officials in the organization, the BBC was ordered to curtail its spending. And last year, confronted with a Conservative-led government skeptical of its financing model, the BBC agreed to freeze the annual licensing fee at its current annual rate of £145.60 until 2017.

The steps amount to a 16 percent cut in income, the BBC says. It has also decided to redirect 4 percent of its current spending elsewhere. Among other things, Mr. Thompson said, it plans to invest more money in dramas and comedies for its flagship channel, BBC 1. Meanwhile, its second channel, BBC 2, will broadcast only reruns in the daytime.

Some of the people faced with losing their jobs might be "retrained and redeployed," Mr. Thompson said. In addition to the cuts, a further 1,000 employees will be relocated to Salford, near Manchester, where the BBC has moved a portion of its operations.

Unions reacted with dismay, saying that the BBC would lose credibility and audiences if it continued to cut its services.

"They are destroying jobs, and destroying the BBC," said Gerry Morrissey, general secretary of Bectu, a union that represents technicians.

Mr. Thompson said that after years of budget-slicing, the broadcaster had cut its spending as much as possible and could not sustain another freeze or decrease in the license fee.

"I don't think we could do this again," he said. "Another real terms cut in the license fee would lead to a loss of services, or potentially a diminution of quality, or both."

Court adviser backs E.U. plan to charge airlines for carbon emissions

EMISSIONS, FROM PAGE 1

The Air Transport Association of America, which brought the case with three major U.S. airlines, said it was disappointed, but that the opinion "does not mark the end of the case." It said the final opinion by the court could "vary from the preliminary opinion." The International Air Transport Association, a global industry body, said so many countries were now opposed to the idea that the Union should drop its plans and restart talks on how to regulate greenhouse gases from aviation at a global level.

"Rather than risking a further escalation of tensions amongst states, I encourage Europe to support a successful, global and effective solution," said Tony Tyler, the director general of the I.A.T.A.

Mr. Tyler said that more than 20 countries — including India, China, Japan, the United States and Russia — signed a declaration last week vowing to challenge the plan at the International Civil Aviation Organization, an arm of the United Nations.

The I.C.A.O.'s 190 member states passed a resolution in 2010 committing themselves to devising a market-based solution, though without a fixed timetable. Impatient with the pace of the I.C.A.O. talks, the European Union moved ahead with its own plan.

Fitch, the ratings agency, warned this week that the issue had the potential to "escalate into a wider international trade dispute, as airlines and governments grow more vocal over the regulation's economic impact."

The case was brought by three U.S. airlines — United and Continental, which merged last year, and American Airlines — and the A.T.A. The parties argued that Europe's decision infringed on the sovereignty of other countries and conflicted with existing international aviation treaties.

On Thursday, the court's legal adviser, Juliane Kokott, rejected those arguments.

"E.U. legislation does not infringe the sovereignty of other states or the freedom of the high seas guaranteed under international law and is compatible with the relevant international agreements," Ms. Kokott wrote.

She also wrote that any flight touching down or taking off from an E.U. airport provided "an adequate territorial link for the whole of the flight in question to be included in the E.U. emissions trading scheme."

The opinion deals a significant blow to the airline industry's effort to avoid being forced into the plan from Jan. 1.

The opinion is not binding on the judges, but the court follows the advocate general's opinion in the vast majority of cases. A final ruling is expected in the coming months.

The system is due to take effect next year, and the airlines would not have to hand over the first batches of permits until the spring of 2013 to compensate for flights made in 2012. That still could leave room for a compromise over the next year.

The emissions rules were approved by the 27 member countries of the European Union in 2008 and were designed to make airlines speed up adoption of greener technologies at a time when air traffic, which represents about 3 percent of carbon dioxide emissions worldwide, is growing much faster than efficiency gains.

But it emerged on Thursday that the mounting international opposition had sown doubts at least two European countries about the wisdom of going forward with the system.

The Dutch state secretary for infrastructure and the environment, Joop Atsma, had become "very worried about the external resistance in other countries," his spokeswoman, Karin van Rooijen, said Thursday.

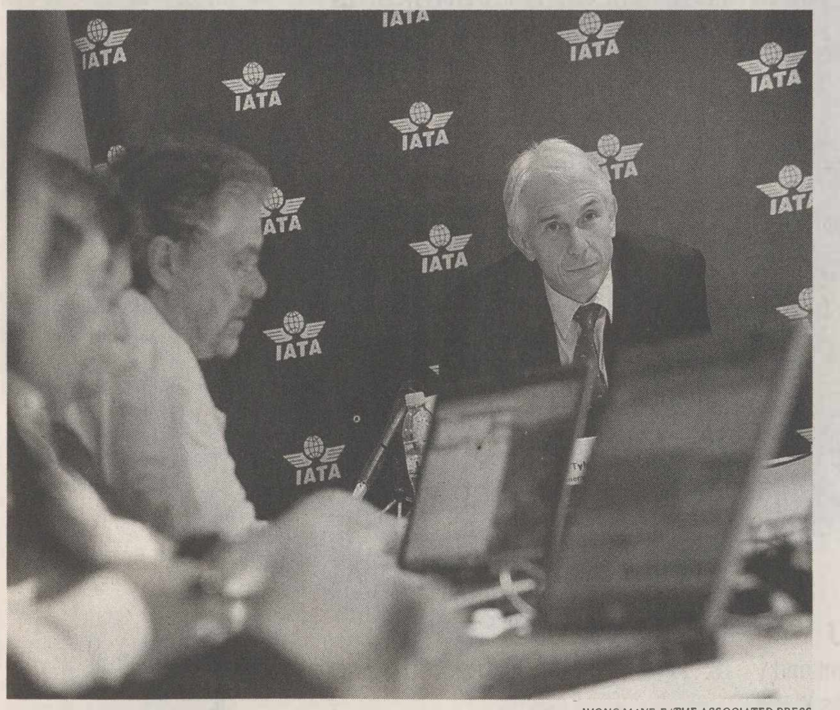
Mr. Atsma "is not against the system," she said. "But if other European countries think the situation is bad, he is considering supporting a postponement."

His main concern, Ms. Van Rooijen said, was that international airlines would bypass Europe to avoid being charged under the system. That would damage the position of Schipol Airport near Amsterdam as an important hub and it could result in longer flights and even more emissions, she said.

Mr. Atsma will raise the issue at a meeting of E.U. ministers next week, she said.

The Italian government had already expressed similar reservations, according to documents seen on Thursday by the International Herald Tribune.

In a written submission on Sept. 29 to the Council of the European Union, the body representing all 27 member states' governments, the Italian delegation said there were "real, urgent problems that call for urgent assessment before the system comes into force." It added, "Consideration should be given to the possibility of postponing the starting date for the system."



WONG MAYE-E/THE ASSOCIATED PRESS

Tony Tyler, right, chief of the International Air Transport Association, said so many countries opposed the measures that the Union should drop its plans and restart talks.

The Italian delegation said that medium- and short-distance air carriers would be penalized more under the system than long-distance carriers, and that any refusal to participate in the system by international airlines could put their European counterparts at a commercial disadvantage.

European airlines and regulators have long maintained that the involvement of all carriers flying in and out of Europe is critical to the success of the system.

The law is flexible enough for the E.U. to seek a compromise exempting all incoming flights from the rules. But that is unlikely to pacify countries like the United States and China, because their airlines still would need to pay for outgoing flights.

The airlines also could seek a compromise with Europe whereby they would accept the system but be exempt from paying for their pollution outside of E.U. airspace.

Connie Hedegaard, the E.U. commissioner for climate action, said Thursday that the Union was ready "to engage constructively" with other parts of the world in applying the law.

Based on current carbon permit prices, the Union estimates that the price of a one-way trans-Atlantic air ticket probably will rise €2 to €12, or about $2.70 to $16.15, although industry estimates put the cost higher.

Fitch, the ratings agency, said that the U.S. airlines most vulnerable to the costs of the system were United Continental, Delta and American Airlines because they derived 20 percent or more of their global revenues from trans-Atlantic markets. The agency said British Airways, Lufthansa and Air France KLM also would face increasing cost pressure.

But Fitch said European budget carriers like Ryanair and easyJet "may suffer disproportionately" because they depended so heavily on a low-fare business model.

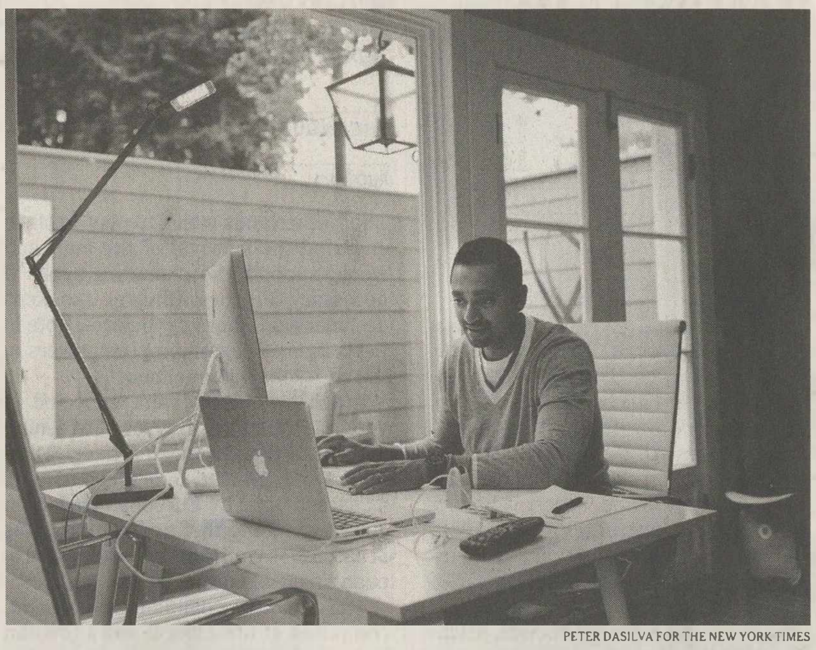
The airlines filed their case in late 2009, at the High Court in London. The British court then referred the case last year to the European Court of Justice in Luxembourg for its ruling.

Nicola Clark contributed reporting from Paris.

Rare pursuit in Silicon Valley: Patience

Window on Wall Street

EVELYN M. RUSLI



PETER DASILVA FOR THE NEW YORK TIMES

Chamath Palihapitiya runs his venture capital firm, Social+Capital, from a converted garage in Palo Alto, California. He often brainstorms with Mark Zuckerberg of Facebook.

Sand Hill Road — the street in Menlo Park, California, lined with Silicon Valley's most powerful venture capital firms — is hallowed ground for many budding investors.

But Chamath Palihapitiya, a newly minted venture capitalist, would rather avoid the strip.

"My office is far from Sand Hill Road," he said in a recent interview.

The sentiment may seem odd, coming from Mr. Palihapitiya, who has long benefited from Silicon Valley's largesse. A former Facebook executive and former principal of the Mayfield Fund, he is a millionaire many times over.

Mr. Palihapitiya, who opened an investment firm four months ago, has no interest in following the traditional venture capital template. In many ways, he sees himself as an activist investor, trying to shake up what he calls a broken system.

"Venture capital firms tend to focus on having large amounts of assets under management and collecting fixed fees," he said. "That creates perverse incentives because you're focused on deploying as much as capital as fast as possible. I want to be antithetical to all of that."

Started in June, his firm, the Social+Capital Partnership, has raised about $300 million so far. Unlike larger venture firms, the founder, a competitive poker player, has the most at stake. Mr. Palihapitiya has put up about $60 million and plans to remain the firm's largest stakeholder.

The rest comes from a dozen handpicked investors, a collection of connected and deep-pocketed technologists and industry insiders, including Adam D'Angelo, an early Facebook employee and founder of the question-and-answer site Quora; Kevin Rose, founder of Digg; Joe Hewitt, creator of the Firefox browser; and Charles Coleman, the hedge fund manager behind Tiger Global Management. The firm's lone corporate investor is Mr. Palihapitiya's former employer, Facebook.

"I really wanted something that was fundamentally a different type of partnership," he said. "I wanted a pool of capital that was exceedingly patient."

"I really wanted something that was fundamentally a different type of partnership."

And unlike a typical venture capital firm, which is usually composed of several managers financed by a passive group of institutional investors, Social+Capital operates like an investor collective.

Led by Mr. Palihapitiya, its limited partners act as on-call venture capitalists, summoned from time to time to evaluate and mentor start-ups. Mr. Palihapitiya frequently calls on his friend Mark Zuckerberg, Facebook's co-founder, to brainstorm investment ideas.

Mr. Palihapitiya, who works out of his converted garage in Palo Alto, California, pays himself a fixed salary of $350,000 a year with no bonus. He says that it is considerably lower than the typical managing partner, who might rake in $1 million to $5 million per year before bonus.

And because his salary is fixed, his annual pay does not depend on accumulating large amounts of capital, as in most venture firms, which skim a percentage off the top in the form of management fees. The standard model "is too tilted towards current compensation versus long-term capital gains," he said.

Born in Sri Lanka, Mr. Palihapitiya and his family emigrated to Canada when he was 6. Soon after college, he followed his girlfriend to California, stumbling onto Silicon Valley's start-up scene in 2000, just after the peak of the Internet boom. While many technology executives flamed out in the ensuing years, he steadily rose through the ranks at AOL, becoming the head of its instant-messaging division in 2004, at 27.

Then venture capital — or the dark side, as it is sometimes called in Silicon Valley — beckoned. Mr. Palihapitiya joined the Mayfield Fund in late 2005. But he did not last long. Though he was close to two of its partners, he felt a bit "out of place with the rest of the partnership," he said.

A year later, he decamped for Facebook to head the fledgling social network's international and mobile initiatives. While working at Facebook, he started to make small, personal bets on start-ups, like the game company Playdom and the software company Bumptop.

His early investments, many made during the depths of the financial crisis, have started to bear fruit. Disney bought Playdom last year, in a deal valued at $763 million, and Bumptop was sold to Google.

The cash from these sales allowed him to accelerate his investing activity, and by early this year, he was ready to start his own fund. Mr. Zuckerberg gave his blessing by signing up Facebook as one of its first investors.

The collective has been busy. Over the past few weeks, the firm has announced investments in SecondMarket, an exchange for private-company shares; Yammer, an enterprise social network; and Red Robot Labs, a mobile gaming company.

It is also helping build four other start-ups, like Glooko, a software maker for diabetes management, and is actively seeking additional opportunities in health care, education, and financial services.

"If you can change the trajectory of whether you can live or die, that's a huge thing," Mr. Palihapitiya said. "The companies we invest in could take 8, 10 years to be successful, but these are areas that need to be fundamentally disrupted."

Still, Mr. Palihapitiya's idealism and swagger could prove to be a liability, as he tries to play nice with other venture capitalists in Silicon Valley's small sandbox.

Last week, his e-mail to the founders of the room rental start-up Airbnb and its investors was leaked to AllThingsD, a technology news site. The letter, which Mr. Palihapitiya has said was supposed to be private, sharply criticized the founders for taking a lot of money off the table in a coming financing round, while leaving employees out.

"I'm passing on this financing because I strongly disagree with what's going on," he wrote.

Though he declined to comment on the letter, Mr. Palihapitiya said he had been disappointed by the path some firms were taking in an increasingly competitive environment.

"Its like an escalating arms race — what control or protective provisions do I have to give up to get the deal done, no matter how bad it may be for me or my L.P.'s?" he said, referring to limited partners.

For now, his investors seem to appreciate his candor.

"I invested in Chamath," said Mr. Hewitt, the Firefox creator. "I trust his vision and his expertise. There's a lot of fluff out there, and Chamath is good at rooting out the bull."

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E.C.B. fails as backstop for Europe

James Saft

INSIDE THE MARKETS

Europe is demonstrating that a sovereign nation without a true central bank is just an uninsured bank, liable to be tipped over by the markets.

While the European Central Bank is a central bank in almost all respects, what it is not is a lender of last resort for individual euro zone countries, a role that is expressly ruled out by the European Treaty.

A lender of last resort is what stops a bank run on a solvent institution from bringing it down. In the case of a country, a lender of last resort, usually the central bank, can simply print money to satisfy debts in its own currency.

And though we have all become terribly cynical about the concept of liquidity crises in the past couple of years, not least because so many people in authority have used it as a place to hide when the real issue was solvency (Greece, Lehman Brothers), the fact is that markets take on their own momentum.

Just as no one viewed euro zone debt as anything other than a haven for the currency area's first decade, now investors are busy driving up the price of even German default insurance.

This is the terrible logic of markets when they view sovereign borrowers as credit risks. It is almost inevitable that markets push, and in pushing, weaken the unbackstopped borrower and ultimately bring it down. This is a process that needs a circuit breaker, and Europe has no adequate circuit breaker, unlike Britain or the United States.

"Rather than viewing government bonds as risk-free, safe-haven assets, financial markets now view and trade euro area sovereigns mainly as credit risks," Elga Bartsch, an economist at Morgan Stanley, wrote in a note to clients. "This has very profound consequences for the stability of financial markets."

"For it seems to me," she continued, "that some markets have lost their ability to find a new, stable equilibrium. This is because, instead of moving in sync with the business cycle, government bond yields now move against the cycle, i.e., rising in a downturn. This seriously undermines the ability of the government sector to stabilize the economy and the financial sector."

Thus Europe is at the mercy of markets, left without a central bank or outside force that can break the cycle and impose order. The E.C.B. has purchased government bonds as a backdoor means of providing support, but this is awkward and will ultimately test the limits of the bank's capital. And, because it is against the spirit of European Union law, it is deeply divisive. The European Financial Stability Facility is not well suited for playing this role, either.

You could object by saying that all sovereign borrowers are ultimately credit risks. Even if one is repaid in the sovereign's currency, that currency can be debased by inflation or the money-printing press. That is true, but markets do not seem to impose the same penalty on inflation risk that they do on default risk

It is almost inevitable that markets push, and in pushing, weaken the borrower.

There are two main lessons from this. The first is that if you do not have a proper central bank, you ought to keep your debt profile slim, so as not to attract too much attention to your vulnerability. This worked for Germany, whose Bundesbank was similarly forbidden by charter from printing money to buy government debt. But this advice is not terribly helpful under the current circumstances.

The second is that Europe needs a democratic way in which to agree to monetize or otherwise write down its debts. Failing that, the risk is that the domino-style run on government credit becomes self-fulfilling, with ever larger sovereign borrowers like Italy being weighed by the markets and found wanting. This ultimately will break the euro.

Europe suffers from unclear lines of accountability. There are easy fixes for that, but imposing them quickly will be difficult. That is certainly how markets are trading, and the result may be a self-fulfilling fracturing of the euro.

James Saft is a Reuters columnist.