FINANCIAL TIMES

WEDNESDAY 13 JULY 2016 · WORLD BUSINESS NEWSPAPER · UK £2.70 Channel Islands £3.00; Republic of Ireland €3.00

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An end to facile optimism about the future — PAGE 11

Merkel's Brexit test
After Greece, migrants and Russia, is this her toughest challenge?— PAGE 9

Cable tied
What next for the battered pound? — MARKETS, PAGE 30

Clinton basks in Sanders' endorsement

Hillary Clinton has secured the official backing of former rival Bernie Sanders after weeks of hesitation by the Vermont senator, a long-awaited endorsement the presumptive Democratic nominee hopes will help win over left-leaning young voters.

In the candidates' first joint appearance since a bruising primary battle, Mr Sanders said: "Hillary Clinton will make an outstanding president and I am proud to stand with her here today."

Mrs Clinton stood alongside Mr Sanders as he spoke in Portsmouth, New Hampshire, before telling supporters: "I can't help but reflect on how much more enjoyable this election is going to be now that we are on the same side."

Clinton appeal bolstered page 6

Mary Schwalm/Reuters

Briefing

▸ Share spikes precede 20% of UK deals
Unusual trading occurred before one out of every five UK public takeover announcements in 2015, the highest level in five years, according to the Financial Conduct Authority's annual report. — PAGE 15

▸ Khan targets TfL agency high earners
Sadiq Khan, London's mayor, has vowed to make cuts to "temporary" staff at Transport for London, some of whom earn more than £100,000 a year on deals that help them avoid income tax. — PAGE 4

▸ McDonald's China franchise sale woes
McDonald's sale of its China and Hong Kong franchise is struggling to attract the calibre of bidders that the US fast-food empire envisioned. The group is seeking to reduce its direct exposure to China, where food-supply scandals have hurt its share price. — PAGE 19

▸ Airbus slashes superjumbo production
Airbus is cutting production of its A380 superjumbo, which has struggled to win customers amid a tepid market for wide-body jets. — WWW.FT.COM/AEROSPACE

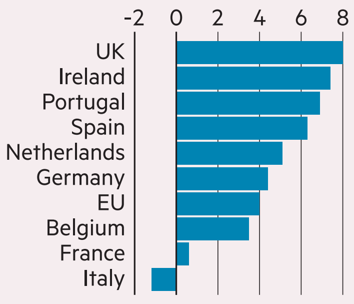
▸ Wang's AMC swoops on Odeon chain
China's wealthiest man has taken advantage of sterling's fall to bet that Brexit's real-life drama will not stop Britons from watching movies, spending £921m on the UK's Odeon cinema chain. — PAGE 15

▸ Israel faces heat over civil rights law
Civil rights activists and the EU have condemned an Israeli law that critics argue is a government move to stigmatise rights groups and to stifle dissent. — PAGE 8

▸ Economists dismiss Celtic Tiger's return
Ireland's great works of fiction may have an addition: the official narrative of the country's economy. Data said it grew 26.3 per cent last year, but economists greeted this with bafflement and scorn. — PAGE 7

Datawatch

House prices
Annual % change, Q1 2016



Source: Eurostat

House prices in the EU rose at a rate of 4 per cent pa in the first quarter of this year, but with big variations. The UK persistently shows strong price rises, while the trend was flat in France and house prices continue to shrink in Italy.

UN hands rebuke to Beijing over South China Sea territorial claims

● Hague tribunal rejects expansive push ● Manila wins 'total victory' after four-year case

TOM MITCHELL — BEIJING
GEOFF DYER — WASHINGTON

A UN tribunal has ruled there is "no legal basis" for China's expansive claims in the South China Sea, handing Beijing a searing diplomatic rebuke of its efforts to assert control of international waters traditionally dominated by the US navy.

The ruling, coming after a four-year court battle with the Philippines, included a sweeping censure of China's efforts to build man-made islands in the waterway and said that there was no historical basis for its claim to 85 per cent of the sea, demarcated by the "nine-dash line" on Chinese maps.

Xi Jinping, China's president, repeated Beijing's stance that the South China Sea has been Chinese territory since "ancient times" and said China's sovereignty and interests there would not be influenced by the ruling, the official Xinhua news agency reported.

The foreign ministry said Beijing "neither accepts nor recognises" the finding. The US state department said it hoped the decision would allow maritime disputes to be settled "peacefully", but the Chinese rhetoric raised concerns that Beijing could attempt to reassert itself.

The 4m sq km sea is crossed by ships carrying $5tn worth of cargo per year and has reserves of about 11bn barrels of oil and 190tn cubic feet of natural gas.

Beijing has insisted its rights derive from the long history of Chinese navigators and fishermen in the region that trump contradictory provisions in the UN Convention on the Law of the Sea.

"There was no evidence that China had historically exercised exclusive control over the waters or the resources," the tribunal said in The Hague. "The tribunal concluded that there was no legal basis for China to claim historic rights to resources with the seas falling within the nine-dash line."

Paul Reichler, a lawyer at Foley Hoag in Washington and lead attorney for Manila, said that the ruling was "a complete and total victory for the Philippines but it is a greater victory for the rule of law in international relations."

Richard Heydarian, political analyst at Manila's De La Salle University, called the ruling "a best-case scenario that few people thought possible" for the Philippines. "China has been branded as an outlaw in unequivocal terms," he added.

The tribunal also ruled that the Spratly Islands, one of the areas Beijing has attempted to claim by building airstrips and bases, had not been inhabited by stable communities. As a result, the countries that controlled the islands, also claimed by Malaysia and Vietnam, were not entitled to 200-nautical mile exclusive economic zones.

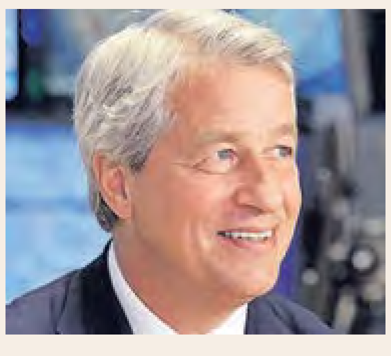
> 'China has been branded as an outlaw in unequivocal terms'
> Richard Heydarian, De La Salle University

In the light of the findings, the tribunal concluded Beijing had "violated the Philippines' sovereign rights". It also alleged that China's activity "had caused severe harm" to the sea's environment.

The US state department warned against "provocative statements or actions" by claimants in response.

Additional reporting by April Ma, Wan Li and Christian Shepherd

Reports & analysis page 5
Editorial Comment page 10



Dimon leads field in bumper year for bank chiefs' pay

Chief executives of big banks enjoyed hefty pay rises in 2015 with an average package of $13.1m. US chiefs were paid almost twice that of their European counterparts, with Jamie Dimon (above) of JPMorgan leading the pack on $27.6m. But the bumper year for pay has not been reflected in investor returns and critics of boardroom excess are gaining support in their calls to curb pay, with new prime minister Theresa May vowing action.

Report & analysis ▸ PAGES 15 & 17

May set to boost ranks of top female politicians and call time on Osborne

GEORGE PARKER, POLITICAL EDITOR

Theresa May's arrival as prime minister today will see more women in senior cabinet jobs and is likely to mark the end of George Osborne's six years at the helm of Britain's economy.

Philip Hammond, foreign secretary, is backed by Tory MPs to replace Mr Osborne, although his hawkish fiscal stance and free market approach are at odds with Mrs May's plan to end austerity and rein in capitalist excess.

Mrs May will immediately start forming her cabinet this afternoon, promising there would be "more women in prominent positions".

Female ministers tipped for top jobs include Justine Greening, overseas aid secretary, Amber Rudd, energy secretary, Karen Bradley, home office minister and former Tory leadership candidate Andrea Leadsom. Mrs May's spokesperson declined to comment on speculation her cabinet would have gender parity, but she has campaigned to get more women into politics.

Meanwhile the woes of the opposition were highlighted when Labour's national executive voted to allow leader Jeremy Corbyn's name to go automatically on a new leadership ballot.

Removal vans yesterday began loading David Cameron's possessions from his Downing Street residence. He will answer prime minister's questions for the last time before travelling to Buckingham Palace to tender his resignation to the Queen. Mr Osborne, chancellor since 2010, is expected to lose his job.

Mrs May has frosty relations with the chancellor and, in effect, gave notice of Mr Osborne's dismissal on Monday when she accused the chancellor of failing to carry out "deep economic reform". Although Mr Osborne has been mooted as a possible foreign secretary or as trade minister, some of his friends believe he may leave government.

The incoming prime minister has charged civil servants with finding a home for a new "Brexit department", a move intended to convey her commitment to delivering on the referendum.

Pierre Moscovici, the French EU commissioner, said formal Brexit negotiations should be brought forward. "The Conservative party went fast," he said. "David Cameron was supposed to be replaced in September, we are only [in] July, so why lose those two months?"

But Mr Hammond told MPs it could take four years for all 27 EU member states to ratify the agreement.

Leadership shake-up pages 2 & 3
Ursula Weidenfeld page 11

No: 39,214 ★

Printed in London, Liverpool, Glasgow, Dublin, Frankfurt, Brussels, Milan, Madrid, New York, Chicago, San Francisco, Washington DC, Orlando, Tokyo, Hong Kong, Singapore, Seoul, Dubai

World Markets

STOCK MARKETS

	Jul 12	prev	%chg
S&P 500	2153.46	2137.16	0.76
Nasdaq Composite	5027.50	4988.64	0.78
Dow Jones Ind	18348.87	18226.93	0.67
FTSEurofirst 300	1330.46	1315.49	1.14
Euro Stoxx 50	2935.52	2885.32	1.74
FTSE 100	6680.69	6682.86	-0.03
FTSE All-Share	3613.66	3611.02	0.07
CAC 40	4331.38	4264.53	1.57
Xetra Dax	9964.07	9833.41	1.33
Nikkei	16095.65	15708.82	2.46
Hang Seng	21224.74	20880.50	1.65
FTSE All World $	270.11	267.35	1.03

CURRENCIES

	Jul 12	prev		Jul 12	prev
$ per €	1.107	1.105	€ per $	0.903	0.905
$ per £	1.318	1.299	£ per $	0.759	0.770
£ per €	0.840	0.850	€ per £	1.191	1.176
¥ per $	104.540	102.615	¥ per €	115.721	113.348
¥ per £	137.821	133.297	£ index	78.415	78.236
€ index	88.652	88.411	$ index	100.287	99.700
SFr per €	1.093	1.086	SFr per £	1.302	1.277

COMMODITIES

	Jul 12	prev	%chg
Oil WTI $	46.68	44.76	4.29
Oil Brent $	48.35	46.25	4.54
Gold $	1357.10	1354.25	0.21

INTEREST RATES

	price	yield	chg
US Gov 10 yr	101.12	1.50	0.08
UK Gov 10 yr	105.32	0.95	0.07
Ger Gov 10 yr	105.68	-0.09	0.00
Jpn Gov 10 yr	103.88	-0.27	0.00
US Gov 30 yr	105.90	2.23	0.09
Ger Gov 2 yr	103.30	-0.68	0.00
	price	**prev**	**chg**
Fed Funds Eff	0.38	0.37	0.01
US 3m Bills	0.31	0.28	0.03
Euro Libor 3m	-0.30	-0.30	0.00
UK 3m	0.50	0.52	-0.01

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EU referendum fallout

Brexit campaign groups eye next chapter

Continued activism shows scepticism over incoming prime minister's plans

HENRY MANCE AND KATE ALLEN

Campaigners behind the two main Brexit groups, Vote Leave and Leave.EU, plan to re-establish their efforts into anti-EU pressure groups that could act as a constraint on Theresa May.

Their activism reflects continuing scepticism among some Brexiters about the new prime minister, who backed the Remain campaign and has said she would not trigger Article 50 this year.

"There is quite a big consensus that there needs to be some kind of an organisation continuing to make the case for Leave, and ensuring we get the best possible deal for the UK," said a senior figure in one of the groups.

Their move comes after the downfall of the leaders of the Leave campaign, with Boris Johnson, Michael Gove and Nigel Farage all stepping back.

Some MPs and EU leaders have already called on Mrs May to bring forward negotiations after her quicker than expected victory in the Conservative party leadership election.

One Tory MP, Peter Lilley, told the FT that the UK could leave "in months rather than years" — by not agreeing trade deals until after it left. That contrasts with the view of Philip Hammond, the foreign secretary and an ally of Mrs May, who said yesterday that Brexit could take as long as six years.

James Brokenshire, immigration minister, rowed back from the points-based immigration system proposed by Leave campaigners on Tuesday. He told the Home Affairs select committee that there were "other arrangements that could be considered as well" and that work had begun on designing a new immigration system.

Vote Leave, the official Out campaign, and Leave.EU, a group linked to the UK Independence party, were both created specifically for the referendum campaign. They claimed to have built large databases of voter information, and won praise for their aggressive use of social media.

In an email to supporters this month, Vote Leave said: "Westminster cannot be relied upon. Taking back control to Britain is just the first step . . . We need organisations like Vote Leave to operate permanently to give a voice to those who otherwise won't be heard."

Leave.EU said it had collected more than 1m email addresses during the campaign. It plans to relaunch on September 1, as "Ukip on steroids; rebranded," said a spokesman.

Key issues for Brexiters include what restrictions on free movement Mrs May seeks, and who she appoints to key Cabinet roles. Leave.EU backed Andrea Leadsom to become prime minister, and is likely to want Cabinet jobs for some of her supporters. Vote Leave, in contrast, has championed MPs with "skills needed to manage normal government departments".

One MP who supported Mrs Leadsom in the leadership contest said it was "gravely important" that both the Fresh Start group of moderate Eurosceptic MPs and the party's longer-standing Eurosceptics should be represented in the new government. "It would be a grave mistake to reject those people's experience," he said.

FT Big Read page 9

Leaving office. Looking forward

Cameron slides into political afterlife

Chancellor and successor pay tribute to achievements at final cabinet meeting

KATE ALLEN AND GEORGE PARKER

Changing of the guard: removals workers at 10 Downing Street yesterday as David Cameron prepares to leave Jack Taylor/Getty

A removal van arrived at the back door of Downing Street yesterday afternoon as after six years in office David Cameron contemplated what he will do in an extended political afterlife.

Mr Cameron will leave office today aged 49, the youngest ex-prime minister since the Earl of Rosebery 121 years ago, with his domestic policy agenda largely unfinished.

At what his spokeswoman said was a "warm and reflective" final cabinet meeting yesterday morning, George Osborne, chancellor of the exchequer, reeled off a list of the outgoing prime minister's achievements, from legislating for gay marriage to the national living wage, educational reform and apprenticeships.

His successor, Theresa May, told ministers that Mr Cameron had led the country through a difficult time, citing the financial crisis and the terrorist threat as tough issues that he was required to face.

But it will now be up to Mrs May to deliver the social reforms that Mr Cameron had set out at the start of this year. The first step will be the publication of a life-chances strategy in the coming weeks, something which Mr Cameron's Downing Street team had originally planned to reunify the party after it won the EU referendum. Instead, most are now looking for new jobs.

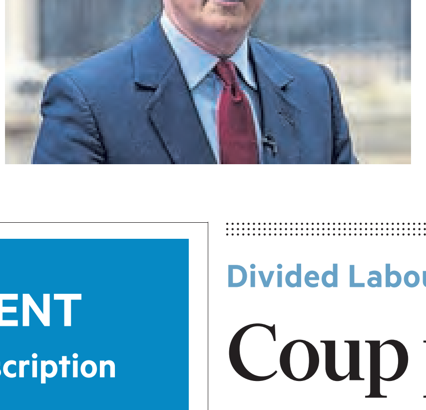
One Conservative MP close to Mr Cameron said: "I feel really sorry for David. He spent five years sorting out the economy, one year fighting an EU referendum and he never really got to do the stuff he wanted to do."

Despite this, he intends to support his successor and not overshadow her. Mr Cameron has told colleagues in No 10 that he would follow Stanley Baldwin's advice to ex-prime ministers: "Don't spit on the deck or shout at the new helmsman."

Mr Cameron is "a pragmatist", one aide said: "He went into politics because he wanted to get things done, and he has got things done," he said. "He always knew politics is a brutal business."

Mr Cameron's most pressing concerns have been to find somewhere to move his young family to — their west London townhouse is rented out, although the tenants have reportedly been given notice — and somewhere to work.

The move will be emotional for his wife Samantha and their three children, the youngest of whom, Florence, was born after they arrived at No10. The Downing Street garden contains a clutter of children's play equipment, reflecting its use as the family's home.



The Camerons carried out extensive renovation works to their flat on the top floors of the building when they first arrived, fitting a new kitchen and creating an open-plan living room.

In the Commons, Mr Cameron has been allocated office accommodation in St Stephen's Tower, close to the oldest part of the parliamentary estate, Westminster Hall. Four MPs have vacated their shared office to make room for him. Mr Cameron's income will similarly shrink: his salary drops from the £143,000 prime ministerial compensation to the £74,000 of a backbencher.

He intends to continue as a backbench MP until 2020 though he will probably then quit, according to aides. Mr Cameron will continue with his focus on life chances, but has not yet decided whether to set up a foundation or charity to pursue his work on the subject.

> 'He went into politics because he wanted to get things done, and he has got things done'

His team, who have worked for him for many years are expected to stay close to him, albeit probably working on an informal basis. They include Gabby Bertin, his former press chief, Liz Sugg, his operations head, and Kate Fall, his gatekeeper.

Mrs Cameron, meanwhile, is expected to step up her high-profile retail career; she is considering launching a fashion line, according to media reports. First, however, Mr Cameron will take his family on holiday "to reflect on what he wants to do", a friend said. "He will enjoy having a holiday where he doesn't have to point at fish for the photographers, and so will Sam."

Citizenship

EU nations report surge in passport applications from Britons

RICK MERTENS

European countries including Germany, Hungary and Poland have seen a surge in citizenship inquiries from Britons looking to guarantee their ability to live and work on the continent.

Depending on the outcome of exit negotiations, Britons face losing the right to move freely throughout Europe after the country voted to leave the EU, unless they can obtain citizenship of another EU member state.

Inquiries about German citizenship by UK nationals increased tenfold since the referendum three weeks ago. The German embassy in London said that 200-250 requests for information on how to apply for citizenship had been received per day since the referendum result was announced, compared with an average of 20-25 daily inquiries a month earlier.

The Hungarian consulate has received 150 inquiries since the vote, while it said it had received fewer than 10 during the rest of this year.

The Swedish Migration Agency has seen citizenship applications by UK nationals rise from an average of 20 a week to 316 in the two weeks after the referendum. In the same period, the Polish consulate in London received 350 queries regarding citizenship, while barely 100 formal applications for Polish citizenship were filed by UK nationals in 2015.

It is hard to tell what the chances are of the citizenship applications succeeding — people living in the UK depend on their ancestry to qualify.

The German embassy said UK residents would need a German parent. "There are certainly quite a number of people where it seems obvious they won't qualify. We don't have any figures for that though," said the embassy.

Other countries have more liberal conditions. Italy, which has received around 500 email requests at its UK embassy since the Brexit vote, offers citizenship to foreigners who can prove that at least one of their grandparents was Italian.

The embassy said: "Now, many British people seem to rediscover their Italian roots. Most of them would never have applied if there would not have been a Leave vote."

Anyone who has a grandparent born in Ireland is entitled to apply for a passport and the country's foreign minister has appealed for people not to overwhelm the country's passport service.

EU citizenship grants the liberty to move and reside freely within any of the 28 member states and also to open a business in any EU country without additional restrictions applying.

Although all EU citizens are granted the same rights within the EU, not all EU passports offer the same freedom to roam internationally. Analysts rank German and Swedish passports highest, because they offer visa-free access to the largest number of countries, while Bulgarian and Romanian passports are considered least advantageous.

Yet that has not deterred inquiries for a Bulgarian passport. The country's embassy has received 15 citizenship inquiries by Britons since June 24. "We usually don't receive such kind of requests," it said.

FINANCIAL TIMES
Number One Southwark Bridge, London SE1 9HL

Published by: The Financial Times Limited, Number One Southwark Bridge, London SE1 9 HL, United Kingdom.
Tel: 020 7873 3000; Fax: 020 7407 5700
Editor: Lionel Barber

Subscriptions and Customer service:
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Executive appointments:
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Printed by:
St Clements Press (1988) Ltd, London, Newsprinters (Knowsley) Limited, Merseyside, Newsprinters (Eurocentral) Glasgow, and Smurfit Kappa News Press Ld, Kells, Ireland

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Divided Labour

Coup plotters use party rule book against Corbyn

JIM PICKARD
CHIEF POLITICAL CORRESPONDENT

A nondescript office block on Victoria Street in London was the scene yesterday of one of the most audacious attempted coups in the history of the Labour party.

Jeremy Corbyn likes to boast about the quarter of a million people who voted for him last September.

But yesterday colleagues used a narrower gauge in their attempt to out-manoeuvre the 67-year-old veteran: the party's rule book.

The national executive committee, with representatives from unions, MPs and affiliated groups, gathered to debate the rules for a leadership challenge by Angela Eagle.

Its meeting, which looked set to drag on late into the evening, was the culmination of weeks of machinations behind the scenes designed to lock Mr Corbyn out of power forever.

Critically the NEC discussed how to interpret an ambiguity in the rule book that said "potential challengers" needed 51 votes from MPs and MEPs.

Mr Corbyn's allies had legal advice that he would not need to reach this threshold. But Iain McNicol, the party's general secretary, obtained legal advice that he did have to.

Mr McNicol is an old friend of Tom Watson, deputy leader, who is among a raft of senior figures to have begged Mr Corbyn to step down after nine months in charge.

At 2pm yesterday the 32 NEC members filed into the Labour offices, passing through placards and a cluster of police.

Jeremy Corbyn arrives at the national executive committee meeting

Mr Corbyn had cancelled a speech in Brighton to attend the gathering.

Earlier in the day, it was reported that Ms Eagle had been offered police protection after a brick was thrown through the window of her constituency office in Wallasey, Merseyside.

Mr Corbyn called for "calm" and "dignity" from members, condemning the "threatening" act, while pointing out that he too had received death threats this week.

As the NEC gathered, barriers and police were deployed outside the office block to prevent protesters from confronting members of the committee.

Dennis Skinner, a pro-Corbyn MP and member of the NEC, compared his colleagues in the Parliamentary Labour Party to "scab" miners who crossed picket lines in the 1980s.

In an upstairs room the NEC members deliberated for hours over the intricacies of rules governing the looming leadership contest.

At one point its chairman, Paddy Lillis, asked Mr Corbyn to leave the room, only for him to refuse. Eventually, the leader walked out and lingered elsewhere in the building to await the result.

In the middle of the afternoon it emerged that the committee had agreed a secret ballot. At that point it looked more likely that they would turn against the leader.

Amid expectations that the result would go badly for the leader, one member of Mr Corbyn's team looked shocked. "This is a massive two fingers up to 250,000 people who voted for him," he said. "If last year was a revolution, this is a coup."

But as the meeting dragged on, it became clear that the decision might not occur until late in the evening.

Mr Corbyn's team had threatened to spark a lengthy legal process if the NEC voted against him.

The contrast with the ruling Conservative party is remarkable. "A proper party shoots the injured, buries the dead and moves on. That's what the Tories have done," said one Labour MP.

"We are still going to be talking about all this in September."

LEADERSHIP SHAKE-UP

Theresa May

Great survivor prepares for new challenge in Downing Street

Spending six years at the Home Office is viewed as feat in itself by observers

GEORGE PARKER AND GONZALO VINA

Theresa May, Britain's longest-serving home secretary for 50 years, was set to bid farewell to her staff today as she prepared to move to Downing Street from a department traditionally viewed as a political graveyard.

Mrs May's survival at the Home Office for six years is a feat in itself, and her record in the job offers a guide to the coolly competent style and ruthless political operation she will bring to her new job as prime minister.

Dubbed the Ice Queen by Nick Clegg, the former deputy prime minister, Mrs May has walked alone in Whitehall, getting on with her job and scarcely bothering to cultivate relations with fellow cabinet ministers.

She has fallen out with Michael Gove on extremism, Boris Johnson on his plan to deploy water cannon and George Osborne on immigration.

And David Cameron, the outgoing prime minister, deemed two high-profile speeches by Mrs May disloyal.

Officials in her department said her preference for working with a close team of advisers, often not bothering to share information with Downing Street or other ministers, was in part to blame for these rows.

"She had in the Home Office people who are totally loyal to her but she did not get on well with powerful colleagues across government," said one senior official at the department. "She does not put a lot of trust in people."

Mrs May discusses issues with officials but prefers to work through problems on her own.

"She is a master of detail," said one minister who worked with her. "She squeezes all the evidence and comes to a decision."

Mrs May was "a respecter of due process", the minister added. "She hates sofa government or the idea of having meetings where no minutes are taken. She will give officials a hard time if they make lazy assumptions."

One official who has worked with her said: "She may sit in silence for some time and the danger is you start babbling away. She will say, 'This is not going to happen again.' Then she will let silence fill the room."

Julia Onslow-Cole, head of global immigration at PwC, the professional services company, said: "Theresa May has an amazing grip on the detail of policies and is extremely thorough in her approach. I believe she will be very effective in Brexit negotiations, especially with Angela Merkel."

Mrs May's tendency to work with a small team, her late nights spent with ministerial red boxes and her lack of trust in cabinet colleagues, have led to comparisons to the political style of Gordon Brown, who replaced Tony Blair as Labour prime minister.

The home secretary shares Mr Brown's willingness to sanction a tough political operation. Her former political

'She hates sofa government [and] will give officials a hard time if they make lazy assumptions'

advisers Fiona Hill and Nick Timothy are expected to move with her to Downing Street.

Mrs Hill, a media adviser, was forced to resign in 2014 after she briefed media outlets in a dispute with Mr Gove over who was to blame for the rise of extremism in Britain's schools.

Mr Timothy has tried to broaden the home secretary's political range to such areas as social reform and responsible capitalism. In 2014 he was blocked by Conservative Central Office from fighting a safe seat, officially because he had failed to campaign in the Rochester by-election. Some saw it as a "malicious" move by Downing Street, frustrated by Mrs May's apparent manoeuvring for the leadership.

"The home secretary licensed them to fight her battles for her," said a senior Home Office official. "Nick and Fiona are both serious operators and highly effective."

Mrs May's allies reject comparisons to Mr Brown. "She is a member of the human race, for a start," said one.

David Laws, who was education minister when the Liberal Democrat were in coalition with the Conservatives, said he and his colleagues had "a sneaking admiration" for Mrs May. "Nobody could say she was not on top of her job."

Theresa May leaves a Cabinet meeting at Downing Street yesterday — Carl Court/Getty Images

'Brave decision'

US hacking extradition case showed steel

Theresa May's willingness to block the extradition of the "seriously ill" computer hacker Gary McKinnon to the US showed a steely determination. The White House was furious.

Mrs May "took a very brave decision", said Karen Todner, the solicitor representing Mr McKinnon. "She was very strong in her decision making and I am told that it was her that made the ultimate decision."

Mrs May has shown she is ready to make enemies at home and abroad. But as prime minister — facing the task of negotiating Britain's EU exit — she may need a flair for making friends too.

The computer hacker, who faced up to 60 years in prison for breaking into Nasa and Pentagon systems, was granted a reprieve by Mrs May in 2012, more than 10 years after being arrested.

Mr McKinnon has Asperger's syndrome, a form of autism. Mrs May at the time described the case as "difficult and exceptional" and said medical reports were sufficient grounds to halt the extradition.

Gonzalo Vina

Past themes

Ascent bodes ill for Heathrow and well for manufacturing

HENRY MANCE AND JIM PICKARD

In her 19 years as an MP, Theresa May has made a habit of sticking to the party line and her brief rather than laying out broad political views.

"I only know in detail what her views are on the Home Office," was the unguarded verdict of her former Cabinet colleague Ken Clarke. The new prime minister has, however, made a few revealing statements.

In 2013, she criticised "Britain's overreliance on financial services" and warned that low labour costs in Asia had "led to job losses at home, especially in sectors like manufacturing".

Her solution was a small state that identified "strategic industries" to promote. For example, the government "could fund deep discounts in tuition fees for students who want to study degrees like engineering, where we have a shortage of skilled workers".

Those themes came to the fore this week, when Mrs May called for an economy that "works for everyone, not just the privileged few" and advocated "changes in the way that big business is governed".

When Labour was in power, several prominent Tory MPs opposed to a third runway at Heathrow attended regular meetings in parliament. They included Mrs May, whose Maidenhead constituency is close to the west London airport.

Her ascent makes it increasingly likely that a third runway could be scrapped, although this has not yet been discussed with Patrick McLoughlin, transport secretary.

"The thing is, she has not criticised it in public. There is no 'read my lips' moment," said one Conservative staffer.

She is, however, in favour of the High Speed 2 rail link.

In her only big intervention in the EU referendum debate, she argued that, outside the EU, Britain would have to make concessions to access the single market. "It is not clear why other EU member states would give Britain a better deal than they themselves enjoy," she said.

Government lawyers have said that invoking Article 50 of the Lisbon treaty — the mechanism to leave the EU — does not require a vote in parliament. Some MPs, lawyers and businesses disagree, saying that the move, although part of the executive's prerogative power, would trample on parliamentary sovereignty.

In 2007, Mrs May criticised the use of prerogative powers, saying there was a need "to redress the balance of power between parliament and government and that the balance of power has tipped too far in the executive's favour".

Also in 2007, Mrs May accused Gordon Brown, who had become prime minister without a general election, of having "no democratic mandate".

But Mrs May's supporters have been quick to rule out an early general election, pointing to the need to focus on talks with the EU. An Ipsos Mori opinion last week found that a majority of the public wanted a general election before EU negotiations started, but that opinion was balanced about a vote this year.

Mrs May backed an elected House of Lords in February 2007. She backed prison reform in 2013 — although at the time that meant Chris Grayling's version, rather than Michael Gove's fuller overhaul. And she was, at least in 2009, in favour of repealing the ban on fox-hunting.

London transport

Khan takes aim at agency staff high earners

Mayor gives numbers of well-paid 'temps' as focus turns to tax arrangements

CONOR SULLIVAN

Sadiq Khan has promised to significantly cut hundreds of "temporary" staff at Transport for London, many of whom have been employed for several years on deals that help them avoid income tax.

TfL confirmed that it had paid 396 agency staff who have been employed more than 18 months in excess of £100,000 a year. Forty-one in place more than two years were making more than the London mayor's £144,000 salary. And four people who had been in place three years earned more than £200,000.

Sadiq Khan, London mayor, is battling to cut costs at the sprawling £12bn organisation and has said he will fund a fare freeze by "making TfL a more efficient and profitable organisation".

He said: "I am determined to bring the number of agency workers at TfL down as part of the root-and-branch review I have ordered."

TfL declined to say how many of the temporary staff were paid via "personal service" companies, which allow income tax and national insurance to be avoided.

There were 2480 agency staff during the 2014/15 financial year, on average, while the number paid through personal service companies was 2,296 in December 2015.

The figures came in the answer to a mayoral question submitted by Caroline Pidgeon, Liberal Democrat member of the London assembly, who said use of contractors was "out of control".

TfL employs so many people temporarily, on a day rate, in part because of projects such as Crossrail and Tube upgrades. "There is an acute shortage of people with the necessary engineering skills, which means that there is a relatively small pool of suitably qualified candidates who often prefer to work on an agency basis," said the mayor.

The day rate included "all costs beyond salary (ie national insurance, pension, etc) which can [exceed a] third of the total employment costs of directly employed staff", the mayor said. Staff employed in this way did not receive paid leave, he added.

HM Revenue & Customs is cracking down on the use of personal service companies, which it says costs it £440m a year. The vast majority of those choosing to be paid this way are avoiding tax they should be paying, it has said.

Deloitte has said the practice can boost take-home pay by 13 per cent. People using personal service companies pay corporation tax and dividend tax instead of income tax and national insurance.

Yesterday, the mayor announced that TfL had signed a contract worth "up to £15m" to license its contactless ticketing technology to other public transport providers. Debit and credit cards can be used on all station turnstiles and buses in London, allowing many ticket offices to be closed.

Cubic Transportation Systems will gain access to TfL's system as it implements similar systems in other cities.

The mayor said the proceeds would be used to fund the fare freeze.

In another money-saving measure TfL is axing conductors on "New Routemaster" buses devised Boris Johnson, Mr Khan's predecessor. The door at the back was intended to be always open, as on traditional Routemasters, but this required a person to supervise it at a cost of £10m a year.

Brexit warnings

Carney to release notes of Osborne conversations in 'phoney forecasts' dispute

CAROLINE BINHAM — FINANCIAL REGULATION CORRESPONDENT

The governor of the Bank of England has reluctantly agreed to release notes of private conversations between him and George Osborne, chancellor, that took place before the UK's vote to leave the EU, to a parliamentary committee for scrutiny.

The move comes amid a political spat over the BoE's warnings about Brexit with Mark Carney, who is fighting allegations from two former chancellors and ex-Conservative party leaders that the central bank tried to frighten the electorate off voting for Brexit by peddling "phoney forecasts" in a pre-determined strategy with Mr Osborne.

"If true, that's pretty much an end to Bank of England independence," said Andrew Tyrie, the Tory chairman of the Treasury committee, to which Mr Carney was giving evidence yesterday. "It could not be recovered by this governor and could not be regained by the bank for many years."

When asked whether notes of minutes of private meetings between Mr Carney and Mr Osborne could be made available to committee staffers for scrutiny to "allay public concern", Mr Carney said he did not want to limit "free-flowing" future conversations between chancellors and governors. But he conceded that he would allow the committee to scrutinise the notes privately.

Negotiations will now begin with the BoE over arrangements for reviewing the minutes, according to people briefed on the matter.

The BoE said last week that its prior warnings around the uncertainty of Brexit being the biggest risk to the UK's financial stability had begun to crystallise, and the outlook for financial stability was "challenging".

Mr Carney responded that the allegation — made in a letter written in June by Lords Lamont, Lawson and Howard, and Iain Duncan Smith — misunderstood how the BoE's independent Financial Policy Committee worked.

Andrea Leadsom — a key Brexiter who stepped down from the race to become the next prime minister — also had accused Mr Carney of speaking beyond his remit before the EU vote.

"I have discussions with the chancellor of the exchequer on a wider range of economic and financial matters. But the views of the FPC are the views of the FPC; they are not predetermined. They are based on robust discussions," Mr Carney told the committee. "I did not prejudge the lines of the FPC, and nor could I."

In an apparent swipe at the tenure of Lord Lamont, chancellor in 1992 when the UK quit the European Exchange Mechanism, Mr Carney added: "Things are different. We don't keep things under wraps. We identify risks and respond to them. We don't look to have exchange rate crises but exchange rate adjustments."

> 'The views of the FPC are the views of the FPC; they are not predetermined'
>
> Mark Carney, BoE governor

Donald Kohn, an external member of the FPC who also appeared at the committee hearing, added that all members of the FPC had agreed that uncertainty around Brexit was the UK's biggest threat to short-term financial stability.

Mr Carney was speaking after the BoE released minutes of the latest FPC meeting, which took place four days after the Brexit vote. It revealed that the UK markets watchdog warned the FPC about possible attempts by commercial property funds to trap investor cash when faced with a run of redemptions.

The warning was borne out: last week, seven funds took action to limit investor redemptions, with so-called gates imposed by funds.

FT Big Read page 7
See Markets

Raqib Shaw's sculptures depicting intertwined figures are made using a wax casting method — Bettina Strenske/Photoshot

Exhibition pays tribute to Mannerism

Bronze sculptures by London-based artist Raqib Shaw that recall the style of the Renaissance Mannerist period will go on display from today in London.

The exhibition also includes paintings by Shaw that in part reference Old Masters from the collections of the National Gallery in London and Prado Museum in Madrid.

Born in Kolkata, the artist was raised in Kashmir but came to London in 1998. His paintings are known for their high detail and enamel paint meticulously applied with porcupine quills on to smooth birch wood panels.

His new bronze sculptures are based on Mannerist sculpture and are made using an old wax casting technique. Small in scale and exhibited on plinths, they depict hybrids such as centaurs in compositions where figures are often intertwined. As with the paintings, the narrative aims to be multi-faceted.

'Self Portraits' runs from today until September 11 at White Cube, Bermondsey

Bitcoin technology

Blockchain trial for benefit payments fuels concerns over privacy

GILL PLIMMER

Britain's decision to trial the use of the technology behind bitcoin to pay welfare benefits to the unemployed and disabled has sparked privacy concerns.

The Department for Work and Pensions began a trial in June of the system, which uses blockchain technology to pay benefits directly to welfare claimants.

GovCoin Systems, the UK technology company behind the blockchain system, said initial trials had proved successful but that final results being collated by University College London were not expected until October.

"Claimants are using an app on their phones through which they are receiving and spending their benefit payments," David Freud, the welfare reform minister, told a payments conference last week. "With their consent, their transactions are being recorded on a distributed ledger to support their financial management."

Blockchain is the shared database technology best known for powering the bitcoin online currency. In this case, a digital "benefit coin" could effectively replace welfare payments in sterling.

If successful, the technology could be used for tax collection and the sharing of health records, according to a government report released this year. Advocates of blockchain technology argue it is more secure and transparent, cutting down the risk of fraud and error. But welfare campaigners are concerned it would allow the DWP to check that payments are spent only on certain things.

Critics including the Open Data Institute, established by David Cameron in 2012 to promote transparency in government, described the move as "very concerning".

"Experimenting with putting highly personal data in immutable data stores is fraught with danger," said Jeni Tennison, the ODI's technical director and deputy director. "To avoid undermining trust in government's use of data, DWP should be much more open and transparent about the policy objective of these trials, the safeguards they are putting in place to limit the risks and the lessons being learnt through the trial."

GovCoin said it was aware of the ODI's concerns and had taken the data protection and privacy issues seriously.

The DWP said: "This trial is designed to explore how distributed ledger technology could help support financial inclusion and budgeting support through the anonymous capture of data and does not place any restrictions or limits on what a claimant can spend their welfare payments on."

The technology has been hailed by admirers as holding the promise that the internet did two decades ago. Banks, insurers and companies want to harness the power of the blockchain, in the belief that it could lead to greater efficiency.

But IT experts caution that blockchain technology is still at an early stage of development and moving any of Britain's public services away from their existing IT systems is likely to prove difficult, expensive and potentially risky.

Day-to-day spending in economy shows signs of bounceback despite drop in consumer confidence

Brexit barometer

CHRIS GILES, EMILY CADMAN AND GEMMA TETLOW

Britain's economy was hit by the country's historic vote to leave the EU last month, but real-time data suggest a recovery in retail despite a sharp drop in consumer confidence, the second FT Brexit Barometer shows.

Clear information about the economic impact of Brexit will only start appearing in August; much depends on companies' willingness to invest and households' readiness to make big purchases.

But according to the Brexit barometer — an FT analysis of alternative economic indicators — day-to-day spending in the economy might have bounced back to slightly below what it was immediately before the June 23 EU referendum.

Sales growth at John Lewis recovered in the week to July 9 to almost the average for the year while the number of e-commerce transactions is also once again growing just below the 2016 average. The company PCA Predict, which helps validate addresses online, noted a 2 per cent annual fall in transactions in the week after the EU referendum. This has since recovered to a 4 per cent annual increase, two weeks later.

Meanwhile, data from retail information company Springboard show that footfall — the number of visits to high streets and shopping centres — was down for the week ending on July 10 compared with last year. There were some big declines on individual days, but not as large as in the immediate referendum aftermath, suggesting some of the shock has dissipated. Nevertheless, high street footfall on Saturdays — the key shopping day — has fallen year on year for three consecutive weeks.

Graduate recruitment is holding up for 2016, but highly uncertain for 2017.

A snapshot survey from the Association of Graduate Recruiters found that 73 per cent of members polled — who between them hired 8,000 people on to training schemes last year — are planning to hire after Brexit as planned for 2016. Just 5 per cent said they would reduce at this stage. But the proportion of "don't knows" rises to 64 per cent when asked about 2017 intentions.

Searches for flights to the UK — a possible indicator of people outside the UK seeking to take advantage of the weaker pound — have returned to a normal level, having been higher than usual immediately after the Brexit vote, according to Skyscanner, a flight comparator website

At the time of the referendum, published survey and official data indicated third-quarter growth of almost 0.6 per cent, according to Now-casting.com. a forecaster. But weaker data released in the past week have caused it to reduce its estimate to just under 0.3 per cent.

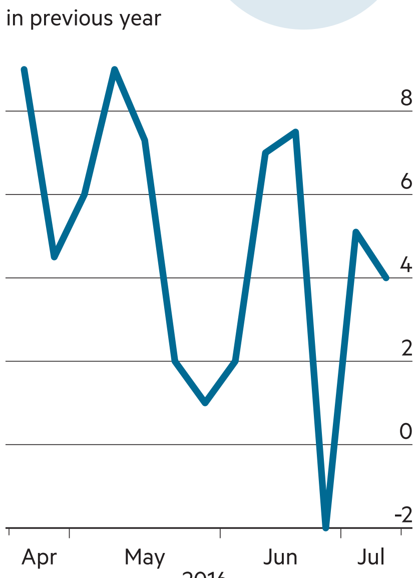
One worrying signal comes from GfK's survey of consumer confidence, which stretches back to 1974. In a special survey in the first few days of July, consumer confidence fell more than in any month for 21 years. But the level of confidence is still far higher than in previous recessions.

These "nowcasts" and snapshots of real-time data can be fickle and unrepresentative of the wider economy, so the FT will continue to monitor the economic landscape until the official data become available.

The first indication of the housing market will come tomorrow with the release of the Royal Institution of Chartered Surveyors monthly report, conducted entirely after the referendum.

E-commerce

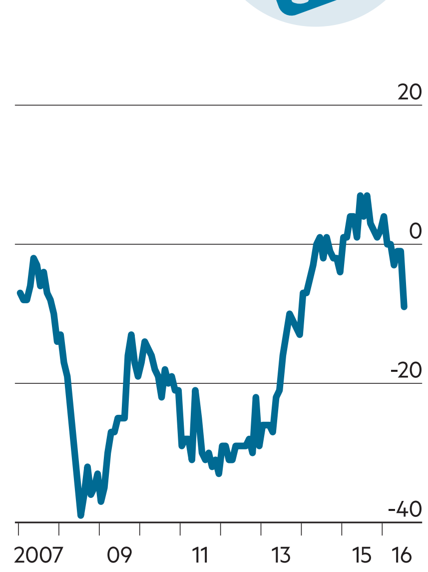
Transactions
% change in number of transactions from same week in previous year



Source: PCA Predict

Consumer confidence

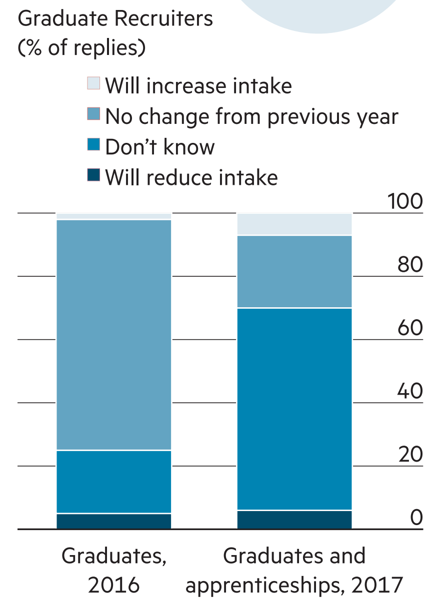
GfK index
Net balance, positive minus negative



Source: Thomson Reuters Datastream

Labour market

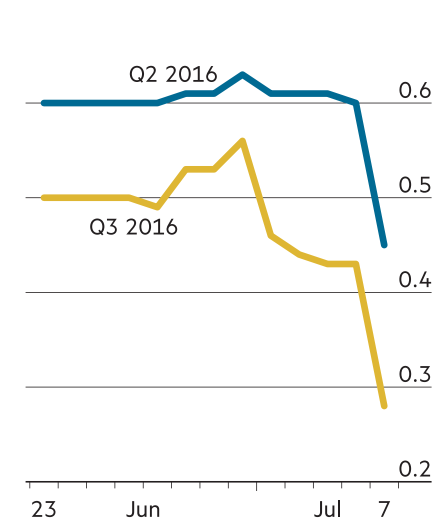
Graduate recruitment
Survey of employers by the Association of Graduate Recruiters (% of replies)



Source: Association of Graduate Recruiters

Predicted growth

Quarterly GDP growth
Implied by published surveys and official data (%)



Source: Now-Casting Economics

US to call for diplomatic solutions in region

Behind sparring lies deeper geopolitical fight between two great powers over long-term control of crucial waterway

GEOFF DYER — WASHINGTON

The ruling by a UN tribunal against China's claims in the South China Sea presents an opportunity for the US to press for diplomatic solutions to the region's territorial disputes but also raises the risk of a sharper confrontation with China.

In a verdict whose stinging criticism of China surprised legal analysts, the UN tribunal in The Hague said there was "no legal basis" for China's claim to most of the South China Sea laid out on maps by the "nine-dash line".

The Obama administration, which has presented the ruling as a test of China's willingness to abide by international law, said the verdict was a "new opportunity" to resolve disputes in the South China Sea.

But the US will also be on alert for the danger that the Chinese leadership, which might see the ruling as a humiliating slap-down, will seek to take action to defend its claims and will react aggressively to any perceived US military escalation.

"We ought to try to give China every opportunity to walk itself back from the ledge," said Admiral Dennis Blair, former head of US Pacific Command. There were factions within China pushing for a less aggressive approach.

"I might be kidding myself, but behind the truculent rhetoric, I detect a desire on the Chinese side to ease off," he said. "The US should do nothing to stop this."

Ahead of the ruling on a case initially brought by the Philippines, the US and China have been conducting a rhetorical battle about its importance. While Beijing has rejected the legitimacy of the tribunal in strident terms, US officials have warned China not to undermine international law. Ashton Carter, US defence secretary, said last month that China could "end up erecting a Great Wall of self-isolation".

Behind the sparring lies a deeper geopolitical struggle between the two great powers over whose navy effectively controls the crucial waterway of the South China Sea, a contest with profound implications for how the Asia-Pacific region will be managed in the coming decades.

"The Chinese effectively say that freedom of navigation is guaranteed [in the South China Sea] because we grant it. Our position is that freedom of navigation is not for you to grant," says Kurt Campbell, former US assistant secretary of state for East Asia.

Paul Reichler, the lead attorney for the Philippines in the case, said the ruling would create space for more diplomacy in the South China Sea because it also affected other claimants, including Vietnam and Malaysia.

"All of those countries can now defend their rights from a stronger position," he said.

"China is faced with a choice of alienating all of its neighbours for a long time or finding an accommodation that reflects the interests of both these states and of China."

Greg Poling, an expert on the South China Sea at the Center for Strategic and International Studies in Washington, said that the Philippines and China could potentially reopen talks about fishing at Scarborough Shoal after the tribunal ruled China had been restricting access traditionally enjoyed by Filipino fisherman. "It opens up some room for accommodation," he said.

However, there is also the potential that an isolated China will step up its efforts to develop military facilities in the South China Sea.

A woman joins a rally in the Philippines city of Makati yesterday protesting about China's claims in the South China Sea — Dondi Tawatao/Getty Images

FT
Video
Beijing in tight spot over South China Sea
ft.com/video

Julie Xue, a Chinese academic at the Royal Institute of International Affairs in London, said that the ruling will play into the historical narrative stretching back to the 19th century of China constantly being humiliated by imperial powers.

"China already sees this as a conspiracy, as a political game cloaked in the idea of international law," she said. "This will only confirm that."

That leaves the Obama administration with difficult decisions about how to use military power to enforce the ruling.

The Pentagon will probably seek to deter any further exercises in land reclamation by China in disputed areas and the ruling gives it a clearer legal framework for where to conduct so-called "freedom of navigation operations" that challenge excessive claims. However, it will also be wary of being seen to provoke China.

Editorial Comment page 10

South China Sea. Inducements

Beijing applies soft power pressure to woo Manila

China is returning to familiar tactics in its efforts to strike a bilateral deal after ruling

CHARLES CLOVER — BEIJING

Beijing has been working behind the scenes to blunt yesterday's precedent-setting rejection of its claims in the South China Sea by a tribunal based in The Hague, offering economic inducements if the Philippines would "set aside" the decision.

The strategy is a time tested one for China — using its economic might to cajole, threaten and outright buy co-operation from its neighbours on internationally recognised territorial claims. It underlines the difficulty for Washington in convincing countries in the region to present a united front to Beijing.

Analysts said the Philippines' temptation to cut a side deal with China could undercut US efforts to put pressure on Beijing to back away from its more maximalist claim to 85 per cent of the South China Sea — the "nine-dash line" — by using the tribunal's decision to mobilise international public opinion.

According to Richard Heydarian, a political analyst at De La Salle University in Manila, the new president of the Philippines, Rodrigo Duterte, "will surely look at ways to leverage the arbitration . . . to extract concessions from China".

"But surely the US and other key allies will put maximum pressure on the Duterte administration to release a strong statement and call for compliance," he added. Meanwhile, he said, China is doing everything in its power to convince the Duterte administration not to use the case to embarrass Beijing.

Euan Graham, director of the Lowy Institute in Sydney, said: "If the Philippines decide not to press their case, but rather use it as a form of back pocket leverage in reopening bilateral negotiations with China, that would undercut what the US and other countries did in the international sphere."

"A lot of the US position on the law of the sea depends on the judgment putting pressure on China," he added.

Zhu Feng, director of the China Centre for Collaborative Studies of the South China Sea at Nanjing University, said Beijing's efforts to cut deals with neighbours on maritime claims is a longstanding policy which even has a name: roughly translated it is called "shelve disputes in favour of joint development". He pointed to a number of diplomatic successes — a compromise with Vietnam on maritime claims in Beibu Bay in 2000 and a joint marine seismic work agreement signed with Vietnam and the Philippines in 2005.

"If the [Philippines and China] take a pragmatic approach, this is of course what China hopes to see happen, as long as the results of the arbitration are laid aside," said Mr Zhu.

"This might not be in line with US interests, but it is certainly a rational compromise."

Last week, the official China Daily newspaper quoted "sources close to the matter" saying that Beijing was ready to start negotiations on joint development of resources and co-operation in scientific research, "if the Philippine government puts aside the tribunal's ruling". China's ambassador to the Philippines, visited Mr Duterte on Thursday, according to the Chinese foreign ministry.

A number of areas of co-operation have been floated in the Chinese media: joint development of oil and gas resources, shared access to the fishing waters and collaboration in research for restoration of coral reefs in the region.

Much depends on Mr Duterte, a populist who was elected on pledges of rejuvenating the Philippine economy, and may need Chinese investment to do so.

While the previous president, Benigno Aquino III, was seen as hawkish by China, Mr Duterte has made conciliatory statements and seems ready to negotiate.

"There has been a stark change in the Philippines' attitude toward the South China Sea arbitration after Aquino left office," said Mr Zhu.

According to Mr Heydarian, the new administration is intent on reviving long-frayed diplomatic and investment ties with Beijing. "Duterte seeks a 'soft landing'," he said.

The US has been quiet on the subject of deals between China and the Philippines. Bonnie Glaser, an expert on China at the Washington DC-based Center for Strategic and International Studies, said: "I think it's wrong to say that the US does not want to see compromise. I think the US really does want to see effective diplomacy, and to see China treat its neighbours with respect, but not a might-makes-right approach."

Previous negotiations with the Philippines failed because China insisted Manila give up maritime claims as a precondition.

Additional reporting by Ma Fangjing

Wave of support: Vietnamese expatriates rally to voice their backing for the Philippines' case against China's claims in the South China Sea — Bullit Marquez/AP Photo

Regional response
Neighbours call for tribunal verdict to be respected

Asian countries locked in maritime disputes with China welcomed the legal victory won by the Philippines over China's claims in the South China Sea yesterday and urged Beijing to respect the verdict in the interests of regional peace and security.

Confrontations over competing claims to the waters have escalated as China continues to build artificial islands in the sea, threatening security and dividing the capitals of the 10-member Association of Southeast Asian Nations.

Perfecto Yasay, the Philippines' foreign secretary, called for China to comply with the ruling, handed down by a UN tribunal in The Hague, as part of efforts at "promoting and enhancing peace and stability" in the region.

"The Philippines strongly affirms its respect for this milestone decision as an important contribution to ongoing efforts in addressing disputes in the South China Sea," he said.

The judgment is the first big test for Rodrigo Duterte, the Philippines' new president. He has promised to improve relations with China but will be under domestic pressure to take a hard line after a judgment so favourable to Manila.

Some observers have questioned whether he may already have reached a deal or understanding with Beijing, although nothing has been said officially by either side.

Hanoi, which has a bitter maritime territorial rivalry with China in the South China Sea, welcomed the ruling and called for territorial quarrels in the region to be resolved using "diplomacy and legal processes" rather than armed force.

Anti-Chinese riots broke out in Vietnam in 2014 after the arrival of a Chinese oil rig near the contested Paracel Islands, causing severe damage to industrial zones.

Japan said it "strongly expects" that compliance with The Hague ruling by the two parties would "eventually lead to the peaceful settlement of disputes in the South China Sea".

Tokyo has a separate conflict with Beijing in the East China Sea over a chain of islands it calls the Senkaku and which China knows as the Diaoyu.

But some analysts say Beijing is likely to respond to the legal setback with a show of strength in the affected areas.

"The ruling . . . potentially limits China's negotiating stance on the disputed maritime area with other countries that also assert claims there, namely Brunei, Malaysia, Taiwan and Vietnam," said Amarjit Singh, senior consultant at IHS Country Risk. "However, initially, China's reaction to the ruling can be expected to be assertive."

Multiple territorial disputes have caused tensions within Asean, where countries such as the Philippines and Vietnam are pitted against China-leaning Cambodia and Laos — the regional grouping's current chair.

Michael Peel in Bangkok

Suzhou Huge pile of dumped rubbish threatens water supply in city famed for its beauty

GABRIEL WILDAU — SHANGHAI

A huge pile of rubbish on a lake shore in the Chinese city of Suzhou is threatening to contaminate the water supply as typhoon season approaches.

Police detained 12 people and eight cargo ships on July 1 for shipping waste from nearby Shanghai and dumping it on an island in Lake Tai in the eastern province of Jiangsu, according to the official Xinhua news agency.

Suzhou is famous for its beauty. The port, where about 20,000 tonnes of rubbish was dumped, is connected to a drug rehabilitation centre on Jiangsu island.

The government has prioritised environmental protection in its latest five-year plan and stiffened penalties for polluters, but enforcement has proved difficult in a country ravaged by 30 years of rapid industrialisation.

"Incidents such as this one in Shanghai, where someone gets caught, are only a minority," said Liu Chunlei, head of the Qingyue Environmental Protection Information Technology Service Centre, a non-profit organisation sponsored by the state government.

Nearly 3,000 dead pigs were found in a river in suburban Shanghai in 2013. Last year in Shenzhen the collapse of a pile of construction waste triggered deadly landslides. "It's not only construction and household waste that gets illegally dumped," said Mr Liu. "There are also dangerous products such as medical waste."

The Suzhou propaganda department last week warned the rubbish was only 2km from a water-collection point, and any contamination would "seriously influence" the safety of drinking water for the city of 6.7m.

Eight cargo ships have been detained following dumping on Lake Tai

Last week floods swept across central China, filling stadiums in Wuhan, capital of Hubei province. Xinhua reported on Sunday that the level of Lake Tai had risen to the top of the bank and that water was covering the wheels of cars near the rubbish pile.

The Shanghai Greenification and City Appearance Management Administration are working with officials in Suzhou to investigate the incident. The dumping is said to have began in mid-June.

The mixture of construction and household waste has been covered with an 8,000 sq m tarpaulin. "We braved hot steam when we started digging into the trash," the leader of the work crew told Xinhua. "It's already producing methane, and the stench is hard to take."

Caixin, the business news group, cited a person with knowledge of the port saying it was operated in part by a company that collected construction waste from Shanghai. "To unload trash from cargo ships requires heavy machinery," the person said. "There must have been companies near the site that helped."

Additional reporting by Ma Nan

INTERNATIONAL

Financial institutions

Merkel soothes fears over Italian banks

Investors greet upbeat remarks as biggest lender moves to raise cash

JAMES POLITI — ROME
JIM BRUNSDEN — BRUSSELS
STEFAN WAGSTYL — BERLIN

Angela Merkel dismissed concerns of an escalating crisis surrounding Italian banks and expressed confidence that talks between Rome and Brussels allowing a rescue of struggling financial institutions could be "resolved well", giving a boost to Italian banking shares.

The upbeat tone of the German chancellor yesterday was interpreted by investors as a sign that Berlin is not panicking about the possibility that Italy's €360bn stock of non-performing loans could spiral into the next big eurozone financial crisis, and may show some leniency towards demands from Rome.

"Overall, I see no crisis-like developments," Ms Merkel said. Speaking of the discussions between Rome and Brussels, she added: "I am convinced that these questions, which are to be decided there, can be resolved well."

Her remarks added to gains among Italian banking shares, with UniCredit, the country's largest bank, closing up 13.5 per cent, Banca Intesa, the second-largest bank, rising 6.6 per cent, and Monte dei Paschi di Siena, the third-largest, up 3.7 per cent.

For UniCredit, the share gains may have also been fuelled by its success at raising €328m through the sale of a 10 per cent stake in online broker FinecoBank. The move was aimed at shoring up UniCredit's balance sheet, and was followed hours later by the announcement of plans to sell up to 10 per cent of its Polish subsidiary, Bank Pekao.

Italy and the EU are locked in intense talks on how Rome could pump public money into its banks — starting with Monte dei Paschi — without violating EU rules, which would require it to impose losses on junior bondholders. The EU rules were instituted after the bloc's debt crisis, and are intended to "bail in" investors in order to shield taxpayers from the cost of bank rescues.

Italian officials say they are wedded to the EU rules, but are looking for a softer interpretation that would allow them to minimise — if not erase — the hit to the holders of subordinated debt, including institutional investors as well as retail investors. Matteo Renzi, Italy's prime minister, said on Monday that an agreement was "within reach" though there have been no signs of any big breakthrough so far.

"The government is now engaged in finding precautionary solutions to support any eventual case of needed intervention," Pier Carlo Padoan, the Italian finance minister, said yesterday in Brussels after a meeting of eurozone finance ministers where Italian banks were not on the formal agenda but were a matter of informal discussion. "This will be done in full protection of households and savings."

> 'I am convinced that these questions [over Italian banks] can be resolved well'
> Angela Merkel, German chancellor

But in a sign that Ms Merkel's comments do not necessarily signal a softening in the German position, Wolfgang Schäuble, the country's finance minister, insisted Italy should stick to EU rules in handling its banking problems and expect no special treatment.

He also warned German banks seeking state help in dealing with their difficulties. "The likelihood of a banking crisis will not be smaller in the face of such demands," he said, responding to industry demands for support and a report by the chief economist of Deutsche Bank, Germany's largest lender, calling for a €150bn European fund to recapitalise banks.

Editorial Comment page 10

GLOBAL INSIGHT
NEW DELHI
Amy Kazmin

Kashmir's uneasy calm shattered after killing of 'Twitter terrorist'

Burhan Wani, a 22-year-old Kashmiri separatist, was a rebel of the social media age. Handsome and well educated, he was just 15 when he ran away from home to join the fight against Indian rule over Kashmir. Legend has it that his embrace of militancy was triggered by his being beaten up "for no reason" by security forces, which maintain an overbearing presence in India's only Muslim-majority state.

His reputation was not for daring military exploits; some Kashmir police claim he never fired a bullet. Rather Mr Wani was a folk hero among young Kashmiris for his adroit use of social media. In videos that circulated on Facebook and WhatsApp, the photogenic, camouflage-wearing militant expressed the discontent of a generation trapped in a halfway house of neither war nor peace, urging youth to resist the Indian state.

On Friday Mr Wani — derided by one analyst as a "Twitter terrorist" — was killed by security forces. His death has prompted the greatest eruption of violence in Kashmir for six years, as massive crowds turned out to mourn him and were confronted by security forces. Officials say the mourners turned violent and security forces responded by firing live ammunition into the crowds.

At the last count, at least 30 people had been killed, while more than 1,000, both civilians and security personnel, were injured. Kashmir is once again under curfew, its mobile internet services suspended.

The unexpected outpouring triggered by Mr Wani's death reflects the anger simmering beneath Kashmir's uneasy calm. It also highlights the failure of India's political establishment to win the hearts and minds of Kashmiris, despite a dramatic reduction of armed militancy.

> 'Delhi needs to be acknowledging that it has something called a dispute on its hands'

"Just because we are not dying every day doesn't mean we have forgotten anything," says Basharat Peer, author of *Curfewed Night*, a memoir of his youth at the height of the armed insurgency. "We still believe the same thing: we don't want to be under Indian rule. Kashmiris want freedom. When I was 13 , that is what everyone around me said, and now I am 39 and people are still saying that."

Omar Abdullah, former chief minister of Jammu and Kashmir state, warned that Wani's death had created a "new icon" for disaffected Kashmiri youth. "Mark my words — Burhan's ability to recruit into militancy from the grave will far outstrip anything he could have done on social media," he tweeted.

Kashmir was transformed into a battleground in 1988 with the eruption of a separatist insurgency from a disgruntled youth, armed and trained by Pakistan, which claims the Muslim-majority region as its own.

The conflict has claimed the lives of more than 44,000 civilians, troops and rebels, but the number of annual casualties has fallen sharply, to fewer than 200 a year since 2010, down from a peak of 4,500 in 2001.

But the decline in militancy has not been accompanied by political overtures to resolve the grievances in what remains one of the world's most militarised regions.

New Delhi has long viewed its aim in Kashmir as simply to achieve a semblance of "normalcy", which it has typically defined as the holding of elections and an unhindered flow of tourists to the region to escape the summer heat.

Many analysts say the government has erred in considering these evidence of Kashmiris' acquiescence in the status quo. Instead, they say, it must reach out to the alienated population to at least acknowledge past abuses.

No Indian government has shown any inclination to do so. Yet the tale of Wani's life and death reveals the danger of allowing Kashmiri resentment to fester.

"Delhi needs to be acknowledging that it has something called a dispute on its hands," says Siddiq Wahid, former vice-chancellor of Kashmir's Islamic university. Kashmir's continued heavy militarisation, he adds, "only underscores its non-resolution".

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Democratic race

Sanders' backing bolsters Clinton unity appeal

BARNEY JOPSON

Hillary Clinton has won the formal backing of Bernie Sanders after weeks of hesitation by the Vermont senator, a long-awaited endorsement that the presumptive Democratic nominee will use to try to win over young left-leaning voters.

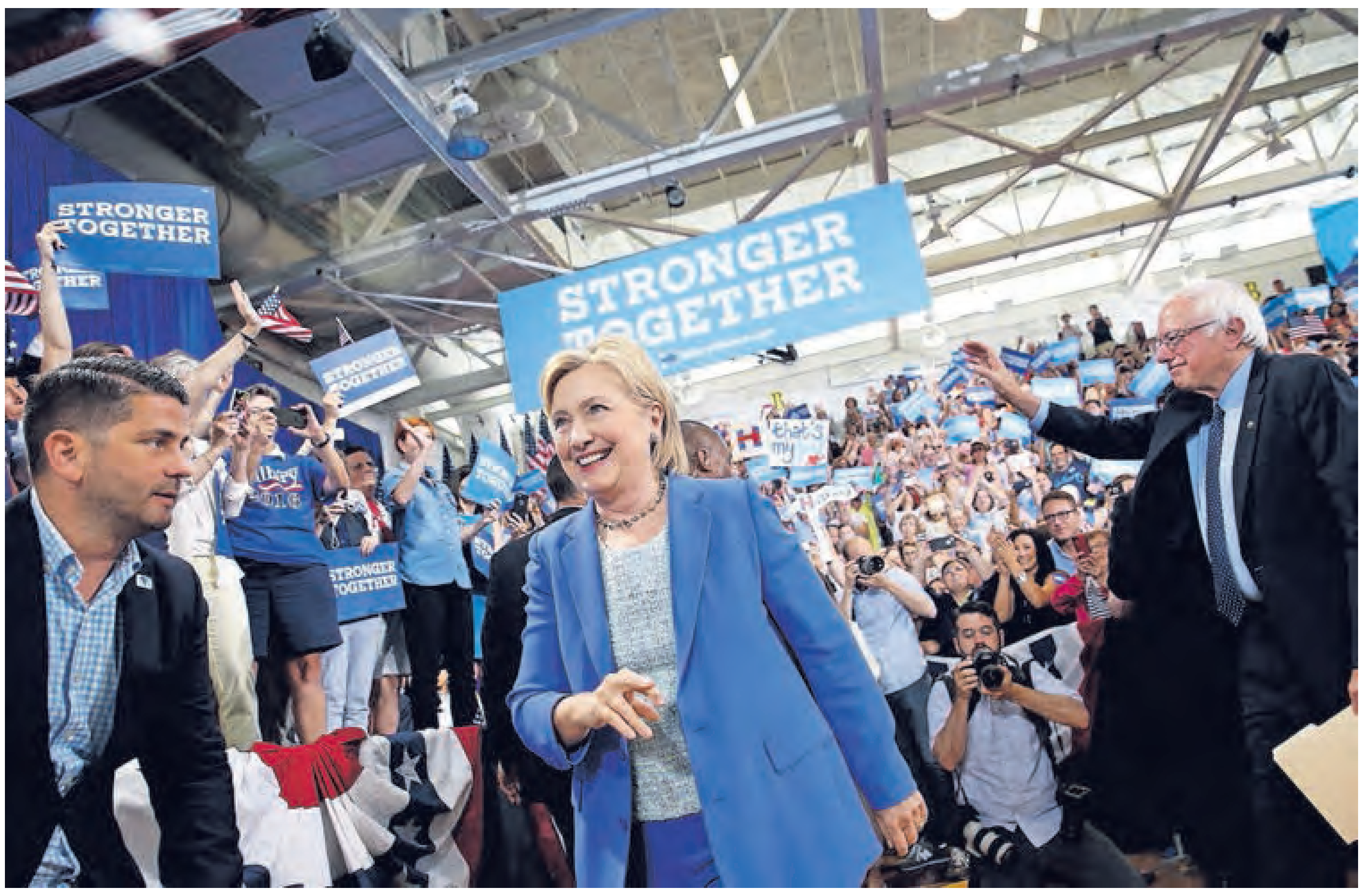
In the candidates' first joint appearance since a bruising primary battle, Mr Sanders, who fired up the party's liberal base, said: "Hillary Clinton will make an outstanding president and I am proud to stand with her here today."

He sought to minimise deep divisions between the progressive and moderate wings of the Democratic party that had been highlighted by the primary campaign.

But Donald Trump, the Republican candidate, tried to ensure that these divisions were not forgotten by explaining why Sanders supporters "will never be excited about Hillary Clinton".

They included the Sanders campaign's criticisms of Mrs Clinton's past support for trade agreements and of her ties to Wall Street and the Washington establishment, against which the self-declared socialist has railed.

> 'It is no secret that Hillary Clinton and I disagree on a number of issues'
> Bernie Sanders



Right behind you: Hillary Clinton, the Democratic presidential candidate, is followed by Bernie Sanders as they arrive for a rally in New Hampshire
Andrew Harnik/AP Photo

After young people defied expectations by voting for Mr Sanders in far greater numbers than for Mrs Clinton, the former secretary of state needs to woo them to boost her performance in November's election.

Mrs Clinton stood alongside Mr Sanders nodding and grinning as he spoke at the event in Portsmouth, New Hampshire.

When it was her turn, she said: "I can't help but reflect on how much more enjoyable this election is going to be now that we are on the same side . . . We are joining forces to defeat Donald Trump."

Mr Sanders said: "It is no secret that Hillary Clinton and I disagree on a number of issues. That's what this campaign has been about."

But the two campaigns had over the weekend forged "the most progressive [policy] platform" in Democratic party history, he said.

While the Sanders campaign failed to get the tough language it wanted on an Asia-Pacific trade pact, it secured victories on raising the minimum wage, expanding healthcare funding and social security for retirees.

"Our job now is to see that platform implemented by a Democratic Senate, a Democratic House and a Hillary Clinton presidency — and I am going to do everything I can to make that happen," Mr Sanders told the crowd.

Polling suggests Mrs Clinton has already made considerable headway with Sanders supporters.

According to a poll by the Pew Research Center last week, 85 per cent of Sanders supporters said they planned to vote for Mrs Clinton.

Charlie Cook, a political commentator and publisher of the Cook Political Report, said those numbers suggested Mrs Clinton was in a stronger position than Barack Obama had been at the same stage of the 2008 presidential election.

Noting how Mr Sanders had inched towards making an endorsement, Mr Cook said: "This has been a process that has been ongoing since early June. This [joint appearance] is just the cherry on the top."

At the end of June Mr Sanders said he would "in all likelihood" vote for Mrs Clinton, but he did not give a formal concession speech and continued to hold rallies even after it became impossible for him to secure the nomination.

Many young Democrats have expressed reservations over Mrs Clinton's perceived lack of trustworthiness and ties to the old political order. Mr Cook said she had not entirely overcome such challenges, but added: "I think Trump will probably do as much or more to enthuse younger voters for her as she will do for herself."

Stephen Miller, senior policy adviser for the Trump campaign, said Mr Sanders was caving in to a "rigged" system.

"Bernie Sanders [is] endorsing one of the most pro-war, pro-Wall Street and pro-offshoring candidates in the history of the Democratic party," he said in a statement.

Over the course of the Democratic primary, Mr Sanders won 22 states and 12m votes, compared with the 28 states and 15.7m votes won by Mrs Clinton.

The two Democrats appeared on stage together in the state where Mr Sanders trounced Mrs Clinton in a February primary election, setting the stage for his string of unexpected wins.

Education

Mexican teachers press Peña Nieto to rethink school reforms

JUDE WEBBER — MEXICO CITY

Mexican president Enrique Peña Nieto is under pressure to water down education reforms after weeks of sometimes deadly protests from teachers and plummeting popularity ratings.

In a failing school system in which more than half of 15 year olds cannot master basic maths, the reform is one of the most significant of the policy changes pushed through by Mr Peña Nieto in his first two years in office. Mexico's students are among the worst performers in OECD nations, so the reforms are critical to improving poor productivity and vaulting Mexico into the big league of world economies.

But a dissident teachers' union, the CNTE, wants the reform bill — which introduces a merit-based system of appointing, promoting and firing teachers — scrapped. It has been staging weeks of roadblocks and marches, which have spread beyond the union's southern power base to Mexico City and the northern state of Nuevo León.

Officials of the CNTE met interior ministry mediators on Monday to try end the impasse with no result. But now the main SNTE union, which had earlier backed the reform, has weighed in with a dozen demands of its own. These include changes to teacher evaluations, the backbone of the reforms.

"The government is going to have to make some concessions," said Sergio Aguayo, a political analyst. "The question is, to what extent teachers are going to want to make life easy for Peña Nieto."

The answer appears to be "not very". The SNTE has begun negotiations with the education ministry on its own demands.

"There's a lot of pressure to water down the reform," said Marco Fernández, a professor at the Tecnológico de Monterrey university and researcher at think-tank México Evalúa. "I'm fearful," he said.

The government insists the reform will emerge strengthened from addressing teachers' concerns. "We are seeing how we can improve processes," said Javier Treviño, a deputy education minister.

"There will be no U-turn on the education reform. No way."

In a country where many schools in rural areas lack floors, running water or electricity, he said the infrastructure of more than 42,000 schools had been improved. New proposals to overhaul the curriculum would be announced in the coming weeks and 150,000 out of 1m teachers have already sat performance tests.

But official assurances of progress are squarely at odds with public perceptions as the protests have snowballed into a new problem for a hapless government.

Last month, eight people died when shots broke out at a dissident teachers' protest in which the federal police at first denied, then admitted, that some officers were armed. Though troublemakers appear to have been non-teachers' groups allied to the CNTE, the government's slow reaction was another public relations disaster.

A masked CNTE union protester marches against education reforms

Even after the unsolved disappearance of 43 student teachers in September 2014, and a scandal two months later over his wife's mansion funded by a government contractor, Mr Peña Nieto's approval ratings have never plunged so low, dropping to 29 per cent.

The teachers' protests is just the latest woe: the ruling PRI party suffered a crushing defeat in gubernatorial elections last month and María de las Ángeles Moreno, a former party boss, told El Universal newspaper: "If we don't correct . . . what let us down, that could be a prelude to [presidential elections in] 2018."

With security a key voter concern, national murder rates have been rising. The government's commitment to fighting graft was also questioned after the PRI helped water down an anti-corruption reform in Congress and the president had to force a backtrack by using his veto.

Budget shortfall

Spanish business faces tax blow over deficit

Madrid to raise extra €6bn via 'minimum rate' to be paid by corporations

TOBIAS BUCK — MADRID
JIM BRUNSDEN — BRUSSELS

The private sector in Spain is set to shoulder most of the burden as the government moves to bring its wayward deficit into line, after the economy minister unveiled plans to raise an extra €6bn in corporate taxes next year.

Madrid is under intense pressure to find ways to cut its yawning budget shortfall after EU finance ministers agreed yesterday to formally open sanctions procedures against Spain and Portugal.

Both countries were found to have done too little to reduce "excessive" deficits, which under EU fiscal rules should be no more than 3 per cent of gross domestic product. Spain is expected to post a deficit of 3.9 per cent this year, according to the latest forecast by the European Commission.

Ministers said that in both cases government efforts to respect EU budget rules had fallen "significantly short of what was promised". Madrid and Lisbon were given 10 days to set out their arguments and convince Brussels they should not be fined.

Luis de Guindos, the Spanish economy minister, said after the meeting he was convinced that Spain would be handed a symbolic "zero" fine.

"It would be a striking paradox if the European economy that has had the most intense economic turnround and that is growing more than the others . . . were [sanctioned]," he said. "That is why I am convinced that there will be no fine."

The minister insisted that Madrid — which has missed its deficit objective for nine consecutive years — would finally come good in 2017. "There is a clear commitment to reduce the deficit to below 3 per cent next year," he said.

Mr de Guindos outlined fiscal measures to help Madrid hit its deficit target next year. The government intends to raise an additional €6bn by establishing a "minimum rate" of tax to be paid by corporations.

In foresees an additional €1bn in tax revenues through a crackdown on tax evasion, and savings of €1.5bn in borrowing costs as a result of lower interest rates than expected.

Crucially, the plan outlined by Mr de Guindos involves neither further spending cuts nor higher taxes on workers and consumers.

At a time when Mariano Rajoy, acting prime minister, is in sensitive talks about forming a new government, either of those moves could have made an difficult negotiation with the centre-left Socialists more complex.

Luis de Guindos, Spain's economy minister, speaks to the media in Brussels yesterday Jasper Juinen/Bloomberg

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But the plan to raise more tax revenue from the corporate sector is unlikely to be met with enthusiasm among Spanish business leaders, especially after Mr Rajoy held out the promise of a post-election tax cut.

António Costa, Portugal's prime minister, said yesterday any decision by the EU to levy sanctions against the country was unjustified.

"Our position is well known," he said. "It would be unjustified and counter-productive to apply any kind of sanctions on Portugal."

He was confident "there will be no effective sanctions".

Valdis Dombrovskis, vice-president of the commission, highlighted the dilemma faced by Brussels in judging two countries that had, on the whole, faithfully implemented the policy prescriptions set out by the EU.

"Spain and Portugal have come a long way since the [global financial] crisis," he said. "But lately both countries have veered off the track in correcting their excessive deficit."

Italy mourns Train crash claims at least 20 lives

University students, commuters and people heading for Bari airport were among the dead and injured after two trains collided on a single-track stretch in southern Italy — EPA/Italian Fire Brigade

Two packed regional trains collided on a single track through an olive grove in southern Italy yesterday, killing at least 20 people and injuring many more in one of the country's worst rail tragedies.

Emergency workers rushed to the scene near Corato in northern Puglia, in the blazing summer heat, to extract victims from the wreckage, amid appeals for blood donations.

The crash occurred at about 11.30am local time.

"This disaster is like a plane crash," wrote Massimo Mazzilli, mayor of Corato, on his Facebook page.

Corato is a town of 70,000 people about 25 miles north of Bari.

The accident immediately triggered calls for a thorough investigation. Matteo Renzi, the centre-left prime minister, was on a visit to Milan to celebrate the victory of his Democratic party in last month's mayoral elections. "We will not stop until there is clarity [on the cause of the crash]," he said.

Mr Renzi was expected at the scene later yesterday with Graziano Delrio, transport minister. The disaster is likely to open up a debate on the state of infrastructure investment in the eurozone's third-largest economy.

High-speed rail, particularly in northern and central Italy, has been a priority in recent years, resulting in a generally efficient and relatively low-cost network between the largest cities.

However, inter-city progress has come at the expense of regional and commuter lines, some of which have been neglected and are severely lacking in development and new funding.

Ferrovie dello Stato, the state-owned railway which is slated for privatisation, recently announced €4.5bn ($5bn) in investments in regional trains. It aims to turn its fleet from one of the oldest in Europe to one of the youngest by 2020.

The trains that crashed were operated by Ferrotramviaria, a private company that has provided rail services in the area north of Bari since 1937.

> Regional and commuter lines have been neglected amid a focus on the inter-city network

Plans were under way for a second track to be added to the line where the crash occurred. According to local reports, the trains were full of university students, commuters and people heading for Bari airport.

The trains were travelling at relatively high speeds on a straight stretch through flat countryside.

The causes of the tragedy are unknown but speculation has focused on possible human error or faulty signals.

"It's an unprecedented tragedy," said Massimo Nitti, director-general of Ferrotramviaria, in comments reported by Corriere della Sera, the Italian daily. "Now we are caring for the injured and then we will establish any responsibilities. That train should not have been there," he added.

The Corato crash follows other rail accidents in Italy this century that have had high death tolls.

In 2009 the derailing of a cargo train triggered an explosion in Viareggio station, Tuscany, killing 32 people.

In 2005 a crash between a local train and a cargo train in Crevalcore near Bologna, also along a single track, claimed 17 lives. *James Politi in Rome*

Statistics

Ireland's 26% GDP growth met with bafflement

VINCENT BOLAND — DUBLIN

Ireland has produced some notable works of fiction. A possible addition to the national oeuvre is the official narrative of the country's economy, which, according to data released yesterday, grew 26.3 per cent last year.

That is the highest level of growth for decades and far outstrips the estimate last year, which the central statistics office had put at 7.8 per cent.

It is nearly three times the highest level recorded during the Celtic Tiger boom years of the early 2000s.

The figures were met with a mix of bafflement and scorn. "Leprechaun economics," tweeted Paul Krugman, the Nobel Prize-winning economist.

Tom Healy, director of the Nevin Economic Research Institute think-tank, said: "I don't know if even Soviet Russia in the 1930s exceeded these figures."

The official explanation gives three reasons for the surge in gross domestic product: "inversions", in which companies move their assets or domicile to Ireland to avail of its 12.5 per cent corporate tax rate; groups moving their intellectual property there for the same reason; and corporate restructurings.

In other words the figures have only a tenuous relation to activity in the real economy and tangible things such as the creation of jobs.

Irish economic data are volatile because of the nature of the economy — small, open and dominated by foreign direct investment, particularly from Silicon Valley and drug companies. Official data are frequently revised, to the frustration of economists and investors.

Yesterday's change is the most extreme by far. "This revision primarily reflects statistical reclassifications relating to the treatment of inversion deals involving US multinationals, purchases by aircraft leasing firms and companies relocating assets," said Philip O'Sullivan, an economist at Investec Ireland.

The data are likely to reinforce domestic cynicism about Ireland's much-touted recovery from the worst financial crisis in its history. If that recovery exists, it is concentrated in Dublin and is mainly in the FDI sector rather than in domestic industries such as services, agriculture and small and medium-sized enterprises.

Enda Kenny, prime minister, lost his parliamentary majority in a general election in February largely because his exhortation to voters to "keep the recovery going" prompted the question: "What recovery?"

Faith in official economic pronouncements could erode further. "If a release of statistical data brings about a question of trust in that data, then the credibility question definitely comes up," said Dermot O'Leary, chief economist at Goodbody Stockbrokers in Dublin.

The question is whether the economy has become so distorted by the tax regime that nobody knows what is happening on the ground. Pearse Doherty, a Sinn Féin MP, said: "We now have an economy so intertwined in international tax and accounting stunts that they bring with them a serious risk."

A further reclassification could bring an equally dramatic drop in activity, he added.

The sting in the tail of the GDP data was that activity in the first quarter fell 2.1 per cent.

"If that happens in the second quarter, then technically we will be in a recession," said Mr Healy.

Data flow Legal threat to US-EU Privacy Shield agreement adds to companies' uncertainty

DUNCAN ROBINSON — BRUSSELS

The European Commission has signed off on a data-sharing arrangement between the US and the EU in spite of doubts about the scheme's legality.

Supporters say the so-called Privacy Shield will provide legal certainty to companies such as Google and Facebook which whizz data back and forth across the Atlantic.

But critics argue that the accord, which required years of negotiations, will fare no better than a previous arrangement.

What is the new deal?

Privacy Shield will give companies that sign up to it the legal right to transfer data to the US from the EU without breaking the bloc's strict privacy laws.

EU law forbids companies from moving personal data, such as payslips or photographs, to countries outside the bloc unless there are privacy laws in place to protect citizens that are similar to those applied by the EU, or separate safeguards such as Privacy Shield.

What did it replace?

A previous framework known as Safe Harbour — used to shift data from the EU to the US since 2000 — was struck down by the European Court of Justice last October after judges ruled that it did not keep EU citizens' data safe from US intelligence agencies.

This triggered protests among the 4,000 companies — from Amazon to small businesses in the EU — who relied on it.

Other data transfer methodswere available, but they were "lengthy and expensive", said Phil Lee, a data protection specialist at Fieldfisher, the law firm.

What are the new terms?

Negotiators from Brussels and Washington spent two years trying to come up with a replacement for Safe Harbour.

They did this by introducing features, such as an ombudsman to deal with complaints from EU citizens. Brussels also secured pledges from the US government that there would be no unreasonable spying.

"It is unusual quite how transparent we are being," Penny Pritzker, the US commerce secretary, who led negotiations for Washington, said yesterday. Vera Jourova, the EU commissioner who oversaw the deal, agreed. "My confidence stems from the fact that we have based the rules of Privacy Shield on the privacy court judgment," she said.

So why don't the critics like it?

To opponents, the deal fails to address the problem: intrusive snooping by US authorities. A letter from a spy promising not to spy "unjustifiably" is not worth much from a legal perspective, they argue. They also have doubts about the impartiality of the US ombudsman.

Max Schrems: Austrian expected to take opposition to the courts

Where does this leave business?

In a pretty sticky situation. With legal doubts still hanging over the future of Privacy Shield, few companies have pledged to sign up to it. Microsoft is the only large exception. Others have been unwilling to throw their support behind it just yet. "It is a bit too early," said an executive at a big Silicon Valley group.

Other compliance methods exist. One involves a company entering into a series of boilerplate legal contracts, approved by the commission, with its various regional subsidiaries. But this is cumbersome and also subject to legal challenge. Companies face another few years, at least, say analysts, before they are on firm legal footing.

Max Schrems, the Austrian law student who brought the original case against Safe Harbour, has already indicated he will challenge Privacy Shield. He gave a curt summary: "This deal is bad for users, which will not enjoy proper privacy protections and bad for businesses, which have to deal with a legally unstable solution."

How bad could it get?

In the worst case scenario, internet groups would effectively face the prospect of having to "silo" EU divisions, building independent data centres in the EU to serve customers in the bloc.

All this comes as cloud computing is becoming the norm, with businesses and consumers storing data in servers all over the globe, rather than locally.

It would come at a significant price: a total ban on transfers across the Atlantic would knock 0.4 per cent off the EU's GDP, according to one estimate from the European Centre For International Political Economy, a think-tank.

Regional superpowers

Iran-Saudi tensions flare over royal's speech

Prince's decision to talk to group opposed to Tehran infuriates Islamic republic

NAJMEH BOZORGMEHR — TEHRAN
SIMEON KERR — DUBAI

Iran has accused Saudi Arabia of supporting an Iranian opposition group in a bid to undermine the Islamic republic, fuelling a war of words between the regional superpowers.

Mohammad Javad Zarif, Iran's foreign minister, claimed Saudi Arabia was tying its fate to "terrorists" after Prince Turki al-Faisal, a former Saudi intelligence chief, took the highly unusual decision to address a meeting of the Mujahedin Khalq Organisation (MEK) in Paris over the weekend.

The exiled MEK is Iran's most organised opposition group, although it has little support inside the country.

It was the first time such a high-profile Saudi had publicly attended a meeting of the group. And although he is not a government official, Prince Turki's address to the meeting was viewed by Tehran as a deliberate provocation by the kingdom.

"The presence of the creator of al-Qaeda and the Taliban [Prince Turki] . . . in that meeting . . . shows inefficiency and thoughtlessness of such individuals who like [former Iraqi dictator] Saddam Hussein are tying their fate to that of terrorists," Mr Zarif said yesterday.

Brigadier General Ramezan Sharif, a spokesman for Iran's elite Revolutionary Guards, also condemned the meeting, saying it "revealed the old ties" between Saudi Arabia and "terrorist" groups.

Tensions between Iran and Saudi Arabia — the self-proclaimed custodians of the Shia and Sunni Muslim worlds respectively — have heightened this year, fuelling and complicating conflicts across the region.

Tehran and Riyadh cut off ties after Saudi Arabia's embassy in the Iranian capital was ransacked in January.

Iranian officials then lashed out at Saudi Arabia after neighbouring Bahrain revoked the nationality of the kingdom's most senior Shia cleric last month.

Saudis are increasingly vocal in their denunciation of Iranian interference in the Arab world, including in conflicts in Syria, Yemen and Iraq, and both sides accuse the other of promoting extremist groups.

Prince Turki's address to MEK — which took responsibility for the assassinations of Iranian officials after the 1979 Islamic revolution — was another aspect of the rivalry between the two, Iranian observers and western officials said.

But they said there was unlikely to be any major regional consequences.

"Both Iran and Saudi Arabia are wise enough not to take their war inside their own borders," said a senior Iranian official.

Saudi observers said Prince Turki's address to the MEK meeting was an attempt to keep the Iranians on their toes. But they also warned of the dangers inherent in aggravating tensions with Iran.

"We need a foreign policy that seeks to stabilise the region around us, even if we have to make reasonable concessions, such as getting out of Yemen and a lighter position on Syria," said a Saudi scholar.

Legislation protest

Israel under fire over law forcing civil groups to reveal funding

JOEL GREENBERG — JERUSALEM

The EU and civil rights activists have condemned the Israeli parliament's decision to pass a law that critics argue is an attempt by the rightwing government to stigmatise human rights groups and to stifle dissent.

The legislation, which was passed after a marathon debate that ended late on Monday, requires rights groups to publicly declare the funding they receive from foreign governments. Critics fear it will be used to delegitimise the groups by branding them as foreign agents.

The EU said it appeared to be designed to constrain the activities of Israeli civil organisations.

"Israel enjoys a vibrant democracy, freedom of speech and a diverse civil society which are an integral part of the values which Israel and the EU both hold dear," an EU statement said. "This new legislation risks undermining these values."

Billed by the government as a means to improve transparency, the law requires non-profit groups that receive more than half of their funding from foreign countries to declare it.

They will also have to make it public in any advertisements they place on television, the internet and newspapers, as well as in any written correspondence with government officials.

Most of the groups covered by the law are Israeli human rights organisations, including those documenting alleged violations and abuses committed by Israeli authorities against Palestinians in the West Bank and East Jerusalem.

Some of the groups have declared their opposition to Israel's occupation of Palestinian territories.

A significant portion of foreign funding received by the rights groups comes from European sources, including the EU, individual governments and foundations.

The new law does not restrict the funding, but seeks to give it greater publicity.

Benjamin Netanyahu, the prime minister, defended the law in a Facebook post, saying it would "strengthen democracy." He argued that it would "prevent an absurd situation in which foreign countries intervene in Israel's internal affairs through funding of non-profits, without the Israeli public being aware of it".

Ayelet Shaked, the justice minister and chief sponsor of the law, insisted there was nothing unusual in the government wanting to monitor foreign funding for local groups.

"Imagine if Israel would have funded organisations in Britain that supported Brexit," she told parliament, referring to the UK's vote to leave the EU. "The (Israeli) ambassador would have immediately been summoned for a reprimand, because Britain has national pride. From now on, we won't bow our heads."

But opposition lawmakers said the legislation — which is similar to a Russian law that requires non-profit organisations receiving foreign donations to register and declare themselves as foreign agents — would deepen Israel's international isolation and present it to the world as anti-democratic.

Isaac Herzog, the opposition leader, said the law "symbolises the budding fascism that is flowering in Israeli society".

Zehava Galon, leader of the leftist Meretz party, called the law an attempt to muzzle critics of government policy.

"You call that McCarthyism," she said in a radio interview, referring to the political repression of supposed communists in the US in the 1950s.

Jihadism. Mindset

Terrorists squeeze through profiling gaps

Search for a single pattern to identify would-be attackers distorts the west's response

TOM BURGIS — LONDON

Since Omar Mateen massacred 49 people in an Orlando nightclub, the New York-born son of Afghans has been described as a homophobe who used a gay hookup app, a jihadi who failed to understand that Isis and Hizbollah were enemies, and a jovial wife-beater who was both relaxed about his religion and furiously devout.

Mateen is not the first paradoxical jihadi. Amedy Coulibaly, who murdered customers at a Jewish bakery in Paris last year, died in the name of strict Islam but left behind a laptop full of child pornography. Samy Amimour was known as a personable bus driver with secular parents before he set off for Syria and returned to unleash mayhem on the Bataclan club in the French capital in November. Among other recent terrorists are immigrants and natives, cradle Muslims and converts, hardened criminals and aspiring dentists.

Fifteen years after the September 11 attacks on the US there is still no consensus about what makes a terrorist. Mateen is widely considered a terrorist. Micah Johnson — who said he shot five police officers in Dallas last week because they were white — is not, on account of apparently having no agenda beyond his own actions. And both men resemble in some aspects the mass shooters who have struck American schools, churches and other public venues over the years — and whose make-up and motivations are just as diverse as those of the "terrorists".

Studies have suggested a history of depression or domestic violence might be a key indicator, or that a society's attitude to the Islamic veil affects how likely it is to be struck. But psychiatrists, sociologists and other terrorism experts warn that such analysis often says less about the terrorist than the neuroses of a country searching for an explanation.

That has meant gun control in the US, secularity in France and multiculturalism in the UK. More troublingly, these experts say, the misguided belief that terrorists — today's jihadis, like nationalists, white supremacists and communists before them — have a single "profile" is distorting the west's response.

"Mateen may have felt like a husband in some situations, a security guard in another, a gay guy in another, an Isis member in others," says Marc Sageman, a psychiatrist and former CIA officer in Afghanistan. "People don't have a single social identity that transcends everything else."

Mr Sageman has worked as an expert witness on the defence team in terrorism cases. He has interviewed 30 violent terrorists and is dismissive of "armchair theorists" who do not enjoy such first-hand access. In 2008 he fought a public feud with other terrorism experts over his prediction "leaderless jihad" would eclipse al-Qaeda's organised plotting.

When attacks happen, Mr Sageman says, "two billion amateur Freuds" rush to extrapolate meaning from scraps of biographical detail. Seeking a pattern is futile, he says, beyond the fact Islamic terrorists consider themselves members of an *ummah*, a community of Muslims.

"It's an imagined community; it lives on the internet," he says. "You can be a punk, you can drink, you can be homosexual — it's your own identification." Those who identify with that community perceive it to be under attack from western military campaigns in the Middle East and react to protect it, Mr Sageman says, just as Americans rushed to join the armed forces after 9/11.

A Facebook post Mateen wrote during his attack appears to bear this out. "You kill innocent women and children by doing us air strikes," he wrote, according to Ron Johnson, chairman of the US Senate's homeland security committee. "Now taste the Islamic State vengeance."

But Isis, as Islamic State is also known, does not appear to have had any contact with Mateen, beyond its propaganda exhorting sympathisers to carry out attacks on their own. And in both Europe and the US, terrorism experts say attempts to predict who is likely to answer that call risk backfiring.

"The problem is lots of people might fit a profile but not act, while those who do act, don't fit a pattern," says Martha Crenshaw, professor at Stanford University. A pioneer of terrorism studies, as far back as 1981 she argued the "limited data we have on individual terrorists . . . suggest that the outstanding characteristic is normality".

In a newspaper column after Orlando, Prof Crenshaw upbraided Donald Trump, the presumptive Republican presidential nominee, for his claim "thousands upon thousands of people" were coming to the US, "many of whom have the same thought process" as Mateen. When it comes to terrorist motivation, Prof Crenshaw wrote, "the possibilities are endless, from personal grievance to mental illness to social frustration".

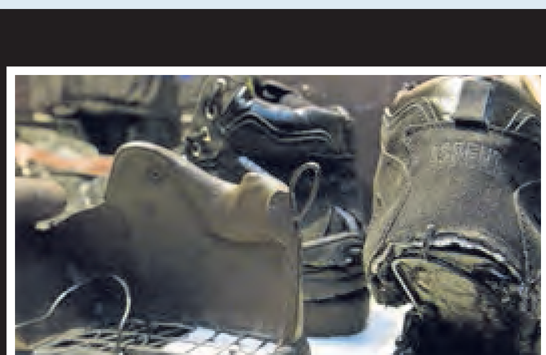
In contrast with the "lone wolves" in the US, the authors of the Paris and Brussels attacks belonged to organised jihadi networks with links to Isis's so-called caliphate. Yet they also fail to conform to a pattern.

Farhad Khosrokhavar, a sociologist at the School for Advanced Studies in Social Sciences in Paris, has spent two decades analysing Islam in France. There, as elsewhere, the political responses to terrorism, including security measures brought in after November's Paris attack, have been based on an erroneous faith in profiling, he says.

"[Political leaders] are playing this game. They need to tell the citizens that there is a type of person we are going to fight against. But we can see at least five or six types of person who will kill."

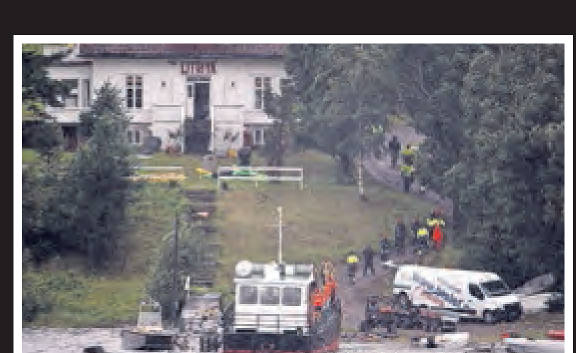
In the UK, Paul Rogers, a terrorism expert at Bradford university and author of a forthcoming book on Isis, argues the search for a unique terrorist profile is "a diversion which means we are not paying attention to the wider trends". Those trends, he says, include the increasing marginalisation of well-educated young men in places such as Tunisia and disruption caused by climate change. "It's looking for easy answers without facing up to much bigger problems."

Disparate faces of terror



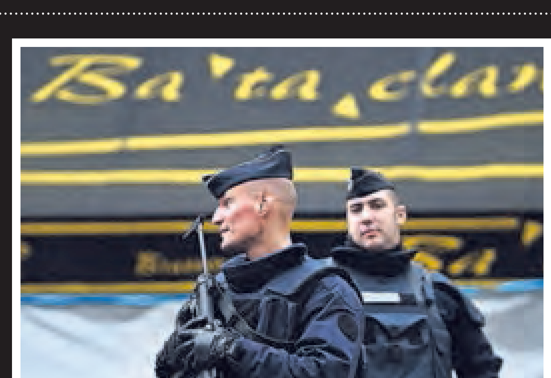

Richard Reid
Shoe bomber

The son of an English mother and Jamaican father attempted to blow up a transatlantic passenger flight with a shoe bomb in 2001. Grew up in a leafy London suburb before turning to petty crime. Converted to Islam in prison and travelled in the Middle East and Asia before attempting his failed attack weeks after 9/11.

Anders Breivik
Rightwing fanatic

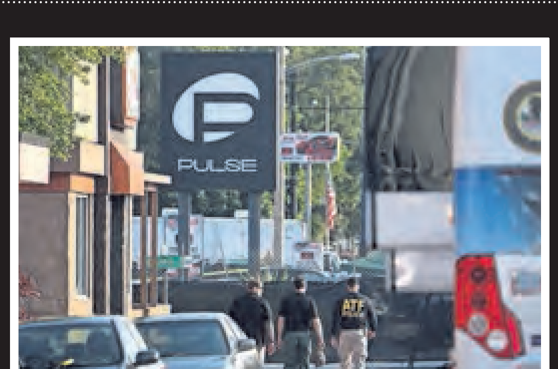
The Norwegian killed 77 in a bomb and gun rampage in Oslo and on the island of Utoya in the summer of 2011. Raised in an affluent part of Oslo, Breivik spent years preparing for the attacks, including writing a 1,500-page manifesto. Experts disagreed over his mental health. He was found at trial to be sane.




Samy Amimour
Paris gunman

One of three gunmen, allied to Isis, who killed 89 at the Bataclan club in the French capital last year.

Born to parents of Algerian roots, the bus driver gradually turned to fundamentalism and spent time in Isis's "caliphate" in Syria before taking part in the atrocity in the French capital.

Omar Mateen
Florida attacker

Claiming allegiance to Isis, Mateen killed 49 at Pulse gay nightclub in Orlando in June.

Born in the US to Afghan parents, Mateen was apparently radicalised online, without direct contact with Isis. Had a hazy understanding of Islamism and prone to violent outbursts.

Saul Loeb/AFP/Getty Images; Jeff J Mitchell/Getty Images; Joe Raedle/Getty Images

Integration African Union takes steps to break down borders with e-passport initiative

DAVID PILLING — LONDON

They are calling it Africa's answer to Brexit. Even as Britain's decision to leave the EU threatens the very fabric of the European project, African countries that were carved up by European colonialists are seeking to break down borders through closer integration.

Next week, the African Union, which comprises 54 countries, will issue e-passports that permit recipients visa-free travel between all member states. Beneficiaries will initially be limited to heads of state, foreign ministers and permanent representatives of those member states to the AU's Addis Ababa headquarters.

The ideal is to roll it out to all 1bn Africans, although that might take years, or even decades.

Nkosazana Dlamini Zuma, who chairs the African Union Commission, said the initiative was both symbolic and important, and was a "step towards the objective of creating a strong, prosperous and integrated Africa".

A goal in the 2063 agenda — a document in which AU members have laid out a 50-year action plan — includes the free movement of goods, services and people around a continent whose borders were drawn by colonial cartographers at the end of the 19th century with little thought to geography or ethnicity. Africa's 55 countries are made up of an estimated 10,000 separate polities, arbitrarily merged, according to Martin Meredith, an Africa historian.

Ghana went one better than the AU last week when it said it would issue visas on arrival for up to 30 days to all citizens of the AU, which includes all African countries apart from Morocco. Ghana, whose founding father, Kwame Nkrumah, was an early advocate of pan-Africanism, already allows visa-free travel for citizens of the 15-member Economic Community of west African States, including Nigeria, Africa's biggest economy. Thirteen African countries offer visas on arrival to African citizens, including Rwanda and Mauritius.

In many ways, however, Africa remains deeply fragmented. Formal applications for visas can be onerous and expensive. The bulk of Africa's trade is with Europe, the US and Asia, with only about 13 per cent of goods and services traded with countries on the continent, according to the AU.

Poor roads, red tape and clogged borders are among the obstacles.

For people, land borders are often porous, especially in times of crisis, such as the 1994 Rwandan genocide when hundreds of thousands of people poured across the border into the Democratic Republic of Congo. Africa also has millions of economic migrants in its cities. As in Europe, big movements of people can provoke a backlash. Last year, there was a spate of attacks, some fatal, against Mozambicans, Zimbabweans and other Africans living in South Africa's crowded townships.

An AU action plan advocates free movement of people and services

In May, Kenya announced it would close the Dadaab refugee camp, often described as the world's biggest, which is home to some 350,000 Somalis who had fled from conflict.

Still, attempts to ease restrictions on the free movement of both people and goods are gathering momentum.

Carlos Lopes, executive secretary of the Economic Commission for Africa, said many African states were too small to go it alone, particularly in manufacturing, and that much closer co-operation was indispensable for industrial take-off.

"This will not be feasible without regional integration," he said. "We have to create a single market."

Among the most advanced is the east African Community — motto, "one people, one destiny" — which groups Kenya, Tanzania, Uganda, Rwanda, Burundi and South Sudan. The six countries, which trade significantly among themselves, are already talking about a European-style monetary union, although negotiators admitted that Britain's Brexit had made them think twice.

"We never discussed voluntary exit," said Benno Ndulu, central bank governor of Tanzania and a participant in negotiations. "For all of us who are trying to have regional integration and monetary union, this gives us pause in terms of making sure that you have provision for exit."

FT BIG READ. BREXIT AND BERLIN

Already damaged by the refugee crisis, Britain's vote to leave the EU has dented Angela Merkel's position in Europe, giving her opponents the opportunity to attack her over austerity and German power.

By Stefan Wagstyl

Crunch time for Europe's crisis manager

Fading star? Angela Merkel knows Britain's vote to quit the EU leaves her facing the fight of her political career — Sean Gallup/Getty Images

For Angela Merkel, Brexit is a threat to everything she has achieved in more than a decade as the EU's dominant political force. But while her ministers, EU chiefs in Brussels and other European heads of government seethe, the German chancellor has kept her feelings to herself. The most pointed comment she has made since Britain's decision to leave the EU on June 23 is that the decision was "regrettable".

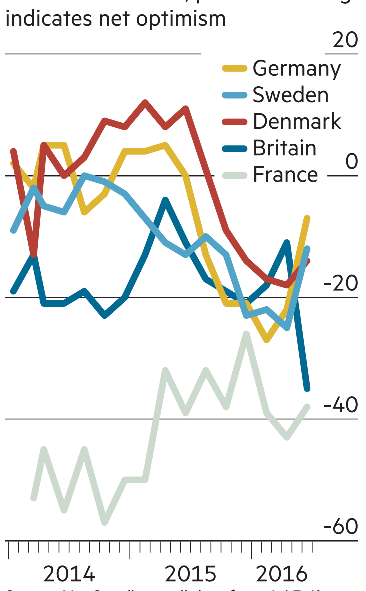
As understatements go it would be hard to beat. Ms Merkel, the 61-year-old habitually cautious EU veteran, is in fact preparing for the fight of her political life. Behind the one word "regrettable" lie multiple concerns — including the loss of a key liberal economic ally in the EU, the risk of further exits and the danger to her position in Europe.

"She faces a historic challenge . . . to hold Europe together. This is in Germany's interest and it is in Europe's interest too. No question, she is very worried," says Jürgen Falter, a professor of politics at Mainz University.

If Ms Merkel's fundamental aims are simple, the execution of them has been made more complex by Brexit, even for a methodical ex-scientist with years of practice in resolving crises. She must now work to keep the EU together, fight off rising populism and ensure that the UK stays as close as possible to the remaining 27 members, above all to Germany. And she must do all this while preparing for next year's German parliamentary elections, the first since Europe's refugee crisis dented her sky-high ratings.

Mood on the future of the EU improves

Selected countries, positive reading indicates net optimism



Source: YouGov (last poll data from Jul 3-4)

Ms Merkel will have to juggle the conflicting interests of Britain — where a new government will have to clarify its intentions — the union and its fractious member states, while facing down rivals with competing visions of Europe's future, not least Jean-Claude Juncker, European Commission president, François Hollande, president of France, and Matteo Renzi, Italian premier. "Merkel's mastery [of the EU] will be weaker," says Josef Janning, head of the Berlin office of the European Council on Foreign Relations. "Brexit will add more divisions and more controversies."

Blame game

For a leader accustomed to dealing with crises — the global financial upheaval, the Greek debt disaster, the Ukraine conflict and now the refugee emergency — Brexit is a challenge of a different order. "We think that we 27 [states] can overcome the situation. But we have no illusions that this is a qualitatively different task," she said at the end of a sombre gathering of EU leaders a few days after the referendum.

Her legacy is at stake. As a child of the former East Germany, she would hate to see new continental divisions. And as heir to former chancellor Helmut Kohl, the driving force of post-cold war European reunification, she would be loath to see the EU break up on her watch.

After 11 years in power her dominance of Germany and the EU is under threat. At home, support for the conservative bloc of the Christian Democratic Union and Christian Social Union has fallen from 41 per cent in the 2013 election to around 33 per cent. The anti-immigration Alternative for Germany has grown into the bloc's first significant rightwing challenger since the second world war. In the EU, the welcome she gave last year to more than 1m refugees won little support from fellow member states. Some feel bullied by German demands to take in migrants — and have forced her to back down on proposals for an EU-wide redistribution of refugees. Worse, to reduce the refugee inflows she has had to swallow her pride and cut a deal with Turkey.

She is widely accused of stirring the hornet's nest of migration politics. Alexander Lambsdorff, the liberal vice-president of the European Parliament, is among those blaming Brexit partly on Ms Merkel's refugee policy. "That some people should now portray her as Europe's rescuer is absurd — Brexit is also her responsibility."

Crucially, whereas Berlin imposed solutions in the global and Greece financial crises, and led the way over Ukraine, the scale of the refugee problem has turned Ms Merkel into a supplicant, asking favours from other member states — and being rebuffed by countries as small as Hungary. "She has lost her influence within the [European] Council," says one EU leader. "She has become the *demandeur*."

Jean-Claude Juncker, the European Commission president, has challenged Merkel with his push to dilute austerity policies

Rome's bid to secure EU approval for a rescue of its indebted banks has pitted Matteo Renzi, Italy's premier, against Berlin

François Hollande's vision of Europe differs to Merkel's, but one CDU MP says compromises with Paris are likely after Brexit

Berlin fears the loss of the UK's wider role in the EU. Under outgoing PM David Cameron, it backed Merkel's line on sanctions for Russia

Mr Juncker has sensed the shift. The conservative Luxembourger has irritated Ms Merkel ever since he got Brussels' top job in 2014 against her will by winning grass roots support from conservative EU parties, including the CDU/CSU. Fending off calls for his resignation in the wake of the Brexit vote, and denying he was "tired or sick", he has gone on the attack, seeking to exploit the chancellor's weakness and shore up Brussels' powers.

In contrast to Ms Merkel, he is pressing for a quick start to Britain's departure negotiations, seeking to squeeze London and shorten the period of uncertainty. He worries that delays could encourage other sceptical EU members to exit — with calls for referendums made by both Dutch rightwinger Geert Wilders and Marine Le Pen, leader of France's National Front, ahead of elections in the next 12 months.

Together with Martin Schulz, the German social democrat and president of the European Parliament, Mr Juncker argues for EU institutions to play a key role in reshaping the post-Brexit union.

Of more concern to Ms Merkel is his push to dilute eurozone austerity policies. In May, Mr Juncker suggested that France — which is expected to fail to meet its budget targets this year — should get special favours "because it's France". He further risked Ms Merkel's ire by defending his approach in the days after the UK vote, saying: "As a commission, we have put an end to blind unilateralism that demanded that austerity alone would be our response to economic, financial and social crisis."

The commission chief especially annoyed Berlin by proposing immediately after the referendum that Brussels alone should approve a controversial EU trade deal with Canada, without recourse to national parliaments. Amid uproar from German parliamentarians, furious at what they saw as a power grab, Mr Juncker has backed down.

In one key respect Ms Merkel believes time may be on her side — the Brexit vote has shocked many Europeans into rallying around the political status quo. YouGov opinion polls carried out in EU states after the referendum showed increases in support for continued membership in Germany and in three previously Eurosceptic states: Finland, Sweden and Denmark.

"In every country there will be people who will make the EU a scapegoat for all kinds of domestic problems or fears," says Manuel Sarrazin, the German Green party's Europe spokesman. "But there are also majorities — bigger than in the UK — that see the benefits of the EU, especially after Brexit."

A different vision

In contrast to the Juncker/Schulz federalist vision, Ms Merkel emphasises the role of member states. Wolfgang Schäuble, her combative finance minister, has warned the commission to do its job better or face losing power to national capitals. "This is not the time for visions," he told Die Welt newspaper. "If the commission does not work with us, then we ourselves will take things in hand."

Ms Merkel is afraid that discussion of wide-ranging reform plans could open the way for populists to advance radical ideas. She also wants to avoid alienating the eastern member states.

On austerity the chancellor may give a little ground. Mr Juncker is backed by centre-left leaders, headed by Mr Hollande, Mr Renzi and German Social Democratic chief Sigmar Gabriel, a minister in Ms Merkel's coalition. She has talked since the Brexit vote about addressing youth unemployment — a key issue in southern Europe and France, where the youth jobless rate is close to 25 per cent.

Sandro Gozi, Italy's secretary of state for EU affairs, says: "We need a constructive role from Germany also on the economic front and we see there is still a lot of work to do."

Ironically Brexit could weaken Berlin's economic hand. London has long been an ally in pushing for liberal markets, with minimal government interference, in the face of France, Italy and others arguing for a bigger state role. "After Brexit, I think there will be more compromises with France and Italy on the economic front," says one CDU MP.

The next test could be Italy's bid to secure EU approval for a rescue of its debt-laden banks, in the face of strict state aid rules agreed in 2013. Ms Merkel has rebuffed Mr Renzi's request, arguing that the regulations cannot be changed "every two years".

But Mr Renzi is fighting for a compromise and suggesting that even Germany might yet need a bank rescue. Last week he claimed that Italian banks' problems were smaller than those of other eurozone "big banks" with derivatives positions. He did not name any institution but was widely thought to have been talking of Deutsche Bank, Germany's largest, whose shares have fallen by 60 per cent in the past year and trade near all-time lows.

No need to be 'nasty'

With regard to Brexit, Ms Merkel wants anything but the Juncker-backed rapid start to talks. Even when they begin, Ms Merkel says there is no reason to be "particularly nasty" to the UK. She worries that misguided pressure would only increase the economic costs to Britain and its partners, especially Germany.

German business interests are close to Ms Merkel's heart, especially ahead of national elections. The economy is doing well, with wages rising, unemployment falling and consumption growing, but companies fear the turmoil in the UK; the Dax stock index is down 5 per cent since the referendum.

"Brexit permanently damages the German economy," says Eric Schweitzer, president of DIHK, the German chambers of commerce. "It is working as a dampener on conditions."

Britain is Germany's third-largest market, after the US and France, taking 7.5 per cent of its exports. For some industries it is much higher: the UK accounts for 12.5 per cent of sales for its influential carmakers. Markus Kerber, managing director of the BDI employers' association, says: "We should not talk about punishing people [in tough negotiations] if we don't know that we might be punished ourselves."

Moreover, Berlin fears the loss of Britain's wider role in the EU. Along with France, it brings to the EU worldwide intelligence services, a permanent seat on the UN Security Council and a rare capacity to project military power. Nato officials, gathered in Warsaw for a summit last weekend, say little of this will change. Also, as the UK was never an enthusiastic backer of EU defence co-operation, they say its departure may make it easier for the remaining 27 members to pursue initiatives opposed by London, such as a joint army.

59%
Germans' approval rating for Angela Merkel in July, up 9 percentage points from June and 14 points from February, according to Infratest Dimap

The EU's broader strategic role could, however, be undermined, notably in relation to Russia, where the UK has backed Ms Merkel's hard line on economic sanctions over Ukraine. ECFR's Mr Janning says: "Russia wants to exploit Brexit as much as possible."

Over the longer run Brexit could strengthen Germany's grip on Europe and with it fears of Berlin's dominance. In the short term, however, the problem is not Germany's strength but the EU's collective weakness. The Brexit process will consume huge political and bureaucratic resources, leaving fewer available for other crises such as refugees, Italian banks or Greece.

However demanding the European questions will be, Ms Merkel will devote more energy to the domestic agenda — and next year's elections. Analysts say it is too soon to say whether Brexit will boost the populist vote, as the AfD hopes, or whether the prospect of a struggling UK will frighten conservative Germans into sticking with Ms Merkel.

"Whatever happens," says a leading CDU MP, "Brexit must not damage our election campaign for next year. She wants to campaign on her record of managing crises in Europe." In the last election that record was self-evident. With the full fallout from Brexit yet to be realised that is no longer the case.

Additional reporting by Alex Barker, James Politi and Henry Foy

Speed read

Slow exit Merkel fears undue pressure would only increase the costs to Britain and its partners, especially Germany

'Her responsibility' Some European politicians blame Brexit partly on the chancellor's open-door refugee policy

Union rebound The Brexit vote may have shocked many Europeans into rallying around the political status quo

FINANCIAL TIMES
'Without fear and without favour'

WEDNESDAY 13 JULY 2016

A big test for Beijing over the South China Sea

The west must press China to reaffirm its fealty to international law

A UN tribunal's ruling on Tuesday that invalidates China's territorial claims in the South China Sea confronts Beijing with a pivotal moment in its emergence on the world stage. At issue is nothing less than whether China accepts the primacy of international law — or only does so when it suits the country's national interest.

The decision by the UN's Permanent Court of Arbitration in The Hague is binding under the UN Convention on the Law of the Sea (UNCLOS), which defines the rights and responsibilities of nations using the world's oceans. As a signatory, Beijing should observe the ruling. Failure to do so would damage its credibility in a host of international forums that use treaty agreements to govern behaviour in commerce, the environment, politics and defence.

If China flouts the verdict — which it has already criticised as reckless and illegitimate — it will send a signal to the world that it regards power as the prime arbiter in international affairs. Its defence that, far from being an outlaw, it has actually been trying to safeguard UNCLOS against a rogue tribunal carries little weight. The five judges on the panel reached a unanimous decision and their verdict under the convention is final.

The main conclusion from the case, which the Philippines brought in 2013, is that China has no claim to resources within a so-called nine-dash line, which encompasses about 85 per cent of the sea's area. In addition, the tribunal ruled that the Spratly Islands, which have also been claimed by other countries including Vietnam and Malaysia, have not been inhabited by stable communities. That means the states that control them are not entitled to 200 nautical-mile economic zones in the surrounding seas.

China's initial reaction has been predictably hardline. The ruling was "null and void and has no binding force", declared Beijing's foreign ministry on Tuesday. Its defence ministry, meanwhile, pledged to deal with "all kinds of threats and challenges" in safeguarding national sovereignty and maritime interests. Injured national pride could impel Beijing to unleash displays of military prowess and risk confrontations with the US navy, which has pledged to maintain freedom of navigation in the region.

The world needs to be absolutely clear about what is at stake. War between the current and future superpowers is a real danger, if the situation is mishandled. Thus, the immediate imperative is for restraint on all sides. Longer term, however, the international community should present a united front to Beijing to persuade it to find an acceptable means to observe the rulings of the tribunal and reaffirm fealty to UNCLOS and international law more broadly.

Although the region is far away, European powers should recognise that a face-off between the world's two biggest powers in a sea that provides passage to about $5tn in annual trade is everybody's problem. Robust and sustained diplomatic pressure is required by all European countries to encourage China back into an international order governed by law. The UK should jettison its myopic focus on China commerce and engage with the US on this vital strategic issue.

The South China Sea is the theatre in which the rivalry between Beijing and Washington is set to be played out. Actions there resonate around the world. China needs to be made to understand — possibly at the G20 meeting to be held in Hangzhou this autumn — that its pursuit of land and resources in this contested arena will carry hefty costs among its main commercial partners.

Weak growth is Italy's fundamental problem

There is a limit to what EU partners can expect of Renzi for now

Matteo Renzi is fighting on all fronts. A fragile economic recovery and the ongoing refugee crisis have fuelled public anger, putting the populist Five Star movement ahead in the polls. The prime minister's resolve to rescue Italy's strained banks has added to tensions with Brussels. His plan for a referendum on political reforms, intended to give his government fresh momentum, may instead threaten its survival. Little wonder that investors now view Italy as the most immediate risk to the stability of the eurozone.

There is little to reassure them in the International Monetary Fund's latest assessment of the Italian economy, published this week. Following the shock of the Brexit vote, the IMF expects growth to fall short of 1 per cent this year and barely to improve in 2017. It warns that Italy — the only major European economy that has not yet regained pre-crisis levels of output — is unlikely to pass this milestone until midway through the 2020s. The country faces two decades of lost growth, with knock-on effects for unemployment and real wages, over a period in which eurozone partners will have grown by some 20-25 per cent.

This lack of growth is the fundamental challenge Mr Renzi must confront. Italy suffers from low investment, low labour force participation and non-existent productivity growth. The OECD estimates its growth potential at a depressing minus 0.1 per cent.

These problems predate the eurozone crisis and the years of austerity. They appear to result at least in part from a longstanding misallocation of resources: skills and capital are not deployed in the most innovative companies, and there are too many small, unproductive businesses that do not grow. Italy's banks have contributed to the problem with cosy links between lenders and the recipients of credit. Low growth now makes it all the harder to restore the financial sector to health.

The good news is that the reforms Mr Renzi has already set in train, in particular his overhaul of the labour market, are bearing fruit. Further reforms to make the legal system more effective; to boost competition in the services sector; help employers to move jobs to poorer regions; and to eliminate cronyism from the banking system could yield relatively swift results.

However, there is a limit to what European partners can expect of Mr Renzi in the coming months. His overriding priority must be to stabilise the banking sector. The IMF has suggested that this can be done without breaching EU bail-in rules; Mark Carney, the Bank of England governor, has also observed that recapitalisation may be necessary. It is to be hoped that Italy's partners will be willing to take a liberal interpretation of the rules in order to resolve the current crisis.

They will also need to be understanding when it comes to fiscal policy. Italy has already won some much-needed latitude from Brussels; and tax cuts have helped to boost consumption. But if growth falls short of expectations this year, Mr Renzi may fail to meet his pledge to set debt on a downward trajectory as a proportion of gross domestic product. This should not be a concern. Fiscal loosening could be better targeted — for example, on public infrastructure investment — but this is no time to tighten the purse strings.

Finally, Italy's partners need to recognise that a pause in unpopular structural reform is inevitable. Mr Renzi faces a risky few months in the run-up to October's referendum, on which he has staked his political future. He remains Italy's best hope for reform and a return to sustainable growth. Until the referendum is over, Italy's allies will need to show patience.

Letters

Email: letters.editor@ft.com or
Fax: +44 (0) 20 7979 7790
Include daytime telephone number and full address
Corrections: corrections@ft.com

Poor national policy leads to poor global policy

Sir, It is indeed disappointing to read Lawrence Summers' retreat from globalism in favour of so-called responsible nationalism ("We need responsible nationalism not reflex globalism", July 11). For a spokesperson for better national policies, at least in the US, and ardent supporter of international co-operation, this shift is regrettable, but also based on several erroneous premises.

The first is that national policies are well crafted — just look at tax policies in the US or labour markets in France — and that therefore stronger national policies must prevail over idealised globalist policies. Policymaking in America has never been more misguided, partisan and ill-informed. With few exceptions, economic policy has missed the boat, whether on fiscal stimulus (for infrastructure spending, as Professor Summers himself has championed), or on raising educational achievement and skills acquisition, or in limiting the influence of lobbyists on the tax code or in catering to special interests.

The second fallacy is that globalism has failed because of supranational interference in national agendas. The Greek bailouts were designed to protect German banks and the IMF was powerless to stop them. The current Italian banking crisis needs independent action by the ECB as the lender of resort, not adherence to some Brussels-based directive aimed at punishing offenders. Prof Summers is right that these are cases of EU overreach, but he is wrong to then jump to the conclusion that each nation should decide its own course without considering the impact on others. He certainly has done a *volte face* on the issue of capital controls, now arguing that the international community should not block national efforts in this domain.

The reality is that poor national policies encourage weak global policies. Countries faced with sluggish growth, high unemployment, and worsening levels of inequality find it convenient to blame globalisation for their ills. Most of these challenges are manageable with better and more enlightened domestic policy. Retreating from the global economy is not the answer. Strengthening global institutions that matter and making sure they do their jobs rather than being cheerleaders is part of the solution. In this context, one cannot but be disappointed in the efforts of the Group of 20, too disparate a group to be effective, and saddened by the lack of policy co-ordination in Europe. Policymaking gets a failing grade almost everywhere, but reflex globalism is no less appealing than reflux nationalism.

Danny Leipziger
Professor of International Business and Managing Director, The Growth Dialogue, Washington, DC, US

Don't let recession take a hold in the UK — support trade and lift your spirits!

Sir, Brexit is the new reality and the UK economy is under threat. However, we mustn't stand by idly and watch a recession take hold — "consumer confidence" is not an abstract construct but the way we all feel and react on a daily basis. So if those who have disposable incomes now stop holding back from spending, the economy will survive and even prosper. Whether you can afford £5 or £500,000 is irrelevant — your actions will make a difference, and treating yourself or someone dear lifts the spirits. Or why not help a struggling family with the purchase of a school uniform or make sure someone gets a hot meal. Equally, accepting a reasonable offer on a house instead of clinging on for further increases could well get the ball rolling in the property market.

By being proactive we may well kick-start an upturn in the economy, and we can and should take collective responsibility for how we deal with the changes now under way. Supporting trade will make all the difference as we truly are in this together, not least as a country of shopkeepers, and indeed shoppers.

Ingrid Nilson
Director,
The Antiques Dealers Fair Ltd,
Newenden, Kent, UK

'We made austerity work well enough so Brexit shouldn't be a problem'

Theresa May's proposal undermines at a stroke the right of owners to elect who they want to run the companies they own, and will be bitterly resented.

Ian McVeigh
Head of Governance,
Jupiter Asset Management,
London SW1, UK

Company owners will resent worker-directors

Sir, Whatever the merits or otherwise of worker-directors, reported in "May vows to target big business in crackdown on 'privileged few'" (July 11), it is hard to think of a clearer way for the UK's new prime minister to tell Europe that it is "regulation as usual" than by importing a notion so heavily identified with corporate Germany.

If some of the negative economic effects of Brexit are to be offset, a flexible and sympathetic review of business regulation in contrast to the EU might help convince chief executives that the UK was doing something that was both different and attractive.

Parisian taxi system needs a good shake-up

Sir, If Paris is serious about "dangling tax carrots" to entice London-based bankers to move there (July 7), then they had better also reconsider their reported plans to regulate Uber and Allocab. The Paris-regulated taxi system is a textbook example of how public/private monopoly partnerships deliver the worst possible outcomes. The erstwhile London and New York cab monopolies may have left much to be desired, but the Paris system simply infuriates.

Paris taxis are just one symptom of the way the city is run — business regulation, residential regulation, even Airbnb regulation are all indicators of a much heavier-handed approach. If Brexit can contribute to a lightening of the Parisian approach to letting people get on with their lives efficiently, then that is a serendipitous beneficial outcome of the referendum.

Craig Sams
Hastings, E Sussex, UK

Could the Bota model work for other countries?

Sir, While I was very pleased to be among those quoted by Kara Scannell in her article on tackling corruption ("Moving money out of purgatory", The Big Read, July 6), I would like to point out that I was not the executive director of Bota, the foundation set up to repatriate cash to Kazakhstan, when it started up in 2009 — I was the director of two of its three programmes and took over as ED in 2011.

The real question the article raises is whether there will there be another Bota. Will a government where corruption took place realise that channelling repatriated funds in a transparent and accountable way, as Bota did, is actually good not only for its citizens but for its own reputation? The money stolen from Ukraine, Nigeria, and many of the Arab spring countries, once tracked down and repatriated, will provide billions with which to test the Bota model anew. Let's hope this path is taken, rather than have returned assets seed more cycles of corruption.

Aaron Bornstein
Independent Consultant and Former Bota Executive Director (2011-14)

A fall in fertility rates will help Africa prosper

Sir, David Pilling is right on target in his column on the population boom in Africa ("This population boom offers promise and peril", July 8). Many African leaders still believe that large populations by themselves will bring prosperity. African leaders who do appreciate the consequences of rapid population growth are afraid to promote family planning and thereby antagonise their pronatalist constituencies. It is the changing age structure brought about by fertility decline and the improving dependency ratios (ie, the more favourable relationship between active adults and young dependants) that is the engine needed to accelerate economic growth. Unless fertility falls rapidly and sharply in Africa, the demographic dividend will remain a distant mirage.

Dr John F May
Population Reference Bureau, Washington, DC, US

Delicate service only the MoD can perform

Sir, It was with great dismay that I read Jonathan Guthrie's "Condolences via Serco" (Lombard, June 21) in which he appeared to suggest that the Ministry of Defence is planning to place bereavement services wholly into the hands of private contractors. In criticising the proposal, he wrote: "If a soldier dies for his country, sympathy should come directly from the nearest proxy." Let me assure him that I agree wholeheartedly; I can think of no greater duty of care than that owed to the loved ones of our fallen.

The notion that families of the deceased might find themselves dealing with anyone but MoD personnel is truly as distasteful as it is fanciful. While the precise composition of Defence Business Services is indeed subject to ongoing consideration, I appreciate the opportunity to be completely clear on this point. The MoD will not consider any proposal that would see this vital and delicate service carried out by the private sector.

Mark Lancaster MP
Parliamentary Under Secretary of State and Minister for Defence Personnel and Veterans

Affordable or otherwise, the F-35 is the only option

Sir, Philip Dunne, the procurement minister, claims the F-35 is still affordable thanks to a currency hedge by the Ministry of Defence ("F35 stealth fighter jets take to UK skies despite cost fears", FT.com, July 8). Unfortunately, affordable or otherwise we will have to buy the F-35 as the decision to omit catapults and arrester gear ("cats and traps") from the Queen Elizabeth class aircraft carriers means the "short take-off, vertical landing" (STOVL) F-35 is the only fighter jet in the world that can be operated from them.

The MoD abandoned cats and traps because of their £2bn cost — but that decision now looks short sighted as they would have acted as both a financial and strategic hedge for the carrier programme. Cats and traps would have enabled the potential operation of at least two other aircraft from the carriers — the French Rafale and the far less costly American Super Hornet. They could have even opened the door to two others, the indigenous development of a navalised variant of the Anglo-Swedish Gripen or the Eurofighter Typhoon.

If a combination of increased development costs and a 15 per cent fall in the value of sterling adds at least £10m to the cost of each F-35 then over the remaining anticipated purchase of 124 aircraft, the cost increase on the F-35 will be almost equal to the cost of the cats and traps that would have unlocked the operation of less expensive aircraft.

Furthermore, cats and traps would have also acted as a strategic hedge through enabling the carriers to operate drones. Drones are being increasingly embraced by naval aviation because of their ability to act as force multipliers in an environment where aircraft numbers are naturally limited — perhaps the best example being the US Navy's plan to operate drones for aerial refuelling, thereby releasing up to a third of carrier aircraft for combat missions.

Edward Longinotti
London SW6, UK

Spaniards' long wait for a latter-day Marshall

Madrid Notebook

by Tobias Buck

Guadalix de la Sierra is a place of no particular distinction in the foothills of the mountain range north of Madrid. It takes only a minute to drive from one end of the village to the other, and there is not much reason to stop along the way. Yet, to most Spaniards, Guadalix and its cream-coloured town hall are instantly recognisable. All they have to do is imagine the scene in black and white, and populate it with Don Pablo, the canny mayor; Carmen, the pretty Andalusian singer; and Manolo, her unscrupulous agent.

They, together with much of the real-life local population, are at the heart of a seminal work of Spanish cinema — the hilarious, poignant, subversive, cruel and utterly absorbing *¡Bienvenido, Mister Marshall!* Filmed in Guadalix during the Franco dictatorship, it has kept its relevance like no other work of the era.

Even today, more than six decades on, it is shown regularly on television. It is part of the national conversation, held up as revealing essential truths about how Spain engages with the world and vice versa. US President Barack Obama's keenly awaited visit to the country on Sunday was just the latest event to trigger a flood of ¡Bienvenido Mr Marshall! headlines. His trip, though curtailed because of the Dallas shootings, offered a moment of cosmopolitan glamour to a country suffering the aftershocks of the economic crisis and facing yet more political uncertainty.

The plot of the movie is quickly told. A Spanish delegation arrives to alert Don Pablo that his dirt-poor village is about to be visited by the US officials assigning funds from the postwar Marshall plan. If he and the locals make a good impression, heaven knows how much money they will receive. The village may even get its long-awaited railway connection.

But how to impress the Americans? The answer is provided by Manolo, who claims to know them inside out: ("They are noble but infantile"). The US delegation will not want to see the real Spain, he explains, but a postcard version. That means converting the place into a faux Andalusian village, and dressing up the locals in flamenco costumes and Córdoba hats.

At considerable expense, the transformation begins. Walls are whitewashed, geraniums hung from window sills. The village rehearses a welcome song for "los americanos". All that is left to do is to wait for the delegates and their dollars to arrive.

In Guadalix today the film is fondly remembered. The school is named after its director, Luis García Berlanga, and a statue of Don Pablo adorns the balcony of the town hall. At a day centre for old people, I meet Pedro García, who appears as an anonymous teenager in the crowd. Like the other villagers, he was paid 25 pesetas for every day of filming — a much-needed fillip at a time of deprivation.

Don Pablo's real-life successor is Angel Luis García Yuste. "People here are proud of the film because it put Guadalix on the map of Spain," he says. He strikes me as a serious-minded local politician, focused on improving the small things. To him, the movie holds a simple message: "Don't wait for others to come and do your work. Just sticking a flower in your hair doesn't change anything."

It's a fair point. But there is clearly more than this to *¡Bienvenido, Mister Marshall!*, a film that leaves viewers in doubt as to who is being mocked more cruelly: the authorities or the people; the foreigners who come to Spain expecting bulls, flamenco and paella; or the Spaniards who are only too ready to fulfil these folkloric fantasies.

On a more subtle level, *¡Bienvenido, Mister Marshall!* also takes aim at Spain's historic inferiority complex and the deeply embedded notion that salvation must always arrive from abroad. What was it that José Ortega y Gasset, the philosopher, said in 1910 about its backwardness compared with the rest of the continent? "Spain is the problem and Europe is the solution." In their own crude way, the villagers embody the same hope.

The Americans do eventually arrive. But their motorcade speeds through the village without stopping, leaving Don Pablo and the locals standing in a cloud of dust, waving their cardboard hats in disbelief. Then the rain starts, washing away the little flags and all those dreams of instant wealth — but heralding a decent harvest, if nothing else. The village, like Spain, will just have to help itself.

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Comment

Tinkering will not fix Japanese democracy

OPINION
Sheila Smith

No one can be happier than Shinzo Abe that Sunday's upper house election tipped the legislative balance in favour of lawmakers open to revising Japan's constitution. But throwing off the constraints that followed military defeat and occupation, long an ambition of the prime minister, will be far less important than building a firm foundation for the nation's future.

A growing number of Japanese people seem taken with the notion that they should try crafting their own constitution. The 100 or so articles of the 1947 document, drafted under occupation by the Allied powers, offset the power of the prewar state by strengthening the individual rights that support popular sovereignty. They protect the choices — of religion, work, protest, due process — Japanese citizens today take for granted.

As tensions intensify across Asia — in the South China Sea, for example — the focus is largely on Article 9, the "no war" clause. Japan's military decisions are increasingly shaped by its neighbours' rising capabilities. North Korea's pursuit of nuclear weapons prompted Tokyo to invest heavily in ballistic missile defence. China's growing maritime reach has drawn attention to Japan's readiness to defend its waters and its islands. Last year Mr Abe's cabinet reinterpreted the constitution to allow the military to co-operate with others, primarily the US, if its own security is threatened.

Mr Abe's push to revise the constitution is widely perceived as a way to free Japan's Self-Defense Force from its post-war restrictions, but the debate is in fact about far more than this. Revising the constitution would equate to nothing less than weighing up the balance of forces that will sustain Japanese democracy throughout the 21st century.

In 1947, the aim was to strip the aristocracy of its economic and political influence. One of the most progressive elements of the document was the establishment of rights for women.

> The popular sovereignty enshrined in the constitution gives the people agency. It must not be abandoned easily

The state set up under the postwar constitution was a far cry from its predecessor. The version promulgated by the Emperor Meiji in 1889 created a state empowered to direct Japan's modernisation — fusing economic, political and social power in the service of the national purpose, legitimised by an absolute monarchy. The later document decentralised power and divested the state of its military power.

Will a new constitution once again seek to mend the social compact? Or will leaders set their sights lower, tinkering, tweaking language or amending the 1947 blueprint of their democracy to meet today's social needs? It is too early to tell. The committee to revise the constitution has catalogued the changes Japan's political parties think could improve their founding document. The governing Liberal Democratic party has a draft to share, as Mr Abe pointed out after the election, a draft he says could serve as a basis for legislative discussion.

But it will take far more than the 242 legislators in the upper house — or even the roughly 700 in both houses — to determine what a new constitution might look like. Article 96 of the present document declares that two-thirds of all the members of each house of parliament must create a proposal for revision. After that, a national referendum must be held to gain approval.

And the fact is that, while voters have created an opening for those who advocate revision, they seem deeply ambivalent about the prospect of tampering with the document that has supported their transition to democracy.

Popular sovereignty brings agency to the people; it should not be abandoned easily. All the social institutions must claim a stake in the process and all citizens must take responsibility for the outcome. Revising simply for the sake of revising will only weaken confidence in Japan's democracy, at home and abroad.

The writer is a senior fellow at the Council on Foreign Relations

An end to facile optimism about the future

ECONOMICS
Martin Wolf

"Some inventions are more important than others." This is the most important point made by Robert Gordon of Northwestern University in his masterpiece, *The Rise and Fall of American Growth*. This book provides a deep analysis of the transformation of US economic life between 1870 and 1970 and the subsequent slowdown. Growth is neither inevitable nor steady. Ours is an age of disappointing growth because the technological breakthroughs are relatively narrow.

Deirdre McCloskey, a distinguished economic historian, insists that such "pessimism has consistently been a poor guide to the modern world. We are gigantically richer in body and spirit than we were two centuries ago." She is right. But, Professor Gordon responds, we have not become richer at a constant rate. On the contrary, growth has been faster at some times than at others, even since the industrial revolution.

Thus, the period after 1890 shows consistent increases in output per person and per hour. But the period between 1920 and 1970 was more dynamic than those before and after: over half a century, output per hour rose at close to 3 per cent a year. A better measure of innovation is the rise in "total factor productivity": the growth of output, less the contributions of extra inputs of labour and capital. The pattern here is still more striking. The US economy experienced two periods of fast innovation: in 1920-1970 and, at a far slower pace, in 1994-2004. (See charts.)

This raises three huge questions.

First, why focus on the US? The answer is that it has been on the global frontier of innovation and productivity since 1870. In the period up to the second world war, one or two European countries were also highly innovative. Since then, the US has been on its own.

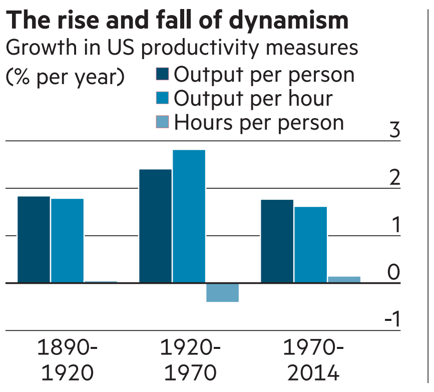
Second, what explains the rising and then falling productivity growth? Prof Gordon's answer is the rate and variety of innovation that appeared after 1870 and were introduced over the 1920-1970 period. This period saw an energy revolution: the exploitation of oil, the taming of electricity and the internal combustion engine. It witnessed the birth of the chemical industry and transformative developments in the supply of clean water and sewage disposal.

These led in turn to the creation of machines: the electric light, the telephone, the radio, the refrigerator, the washing machine, the automobiles and the aircraft. They led to the transformation of lives via urbanisation and the grid-connected home. These then drove an education revolution, as the economy demanded literate and disciplined workers. By comparison, the years since 1970 have seen relatively small changes in high-income countries. The productivity spike between 1994 and 2004 reflects the impact of the internet. It came and, soon thereafter, departed.

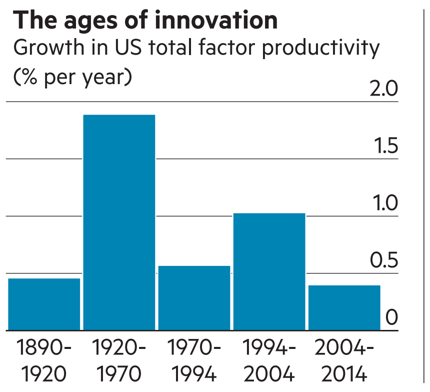
Third, how far does mis-measurement distort the picture? The answer is that it does so significantly but not in ways that make today's performance look better, relative to that of the past. The opposite is far more plausible.

Growth of gross domestic product has indeed been hugely underestimated. One reason for this is delayed inclusion of new products in the data: there was no US price index for cars until 1935, decades after their invention. Such delays are smaller today. Another way in which measurement fails is the difficulty of evaluating improvements in new models.

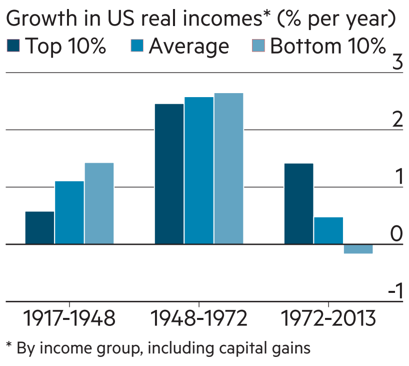
The rise and fall of dynamism



The ages of innovation



Incomes wax and wane



* By income group, including capital gains

Source: Robert J Gordon - 'The Rise And Fall Of American Growth' (Princeton Univ Press, 2016); ; World Top Incomes Database

More important, GDP is not a good measure of the standard of living. As Prof Gordon notes, GDP does not value the increased variety of foods, the removal of horse droppings from urban streets, the faster speed of travel, the transformation of communications, the improved quality of entertainment, the enhanced comfort of central heating, the reduction in household toil, the diminution in the effort and danger of work, the ease of access to clean water, the safety of packaged food and, above all, the jump in life expectancy. In wealthy countries, almost everybody now alive takes all this for granted.

There is simply no reason to believe the rise in GDP or living standards is any more underestimated today than it was before. Measured growth is slowing because invention has slowed. Moreover, today's innovations are narrower in their effect than those of the past.

> Measured growth is slowing because invention and innovation has slowed

Worse, their benefits seem to be less widely shared. Since 1972, not only has the growth in US real incomes been lower than before but the distribution of the gains has shifted away from those below the top 10 per cent of the income distribution. This helps explain the increasingly fraught politics of the US and other high-income countries, too.

The story told by Prof Gordon demolishes both facile optimism about prospects for economic growth and facile pessimism about the end of employment. We are neither in the middle of an era of unprecedented economic advance nor on the brink of an era of exceptional job destruction. This is partly because technological progress is so limited. It is also because so much of our economy is immune to rapid productivity rises. Thus, in 2014, fully two-thirds of US consumption went on services, including rent, healthcare, education and personal care. The challenge in these sectors is not that all the jobs are going to disappear but rather that it is hard to make them do so. That shift in the composition of output towards sectors where it is hard to raise productivity is a big reason for the slowdown.

The view that steady and rapid rises in the standard of living must endure is a pious hope. The tendency to believe that some "structural reforms" will fix this is, similarly, an act of faith. It is essential for policy to promote invention and innovation, so far as it can. But we must not assume an easy return to the long-lost era of dynamism. Meanwhile, the maldistribution of the gains from what growth we have is a growing challenge. These are harsh times.

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Beware of imitating the German model, Mrs May

OPINION
Ursula Weidenfeld

At a reception in Berlin at the end of June Joachim Gauck, the president of Germany, along with ministers, trade unionists and the heads of employers associations, assembled to celebrate the 40th anniversary of the *Mitbestimmungsgesetz* or "co-determination" act.

After the champagne toasts, the guests began to discuss the future of this system of joint decision-making between employers and employees in the age of globalisation. Optimism was in short supply. As politicians in other countries, including Theresa May, the incoming British prime minister, are thinking about expanding workers' rights, Germany, it seems, is quietly bidding farewell to them.

The great and the good gathered in Berlin were celebrating a glorious past. Since the act was passed in 1976, half of the seats on the boards of companies with 2,000 or more employees must be occupied by labour representatives. In companies with fewer than 2,000 employees, the proportion is one-third. The *Mitbestimmungsgesetz* transformed workers into co-managers of their companies. Employees in Germany not only have a say when it comes to working conditions; they are also involved in executive appointments and decisions over job cuts or the introduction of new technology.

In the past 40 years, workers have helped to reduce production costs, and agreed to flexible working schemes and short-time work where necessary. Owners and shareholders, meanwhile, have often given job guarantees and have invested in areas where labour costs were high.

"*Mitbestimmung* [co-determination] is part of our identity," said Ingo Kramer, president of the federation of German employers. But its best years are behind it. While it has contributed to industrial peace within companies, it has also hindered innovation and reduced profits. Moreover, only 641 companies are at present covered by the law, 126 fewer than in 2002. According to Reiner Hoffmann, chairman of the German Trade Union Federation, "800,000 employees are deprived of their right" to *Mitbestimmung*. Where possible, shareholders and chief executives try to evade the legislation by exploiting loopholes.

> Co-determination has secured industrial peace but it has also hit corporate profits

It is not only the employers who are downbeat about the future of co-determination. Young employees, too, are less than enthusiastic about worker representation. They prefer taking stock options in start-ups to works councils and representation on the board. Since many no longer want to spend more than a few years with one company, they are reluctant to invest too much time in stakeholder matters. If something goes wrong in a job, they would much rather resign than stay and fight for their rights.

The changing nature of the German labour market is also causing problems. Part-time and self-employed workers complain that trade unions and employers collude in protecting the interests of predominantly male full-time workers. *Mitbestimmung*, they argue, has entrenched existing privileges. Employers also worry that workers representation does not reflect the increasingly multinational character of German companies' workforces. "We need to talk seriously [about *Mitbestimmung*]", Mr Kramer said.

As Mr Gauck acknowledged, in companies with strong worker representation there is a tendency to be reactive and to innovate only in a crisis. It is much harder for businesses to be innovative when times are good, which means that they do too little too late.

Germany probably has no option but to stick with *Mitbestimmung* and make the best of it. Other countries, however, would be well advised not to go down this path.

The writer is a business journalist based in Berlin

Help the decile of discontent to help themselves

OPINION
Diane Coyle

One of the messages in the Branko Milanovic's latest book, *Global Inequality*, is that nine-tenths of the world's inhabitants have seen their incomes rise in the era of technology-enabled globalisation. The one-tenth who have not, the "decile of discontent", are those on middle and low incomes in developed economies, which must surely go a long way to explaining politics in countries such as Brexit Britain and the US of Donald Trump.

Among the happier 90 per cent, the gains have not been evenly spread either. For example, inequality within China has increased as incomes have risen.

The shifts in income distribution, within and between countries, during the past generation are the result of the interplay between information and communication technologies, global movement of goods and services, capital and people, and politics.

This makes it unlikely that there are simple causes — or fixes. But given that inequality seems to have reached the point of social or political unsustainability in a number of places, it is surely important to think about how the gains from technology and globalisation could be shared out better.

In this context a report from Vodafone, the mobile phone provider, on access to the internet (via smartphones) in lower income economies has some interesting lessons. In three separate contexts — micro-entrepreneurs in Ghana, women in Kenya and small farmers in India — the research suggests ways in which access to online information could help to redress inequalities experienced by these groups.

But digital access by itself is not enough. In poor as well as rich countries, the benefits of new technologies are linked to skills. People need to have the education or at least digital literacy to be able to use the information they find online.

> Policy should be aimed at improving the skills towards which technology is biased, leaving the rest to the robots

In the case of the farmers, for example, the biggest impact on their income comes not from better information about market prices but from highly localised reports about soil or weather conditions that can lead to dramatic increases in crop yields. Without this, the biggest beneficiaries of new technologies will be large-scale farmers able to invest in and use sophisticated equipment and services.

The time has come for policymakers to take the "skill bias" in the digital technologies seriously. This goes for poor and rich countries alike. Concern is mounting about whether the next wave of automation will exacerbate the decline in middling jobs and therefore reinforce income inequality.

Up to now, the political response to the trends in incomes driven by technology and globalisation has been negligible. Yet there is no mystery about what policies might help. In the short term, it is public spending on housing, services, education and transport infrastructure for people in the poorest areas.

It is the core job of governments to insure citizens against large-scale risks they could have done nothing themselves to avoid. In the longer term, policy should be aimed at improving the skills towards which the technology is biased, leaving what machines are good at to the robots.

I was shocked this week to hear an eminent British economist assert that we know all there is to know about the economies of poor northern towns and that to get good jobs their inhabitants will have to move elsewhere, as they have been doing for a couple of generations.

Yet many less complacent economists have long been pointing out the unevenness of growth during the past quarter century. Whatever the outcome of the UK's post-referendum political meltdown, and the febrile politics elsewhere, those in power will have to deliver for the decile of discontent, irrespective of economic growth.

The writer is professor of economics at Manchester university

Olympic effect will not shield Brazil's workers from recession

Joe Leahy

On employment

Here in Brazil, it is hard to find anyone in the labour market who has not been touched by recession.

I can see the toll it has taken on the professional circle of my Brazilian wife. Anny is an architect, which means her industry is usually the first to enjoy economic growth — and the first to be hit by a slowdown as companies stop building.

Of her closest colleagues, at least half are out of work while the others are scrambling for anything they can get their hands on. Her former boss, for instance, has laid off most of the office workers and is now doing the jobs she used to assign to Anny. Today, she draws most plans for clients herself.

Despite government hyperbole over the economic boost supposedly created by next month's Rio 2016 Olympic Games, this recession is the worst in more than 100 years. Brazil's unemployment rate is running in double digits at 11 per cent, from about 6 per cent in 2014.

Ordinary Brazilians are not the only ones who are unemployed. In a sign of the depth of the country's political and economic crises, President Dilma Rousseff has been left kicking her heels at the Alvorada Palace, the presidential residence. She is suspended pending an impeachment process for allegedly manipulating the government budget.

At least she can look forward to her pension. For many young Brazilians, by contrast, the hard times have come as a shock. For much of the decade leading up to 2014, they had become accustomed to a hot labour market, in which they could change jobs frequently — and each time for a higher salary. So scarce was talent during the boom years that employers were forced to pay over the international odds for people even of moderate ability.

Stories were rife of investment bankers paid more than higher producing counterparts in New York, or engineers who were more costly than those in Europe. Brazil's labour market became so attractive that Portuguese and Spanish professionals began seeking work in the country to flee the crisis in southern Europe.

The hot market worked with archaic labour laws to ensure Brazilian wages soared while productivity soured. With more than 900 articles, Brazilian labour law is so convoluted it discourages companies from hiring. Employers are required to pay almost double an employee's base salary in additional payroll taxes and social security payments, and are liable for huge payouts in worker-friendly labour courts if a former employee decides for whatever reason to sue.

But now, employers battered by the boom years are gearing up to use lean times for workers to their advantage.

It may have only been a Freudian slip, as he later claimed, but a statement by the leader of Brazil's main industry association last week was telling.

Robson Andrade, head of the confederation of national industry, or CNI, bemoaned Brazil's labour laws while making a call for tough reforms in a public appearance alongside interim president Michel Temer.

Why, even France, he said, had recently changed the law to allow employees to work for 80 hours a week in the interests of competitiveness. Considering that this would mean working 16 hours a day in a five-day week, he later realised his error and corrected himself. France was allowing employees to work for 60 hours a week (but even then, only apparently with a court order).

Employers battered by the boom years are gearing up to use lean times to their advantage

But reforms to labour laws, even if they do make the market more flexible and encourage hiring, will be slow to arrive.

In the meantime, the government is pinning its hopes on the Olympic effect. An EY study exclusive to Valor Econômico, Brazil's business newspaper, found that the events would create 1.79m permanent and temporary job positions. EY is an official sponsor of the games.

A number that high would be enough to fill a large part of the hole created by the recent rise in unemployment. But of course, most of these jobs will be temporary or one-offs related to construction or services that will disappear when the games are over.

Another way of looking at the Olympic effect is that unemployment may surge once the games are over, as this huge contingent of temporary workers is thrown back into the labour market.

Whatever happens after the Olympics, for Brazilians, there is no escaping it. The days when employees occupied podium position in workplace relations are in the past.

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Let's launch in . . .

Nantes, France

Dreamstime

Population **300,614**
Average age **37**
Digital businesses in 2014 **1,683**

In the 1990s, French football journalists coined the phrase *Le jeu à la Nantaise*, "the Nantes game", to describe the style of FC Nantes, whose players combined individual flair with tight teamwork on the field. Now the slogan has been adopted by young tech founders who are moving to the city in the north-west of France.

In the process of launching disruptive businesses, they are building a strong support network for entrepreneurs.

The case for: Nantes was one of nine cities identified by the French government as fertile for digital start-ups under a national scheme, the French Tech initiative. Between 2009 and 2014, it grew faster than the other cities on the list, including Montpellier, Toulouse and Lille. Many Nantes founders have moved here after working in London, Paris or Dublin for big tech companies, hankering for somewhere family-friendly as well as entrepreneurial. The city mayor's office has championed entrepreneurship, led by Francky Trichet, deputy mayor for digital innovation.

The case against: Finding skilled staff can be a challenge for tech start-ups and several say they are forced to search further afield than Nantes for key hires. It can be hard to persuade staff and backers alike to think as globally as would be the case in Paris.

Local heroes: Adrien Poggetti is general manager of the Atlantic 2.0 network, whose mission is to connect digital entrepreneurs from the Pays de la Loire region. It has more than 250 member companies, employing about 5,000 people. He is also president of TechPlaces, a network for France's digital co-creation and working spaces.

MyScript is a leader in handwriting recognition tech for handheld devices, smartphones, electronic whiteboards and wearable devices. It employs 110 people, with offices in Paris, San Francisco, Seoul, Tokyo and Hong Kong. Wiztivi is a software business, assisting editors, operators and television manufacturers to create interactive services, such as catch-up TV and video on demand.

Show me the money: Several venture capital companies are active in the region, among them Go Capital. Nantes has also attracted larger Paris-based companies, such as Alven Capital, Serena Capital, BPIFrance, or IRIS Capital.

However, securing initial funding remains complex because the city has had no major exits so far. There are local business angel groups but few are putting money into the digital sector.

It is easier to find backers for larger funding rounds, in excess of €500,000.

What the locals say: Julien Hervouët, CEO of iAdvize, whose software enables customer service online chats, welcomes the help offered to incoming talent from overseas, but adds that it "needs to simplify the way they can install their family".

Mickael Froger, co-founder of Lengow, a cloud computing service for ecommerce sites, says: "As a French start-up, we had to think globally from the off, but this was even more important being based in Nantes."

Jonathan Moules

Entrepreneurship. Google's Launchpad accelerator

Bridging the tech divide

Global entrepreneurs come to California to learn from Google and to share lessons of their own, writes Hannah Kuchler

Information in two directions: founders from emerging markets, such as those behind the HiJup designs, come to Silicon Valley to exchange insights

Under an umbrella on the edge of the Google campus, two young Indonesian women wearing hijabs are scribbling down advice from an Israeli serial entrepreneur in bright blue hipster glasses.

"How do you decide what the right target is?" asks Diajeng Lestari, chief executive of HiJup, an e-commerce site for fashionable hijabs, which is participating in Google's Launchpad accelerator programme. The nascent company has had some success, including an appearance at London Fashion Week, but now Ms Lestari is in Silicon Valley to learn some business basics. Barak Hachamov, a board member with the programme, is explaining how using key performance indicators will help her take stock of progress each month.

For guidance ranging from advice about growth strategies to technical instruction in new machine learning tools, 24 start-ups have gathered at Google's Silicon Valley headquarters to learn from mentors at the internet company. After two weeks, the entrepreneurs will return to their home countries with $50,000 and a book full of contacts.

Google also sees the programme as an opportunity to learn from the entrepreneurs. As the company targets the "next billion" internet users in markets such as India, Brazil and Indonesia, it wants to adapt its products for a mobile-first audience that may often have to rely on spotty internet connections and uses different searches from the average western user.

Google owns Android, the primary operating system in emerging markets, and is adapting its apps, creating easier ways to search in local languages, providing detailed topic pages for the movies and sports more popular in other countries, such as Bollywood and cricket in India, and making maps operate more easily offline.

"We in Silicon Valley, Tel Aviv or London, the centres of start-ups in the world, are so focused on the top-notch technology coming from these markets that we forget that in the next 10 years there will be a next billion coming online," says Roy Glasberg, who leads the programme for Google. For Mr Glasberg, these future internet users are "way more fascinating" and it is worth spending the time to understand their needs.

The start-ups are varied. Also participating in the accelerator programme is Miroculus, a Mexican company founded by molecular biologists who have developed a new way to detect disease: the first commercial application is stomach cancer. Google employees pop across campus to mentor the entrepreneurs who have travelled from around the world. In small groups scattered across a dozen long white tables, start-up founders eagerly take notes on laptops and on paper.

As they teach, those from Google learn about the problems of building technology in different countries and "real pain points" in emerging markets, Mr Glasberg says.

For instance, western technologists can "take for granted" infrastructure such as high bandwidth internet and online billing built on the assumption that people have credit cards.

At Launchpad, the entrepreneurs realise that they are bringing valuable knowledge to the table. Jorge Abraham Soto Moreno, co-founder and chief technology officer of Miroculus, is able to teach his Google mentors about how local regulation in a country such as Brazil restricts his ability to keep health data in the cloud.

Others say that they are telling Google about cultural differences, and their fellow citizens' technological capabilities.

Luciana Caletti, co-founder and chief executive of Love Mondays, describes her site as the "Glassdoor of Latin America" after the review site for staff to rate (and sometimes hate) their employers. She says she was able to explain to Google that "Brazil has a history of corruption and distrust in institutions. Providing a service for Brazilian professionals means we must make sure they trust us, to go to much greater lengths than you would in the US."

Anshoo Sharma, co-founder and chief executive of Magic Pin, a local app that connects users with merchants, is showing his Google mentors a crowded style of user interface, which is more popular in Asia.

"The western style is sparse, clean and simple," he observes, explaining that in China as well as India "the population, the demographic is much younger. They have the ability to understand the clutter, if you were to call it that."

One week in, some of the entrepreneurs have already built new features for their apps. Ms Caletti has been taught how to install a live chat app to communicate more easily with the site's users.

Magic Pin has knocked up a web app that can help users who struggle to download full apps from the Google Play store because of bandwidth problems.

Others say they have benefited from less technical teaching. At Miroculus, Mr Soto Moreno says the company has learnt how to communicate the results of the cancer test in a "compelling way" that makes patients and their families feel comfortable.

But the real leap forward embraced by every entrepreneur is machine learning. Silicon Valley is excited about how to apply this artificial intelligence technique but in many cases the buzz has not yet reached emerging markets. The group has been focusing on the TensorFlow machine learning platform.

"A lot of the emerging world start-ups didn't immediately see the applications for it but now a lot are really interested," explains Mr Glasberg.

Iman Usman, co-founder and chief executive of Ruangguru, an Indonesian online education platform, feels that the artificial intelligence would help his start-up develop personalised learning techniques. Miroculus believes that machine-learning could help it lower data storage costs by making cloud management more efficient.

Ms Caletti says that she is working closely with her mentor, who is keen to carry on helping when she returns to Brazil.

"We need to show the right job for the right professional. Learning how to get started on machine learning was one of the great goals," she says.

Outside, Ms Lestari has moved on from key performance indicators to extol the virtues of the Launchpad programme as a bridge between two worlds. HiJup, she says, is designed to tell a different story about Islam, to stop stereotyping Muslim women for what they wear.

"I'm a Muslim, Barak is an Israeli, a lot of mentors here have different backgrounds. But we're not here to speak about that," she says, gesturing at her mentor.

"It is about how to build a business, how to make an impact."

Power point

Connecting emerging markets

Silicon Valley companies are investing in serving newly connected populations in emerging markets. But doing so from their California headquarters risks accusations of "digital colonialism" — concerns that foreign technology companies have the power to shape economies and cultures.

Google has expanded its Singapore office to create an engineering hub focused on the "next billion" users, while Facebook's FbStart programme includes start-ups from emerging markets.

The term "digital colonialism" arose in India where Facebook's Free Basics app, designed to help connect people to the internet, was criticised for breaking the principle of "net neutrality", in which all internet users and content are treated equally.

The app created a two-tier system and the local regulator banned it after a campaign by Indian technologists.

Innovation to watch

Quiet Revolution for leaders

HANNAH KUCHLER

Dreamstime

What if the best shampoo sellers, pill purveyors or astronauts were introverts? That question led Procter & Gamble, Roche and Nasa to turn to an online platform that promises to help organisations get the best out of their quietest employees.

The Quiet Revolution and the Quiet Leadership Institute, its business-focused branch, were founded by Susan Cain, author of best-selling book *Quiet: The power of introverts in a world that can't stop talking.*

Half of US workers describe themselves as introverts and almost two-thirds believe their organisations do not harness introverts' talents fully, says the institute.

As companies look beyond their usual employee base to hire and promote more women and minorities, the Quiet Leadership Institute believes they should also go past the loudest and most forthright candidates when they seek leaders. The Quiet Revolution has developed a personality assessment tool to help people understand their introversion or extroversion, and created an online learning programme that encourages introverts to draw on their strengths.

The course covers everything from how to work in "mixed" teams of introverts and extroverts, how to make meetings productive and how to be an effective introverted leader. There is a Quiet Kit for small businesses.

The company runs a six-month "Quiet Ambassador" programme, where it trains 10 current and future leaders from different parts of a company to advocate greater inclusion of introverts. The online resources are supplemented by up to four hours of coaching over the phone. LinkedIn, the social network for professionals, has instituted a quiet ambassador programme.

ARTS

Distant days of hope and handshakes

THEATRE

Oslo
Lincoln Center, New York
★★★★☆

Max McGuinness

What now remains of the Oslo Peace Process? Perhaps only J.T. Rogers' engaging new play about how a Norwegian sociologist, Terje Rød-Larsen, and his diplomat wife facilitated secret Israeli-Palestinian meetings that led to that historic handshake on the White House lawn between Yitzhak Rabin and Yassir Arafat in September 1993.

It all seems very long ago. "The grip of history is loosening," as Larsen declares in the first scene. "In our lifetime there will not be another moment like this," he later adds.

Since those heady days at the end of the cold war, history's grasp has closed ever tighter around the Middle East. A poignant sense of dramatic irony thus hangs over *Oslo*. For more than two and a half hours, the rival delegations go at each other hammer and tongs while gradually moving towards a deal. But we know it is all destined to end in failure.

The play itself succeeds in drawing us into the minutiae of now dimly remembered diplomatic brawling. It's a dramatically conventional and occasionally heavy-handed work lacking the intellectual zing that a Michael Frayn or a Tony Kushner might have brought to the material. But the frustrations and triumphs of the year-long negotiations are scrupulously conveyed. Bartlett Sher's by-the-book staging also seems in keeping with the gravity of the subject.

Among the dexterous, accent-juggling ensemble, Joseph Siravo stands out for his imposing portrayal of Joel Singer, the Israeli lawyer and ex-army officer who authored much of the final agreement. Jefferson Mays also impresses as Larsen, the unassuming functionary whose latent desire for prestige and influence slowly reveals itself.

Like Larsen, who was the original source for the story, Rogers avoids openly taking sides. Yet he drops hints that the Palestinians, exhausted by decades of war and exile, were desperate to cut a deal at all costs and eventually came away with relatively little.

At the end, Larsen, clearly preoccupied with his own place in history, begs us to glimpse "the possibility" of a future peace. But no, we can't see it any more.

To August 28, lct.org

Imposing: Joseph Siravo (foreground, far right) in 'Oslo'. Below right: Kaitlyn Gilliland and Eva Tharp in Twyla Tharp's 'Country Dances'
T. Charles Erickson
Yi-Chun Wu

JAZZ

Ches Smith, Craig Taborn & Mat Maneri
Vortex Jazz Club, London
★★★★★

Mike Hobart

The central theme of this intensely focused gig was established from the outset. Drummer/vibraphonist Ches Smith smashed a small crash cymbal to sound like a bell; there was a scratch from Mat Maneri's violin; and, after due pause, the cymbal's bell-like sonorities were exactly replicated by Craig Taborn on acoustic grand. As the gig evolved, brief bell-like themes established mood, ghosted into high-energy improv and acted as an organising force.

The trio's dramatic minimalism was first captured on the 2015 album *The Bell*, its mood of left-field pessimism captured by titles such as "I'll See You on the Dark Side of the Earth" and "It's Always Winter Somewhere". Now the trio is being road tested — the current European tour has taken in the North Sea Jazz Festival — and the contrasts between impending apocalypse and triumph-in-survival are more extreme. In both sets, melancholic motifs tolled briefly and fractured into improv, only to reappear as a pounding off-kilter riff supporting a wall of sound.

Smith's drumming reflects his sideman credits ranging from indie rock and modern jazz to John Zorn. At this performance, he interspersed the fractured splatters of free jazz with ear-splitting 1960s rock, the hushed patter of fast, brush-driven swing and more besides. And it was his precise, deep-toned and dramatic drumming that gave the performance its overall shape.

The detail, though, was collaborative. Smith was equally astute when he switched from drums to vibraphone, while the percussive Taborn and amplified Maneri have a similarly fine-tuned sense of sound. For two sets, the trio delivered sharply-drawn soundscapes that varied greatly in texture and tone.

At one point scurries of free jazz morphed into a violin melody so plangent that it conjured the desolation of a recently abandoned village; later, Maneri delivered a capricious impish dance. At another, Taborn sustained a pulsating single-note jangle, his left hand striding into the bass supported by a slash of amplified violin and pounding mallets. At times the music was abstract and dissonant, at others tuneful and rhythmic.

Both sets finished on a high — the first with solitary "Funky Drummer" drums and bell-like bash; the second with violin soaring over a thumping backbeat and piano mimicking a bell-ringer's peal.

Touring to July 17
chessmith.com

DANCE

Twyla Tharp Dance
Joyce Theater, New York
★★★★☆

Apollinaire Scherr

The quintessentially American choreographer Twyla Tharp has an affinity for music of fearsome effort and endurance. Her 1980 *Brahms Paganini* unfolds, over half an hour, to 28 variations on a single theme; the dancing offers as many variations. The new *Beethoven Opus 130* matches the composer's *Grosse Fuge* with a dense sublimity of its own. Grace, according to Tharp, comes only after a Sisyphean climb — and on opening night her three dances and the dancers reached the peak.

With the programme's two repertory pieces — both from the 75-year-old choreographer's decade of ascent, the 1970s — the relentless invention is in the steps. The quartet *Country Dances* is all about the pleasure of dancing. The solos are especially joyous, not only because they escape the predatory heterosexuality that creeps in whenever Tharp sets men and women together, but also because the dancing is the most taxing. In Tharp's worldview, effort always brings rewards. So after a series of strenuous manoeuvres — push-ups, barrel turns — long-time Tharper John Selya lit into the air to hang there like a cloud. As for the solo to the whole first book of Brahms variations, just when he seemed to have exhausted his momentum Reed Tankersley would suddenly unfurl like a runner breasting the finish-line tape.

The architecture more than the movement carried *Opus 130*. The deeply layered eight-person ballet is Tharp's answer to Balanchine's *La Valse*. This time, Death (riveting Kaitlyn Gilliland) danced as much as her victim (Tharp veteran Matthew Dibble in bravura mode). And she had other things on her mind than luring him to his end. When Dibble was out of the picture, Gilliland was happy to join an evanescent chorus that emerged from the dark in Norma Kamali's equally inky outfits or flitted from the wings like snow flurries. Even death, it turns out, is not immune to distraction — the background noise of life.

To July 23; joyce.org

Small opera with roots that run deep

OPERA

Kalîla wa Dimna
Aix Festival, France
★★★★☆

Shirley Apthorp

While the world around him has been obsessively cultivating division, Aix-en-Provence Festival director Bernard Foccroulle has spent years quietly emphasising common humanity. Not just throughout Europe, with initiatives such as his Opera Academy, but also through countless projects examining France's role as a Mediterranean nation, and all that this implies.

The world premiere of Palestinian composer Moneim Adwan's first opera, *Kalîla wa Dimna*, is just such a project. This is a beautifully made chamber work, unpretentious but profound, retelling an ancient Arabic tale that speaks directly to today's political realities. Adwan, whose work has consistently drawn on Arabic poetry and explored points of intersection between Arabic music and the western canon, has been nurtured by Foccroulle's Aix incubator for a number of years, and this production is the result.

Dimna, born to a poor family, claws his way up the political ladder by flattering the King. To cement his own primacy, he intrigues against popular poet Chatraba. His initial victory will later cost him everything. The King's manipulative mother and Dimna's empathetic sister Kalîla have warned the men throughout, to no avail.

The roots of Fady Jomar and Catherine Verlaguet's libretto grow deep. At its core is 8th-century Persian author Ibn al-Muqaffa's seminal interpretation of the *Panchatantra*, a Sanskrit collation of animal fables dating from about a thousand years earlier. Yet the action and intrigue could have been written yesterday as an allegory of the Assad family, or of contemporary British politics.

In a sense, Adwan's opera is a staged evening of Arabic song. Harmony does not play a significant role, but ornamentation does, and the instrumental quintet plays with an improvised freedom and an ear for each other that is quite different from that of most western opera.

Olivier Letellier's staging, at the Théâtre du Jeu de Paume, is simple but perfect, the space, set and props used with consummate imagination and attention to detail. The cast, all from Arabic vocal backgrounds, sing and move with eloquence; the composer plays the part of Dimna himself, and Zied Zouari directs with impish flair from the violin.

This is an eloquent offering that has found its own musical and dramatic syntax, an impressive feat for any first opera, and a mark of how strongly the Aix-en-Provence Festival believes in cultural diversity.

To July 17, festival-aix.com

Eloquent: Ranine Chaar and Moneim Adwan in 'Kalîla wa Dimna'
Patrick Berger

TODAY'S TELEVISION & RADIO

TELEVISION

Shades of Blue (Sky Living 9pm) starts with what seem like clichéd situations and stereotyped characters, but sheer assurance carries this US crime serial with its bent cops, female detective coerced into spying on her crooked boss by the FBI, attendant twists and turns and distorted code of honour. Above all, the interplay between Ray Liotta as the ruthless criminal detective and Jennifer Lopez as the enforced informer is hypnotically compelling.

Exodus: Our Journey to Europe concludes its three-day serial (BBC2 9pm): migrant/refugee subjects have been entrusted with camera phones and have recorded illegal rides, shady deals, kidnapping, buying fake passports — all impossible for a film crew — and even some happy endings. On the way, their dignified assertion of basic humanity makes for deeply moving viewing; though sometimes, as when a young man breaks down recalling police beatings for hours on end, we are reminded of the background of violence, corruption and repression.

Compelling: Ray Liotta in the new crime serial 'Shades of Blue'

RADIO

The JAM (John Armitage Memorial) on the Marsh Festival fills the evocative setting of Romney Marsh, its landscape and churches, with such activities as tonight's **Radio 3 in Concert** (7.30pm), devoted to music inspired by literature. Reader Janet Suzman joins the BBC Singers with Nicholas Cleobury in music by Vaughan Williams, Holst, Finzi and others, drawing on Shakespeare, Tagore, Rossetti and Hopkins.

Martin Hoyle

Lex.

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UniCredit: initial overtures

In show business, opening scenes are a tough balancing act: too little and you risk losing the audience's attention, too much and its expectations will be overwhelmed. In Italy's national *opera buffa* — otherwise known as the country's banking system — the new chief executive of UniCredit has opted for a full-throated aria.

Yesterday, Jean-Pierre Mustier began a strategic review of Italy's largest bank by assets, sold a 10 per cent stake in Fineco, its lucrative asset management arm, and announced a placing of shares in Bank Pekao, its Warsaw-listed subsidiary. The audience loved it, and the stock gained 13 per cent.

In normal times, a bank would not have to sell a discounted stake in a trophy asset in its biggest market, nor raise capital at a subsidiary whose core equity tier one ratio is approaching 20 per cent. But investor sentiment towards Italian banks is plumbing depths last seen during the eurozone sovereign crisis. Even with a supporting cast of tottering institutions, UniCredit hogs centre stage; its share price has fallen 60 per cent this year, lagging behind FTSE Italian banks index by 20 per cent. The Fineco sale will add a few basis points to Unicredit's tier one ratio, currently 10.8 per cent; the Pekao fundraising perhaps 10 more. With gross non-performing loans amounting to €79bn, or 15 per cent of total lending, it will still need more capital, either from disposals, a capital increase, or both. Mr Mustier's review of "strategic" assets should include operations in Germany, Poland and Turkey. Further changes on the board (the chairman, deputy and two vice-chairmen have been there for nearly 10 years each, on average, according to Berenberg) would also be welcome.

Self-help may not be enough. Any investment in Italian banks comes with a disclaimer about things they cannot control, such as political uncertainty over the future of Matteo Renzi — who has tethered his legacy to an autumn constitutional referendum — and bad-tempered discussions with Brussels about how best to recapitalise the banking system. As Italy's only bank of global systemic importance, for UniCredit to stagnate, never mind fail, should be economically unthinkable and politically infeasible. In the *opera buffa* tradition, a farcical plot usually has a happy ending. Even after yesterday's pop, its shares, at a 70 per cent discount to book value, are still priced for tragedy.

Asos: if looks can bill

"Turnover vanity/profits sanity": that couplet was received wisdom in retail — until Amazon proved that if turnover grows fast enough, it is the other companies that go insane. Asos is one of Amazon's spiritual heirs.

One of the UK's earliest online fashion specialists depends on the conceit of 20-something fashion lovers to support sales growth. In turn, rapid sales growth makes the market happy. Yesterday Nick Beighton, Asos' chief executive, walked some very attractive figures for the June quarter down the runway. Sales were up 30 per cent.

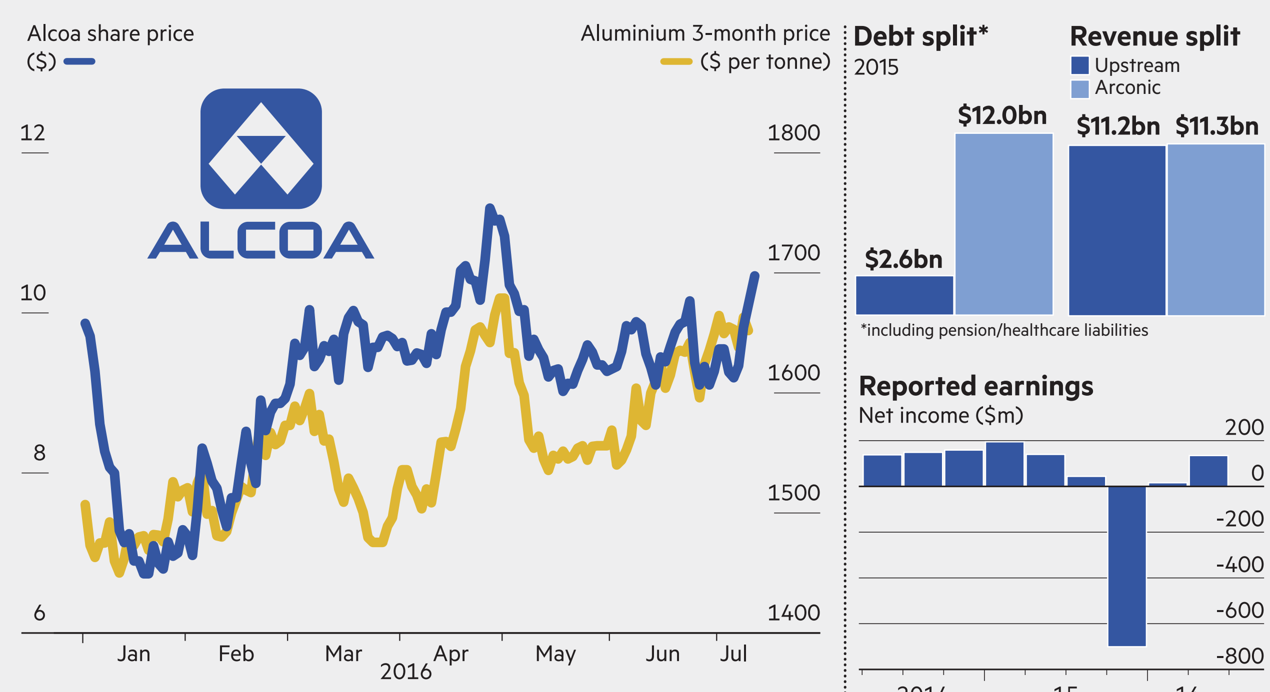
The Amazon/Asos approach is working particularly well in an equity market starved of growth. Asos shares rose 4 per cent yesterday morning, adding to their post-Brexit rally. A weaker pound will boost full-year sales (to August) as more than half originate from outside the UK. Moreover, four-fifths of operating costs are sterling-based.

Mr Beighton can also point out that Asos' efforts in the US are paying off. It has cut prices to stimulate sales there, and it has worked. Sales in constant currency terms rose 39 per cent, faster than any other region. Asos has focused on the US — now an eighth of revenues — given the low penetration of online retail (16 per cent) in such a big fashion market. Not that Asos had a dressing down elsewhere; group turnover this year should rise at the fastest pace since 2014.

Price-cutting does not help profit margins. Mr Beighton noted that his margin target for this year has not changed, however. In any case, with a 24 per cent return on capital implied, Asos scarcely needs wider margins. Even adjusted for leases, UK retailers on average earn only 15 per cent, notes Citi. With cash flow already exceeding its investment needs, higher margins would only encourage new entrants. That a high-turnover, low-margin model creates its own barriers to entry is another Amazon insight. After a brutal correction in 2014, the market loves Asos again. Vanity is all.

What's in a name

Alcoa will soon split its commodity aluminium business from Arconic, its engineered products unit, in order to make the businesses easier to value. Their fortunes have diverged recently; demand for jet-engine parts has slowed while aluminium prices have rallied



FT graphic Sources: Thomson Reuters Datastream; S&P Capital IQ; company filings

In fairness to Alcoa, the aluminium titan has been too occupied with its capital structure to be clever about names. Last year, Alcoa announced that it would resort to breaking into two companies — its commodity mining and smelting business, and its higher-margin value-added products unit, built through acquisitions in recent years. The fancier business will be dubbed Arconic, which aims for grand ("Ark" + "Iconic"?) and hits silly. As distinct as the naming may be, the split may not be as clean as envisioned.

When Alcoa acquired jet-engine parts maker Firth Rixson for $3bn in 2014, and RTI International Metals for $1.5bn in 2015, the hope was that it could be perceived as more than a pure commodities play. Well, no: with a sharp decline in aluminium prices, Alcoa shares still lost half their value in 2015. A separation then seemed like the only way to capture the value embedded in the group.

Arconic will retain all of the combined company's $9bn of gross debt, along with $3bn worth of pension and health-benefit liabilities. The upstream business (technically, the bit that is getting spun off) will retain the Alcoa title and raise $1bn of debt to pay a dividend to Arconic, and itself keep $2.6bn of retirement liabilities.

The prospects for the pair may have flipped, to some extent, since the split was first contemplated. As a result of softness in the aerospace market, the company has lowered an initial three-year target revenue forecast for the Arconic segment by more than a tenth. Meanwhile, as aluminium prices have rallied this year, shares in Alcoa are up nearly 50 per cent.

Late on Monday, second-quarter results revealed that tight cost control helped it beat forecasts for earnings by a wide margin.

Breaking up conglomerates makes sense, as a general rule. Investors can diversify at the portfolio level, and management focus is more than a slogan. At the same time, though, it is not easy to pin down the line between "trapped value" — which financial engineers see in every conglomerate — and the mundane realities of volatile earnings and the attendant swings in share prices.

Daimler: keep on trucking

Now do you believe us? On Monday evening, Daimler pre-released second-quarter earnings that beat analysts' forecasts by 13 per cent. The shares duly rose 5 per cent yesterday — but still lag those of BMW and even scandal-hit Volkswagen so far this year.

The standard explanation is that Daimler's stellar performance is not sustainable. After a decade lost to the terrible Chrysler merger, new managers reinvigorated the car division with a fresh new model line-up and made an aggressive push into China. Car sales are poised to overtake those of BMW for the first time in a decade, and margins are fat. But the revamped E-class, released this year, marks the end of the upgrade cycle. By contrast, BMW's new 7-series marks the start of its product cycle, while at Volkswagen there should be huge cost savings to come as the company restructures in the wake of dieselgate. Equity investors look ahead, rather than revelling in past glories.

There is another possible factor, though. Daimler makes heavy trucks as well as luxury cars. These contribute around a quarter of sales and a fifth of operating profit; at Volkswagen, the only other European carmaker that also makes trucks (via majority stakes in Scania and MAN) the figure is less than 10 per cent. Truck sales have been under pressure, especially in the US where Daimler is the market leader — sales of the biggest rigs there were down 34 per cent year on year in June, and Daimler has already warned that truck earnings will be well down on last year. Shares in pure-play truckmakers like Paccar and Volvo have lagged behind benchmark indices. In Europe, the EU is set to fine truckmakers for fixing prices and delaying the rollout of emissions technology.

Daimler held an investor day for its truck division last month, outlining plans to push further into China, increase manufacturing efficiency and invest in new technology. Such moves paid off richly in cars. They could help reinvigorate the trucks business too.

Risk allocation: 24-hour parity people

Last year critics predicted the end of risk parity investing. Ray Dalio's All Weather fund, the most prominent exponent of the genre, lost 7 per cent in 2015. Risk parity funds tend to have a high allocation to fixed income. Rates will keep ticking up, the naysayers said (where else can they go?) bonds will fall, and the parity folks will be routed.

In the event, bond prices have risen and the strategy lives on. Traditional portfolio construction picks the asset mix that maximises returns for a given risk limit. Risk parity aims for each asset class in a portfolio to contribute the same amount of risk. If the portfolio offers less total risk (and therefore return) than desired, borrowed money adds juice. The core idea is that all asset classes provide similar risk-adjusted returns over time — investors chasing returns ensures that. So balancing all risk types maximises the benefits of diversification.

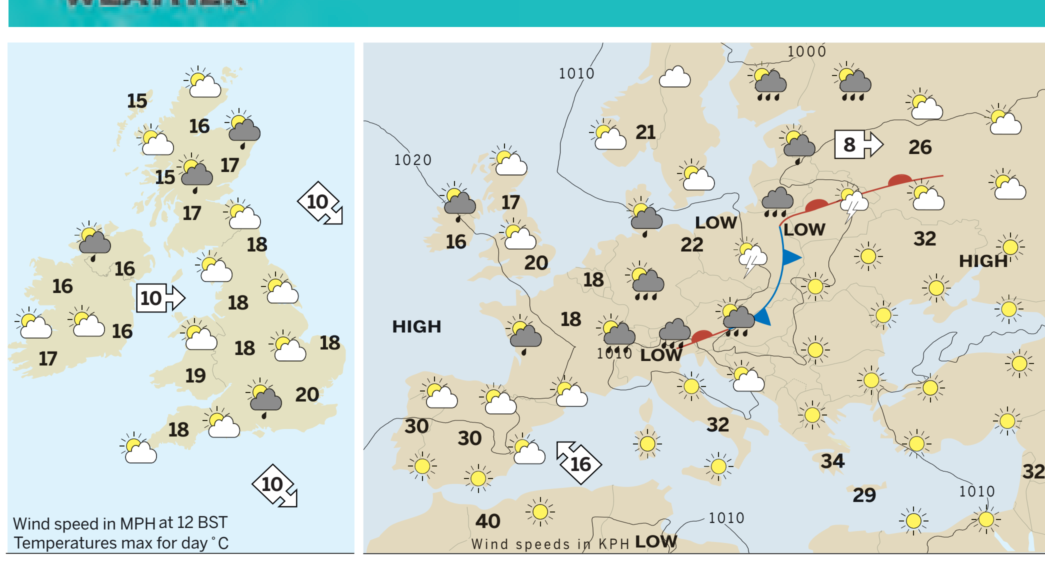
The result is that more money must go into stabler assets (Treasury bonds, for example) to increase their risk contribution. Risk parity adherents do not worry about apparent dislocations such as extremely low bond yields because, over the long run, diversification works and imbalances correct themselves.

A portfolio with 60 per cent in the S&P 500 index and 40 per cent in the Barclays 20+ year Treasury index would have returned 10 per cent so far this year. That is 1.2 per cent for each percentage point of volatility. The Salient Risk Parity index, representing a typical risk parity investment, has gained 20 per cent, 1.7 per cent per unit of volatility. Given this year's gains in fixed income and commodities, the difference is not a surprise.

The theory is appealing. Its success in practice depends on the time period over which risk-adjusted returns equalise. That they will equalise at some point does not make ultra-low bond yields any less scary for investors whose time horizons are measured in mere decades.

Lex on the web
For notes on today's breaking stories go to **www.ft.com/lex**

WEATHER

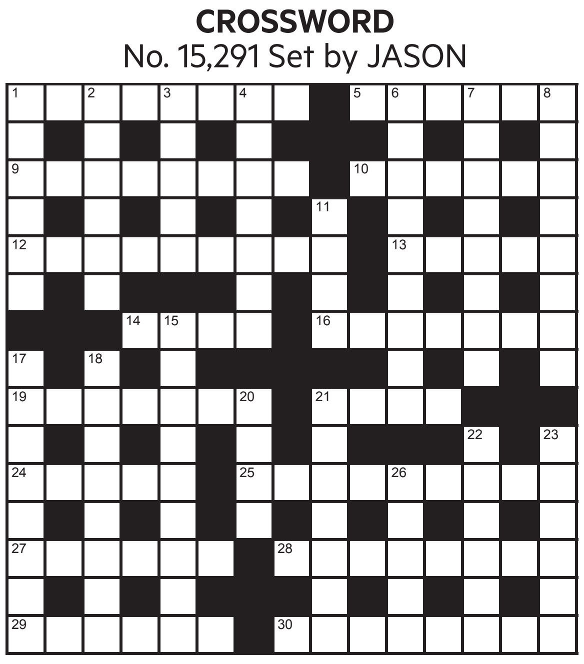


Forecasts by MeteoGroup

Today's temperatures Maximum for day °C & °F Warm front Cold front Occluded front

Abu Dhabi	Sun	39	102
Amsterdam	Shower	18	64
Athens	Sun	34	93
B'ham	Fair	18	64
Bangkok	Thunder	34	93
Barcelona	Sun	27	81
Beijing	Fair	35	95
Belfast	Shower	16	61
Belgrade	Sun	36	97
Berlin	Thunder	22	72
Brussels	Shower	18	64
Budapest	Sun	32	90
Buenos Aires	Fair	15	59
Cardiff	Shower	19	66
Chicago	Shower	30	86
Cologne	Shower	20	68
Copenhagen	Fair	19	66
Delhi	Cloudy	35	95
Dubai	Sun	38	100
Dublin	Shower	16	61
Edinburgh	Shower	17	63
Frankfurt	Thunder	20	68
Geneva	Shower	19	66
Glasgow	Shower	17	63
Hamburg	Shower	18	64
Helsinki	Sun	21	70
Hong Kong	Fair	31	88
Istanbul	Sun	30	86
Jersey	Sun	18	64
Lisbon	Sun	30	86
London	Shower	20	68
Los Angeles	Sun	28	82
Luxembourg	Shower	17	63
Lyon	Shower	19	66
Madrid	Sun	30	86
Manchester	Fair	17	63
Miami	Thunder	33	91
Milan	Thunder	27	81
Montreal	Fair	33	91
Moscow	Shower	26	79
Mumbai	Thunder	29	84
Munich	Shower	17	63
New York	Fair	30	86
Nice	Shower	29	84
Paris	Shower	18	64
Prague	Shower	22	72
Reykjavik	Cloudy	14	57
Rio	Sun	28	82
Rome	Sun	29	84
San Francisco	Sun	21	70
Stockholm	Cloudy	20	68
Strasbourg	Shower	19	66
Sydney	Sun	14	57
Tokyo	Thunder	29	84
Toronto	Fair	33	91
Vancouver	Cloudy	20	68
Vienna	Cloudy	25	77
Warsaw	Thunder	21	70
Washington	Thunder	30	86
Zurich	Shower	16	61

CROSSWORD
No. 15,291 Set by JASON



ACROSS
1 Judgment dispatched from this place, husband in absentia (8)
5 Self-catering slashes IOUs of a form (6)
9 Leaving college in third place could be thrilling (8)
10 More theatrical holidaymaker? (6)
12 Lean priest with cool recommendation? (4,5)
13 Naughty son is not commonly a ----- (5)
14 Junk heads to some port around Macao (4)
16 Place of piers, donkeys and kiss-me-quick hats is English alone (7)
19 Ring to supply address (7)
21 I've new wife making an appearance (4)
24 Two bits of Indian bread, one cut, for relative (5)
25 A part of shoe relies on fixing name within (9)
27 Slate covering (6)
28 Pub baron troubles island (8)
29 Direct from cheeky specialist (6)
30 Breathe new life into Bible studies by reading app? (8)

DOWN
1 Stints which Harry's teachers taught? (6)
2 Most agreeable lollies, say, in New Territories (6)
3 Finish relish (3,2)
4 Establish cheat over company (7)
6 Quality game's ending for kid from your lessons? (9)
7 Absolute urchin acknowledged (8)
8 Special hotel pressing monarch's drink (8)
11 Place to eat pickle (4)
15 I pervert a sailing vessel (9)
17 Roller? Once rich, in another way (8)
18 This falls in shower and sink (8)
20 Pin down nothing about adult (4)
21 Old French wine with time to mature (7)
22 Seedy type finally slipped off, cheated (6)
23 Reclusive Scot is seen photoshopped (6)
26 Teacher's interminable blather (5)

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JOTTER PAD

Companies & Markets

FINANCIAL TIMES

Incentive to honesty A lesson in curbing Chinese corruption

INSIDE ASIA, PAGE 16

Sumitomo Mitsui Trust	Tokuyama Corp	Tencent	Sterling/euro	Brent oil	US 10-year Treasury	Dollar/yen	Gold
8.77%	4.01%	0.50%	2%	4.5%	7bp	2.1%	$24
¥333.7	¥287.0	HK$180.90	€1.1976	$48.35	1.5%	¥104.92	$1,330

Bank chiefs enjoy hefty pay rises

● CEOs of biggest lenders receive 7.6% increase ● Heads of US groups outstrip European rivals

LAURA NOONAN — LONDON
BEN MCLANNAHAN — NEW YORK

Pay for chief executives of big banks jumped 7.6 per cent in 2015 — more than 10 times faster than a year earlier — to an average of $13.1m.

Heads of the top six US banks did particularly well. Their packages rose by an average of just over 10 per cent and are almost twice as large as those of European rivals, according to an analysis by compensation consultancy Equilar and the Financial Times of the 20 top paid international bank chiefs in Europe, the US, Canada and Australia.

The escalating growth and widening gap are likely to create a political difficulty for US presidential candidate Hillary Clinton, who has come under fire for her close ties to Wall Street.

The numbers also lend support to calls by the UK's incoming prime minister Theresa May for binding shareholder votes on pay.

In the US, the chiefs of JPMorgan Chase, Goldman Sachs, Citigroup, Wells Fargo, Bank of America and Morgan Stanley were paid an average of $20.7m last year including salaries, bonuses for 2015 performance and pension contributions. Jamie Dimon of JPMorgan led the field with $27.6m.

By contrast, the heads of 11 European banks averaged $10.4m. That number was boosted by one-off stock awards to the new chiefs of Standard Chartered, Credit Suisse and Barclays to compensate them for income forfeited by leaving their previous jobs. European bank chief executive pay rises averaged 9.6 per cent last year.

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In 2014 average chief executive pay rose just 0.5 per cent across the 20 banks.

Bill Smead, chief investment officer of Smead Capital Management, a Seattle company with $2.4bn in assets under management, said pay in the industry looks high, given the low returns on equity. But he added that some executives, including Mr Dimon, had earned their rewards by helping their banks adjust to rock-bottom interest rates and a much tougher regulatory environment.

"The job of running these businesses in the last four or five years has been as big a hellhole in the land of CEOs as you'd ever ask for," he said.

Wall Street's higher pay reflects the stronger profitability of US banks relative to European competitors.

Mr Dimon's package rose 36 per cent to $27.6m, and 92 per cent of the bank's shareholders voted to approve it. He must meet three years of performance targets before he is paid out in full.

Boardroom excess page 17

Short View

Katie Martin

If you pulled "emerging markets" out of the hat in the office sweepstake for "assets that will perform well in the event that the UK votes to leave the EU", then you struck lucky. If you predicted it (and come on, be honest now) then, really, pat yourself on the back. The rally in emerging markets, and global stocks, for that matter, has been the wild card from this very British crisis.

The MSCI emerging-markets stocks index took a dive immediately after the referendum result, but it has now retraced that, and then some, to climb 6.7 per cent since June 27. Dollar sovereign bonds in emerging markets are up about 4 per cent over the same period.

Goldman Sachs' financial conditions index, a broad measure of financial health in the asset class covering stocks, currencies, implied default risks and so on, shows EM hasn't had it so good since 2011.

In the week after the referendum, EM bond funds lured their biggest weekly inflows on record — more than $3.42bn. If this is Project Fear, then Project Joy must be quite something.

Whether or not this all makes sense, given the potential for a full-blown UK recession and — if you are really gloomy — the existential risk to the EU, is incidental. Markets and common sense parted company several years ago.

Put simply, the Fed will not be in a hurry to raise interest rates again, despite decent growth and blowout headline jobs numbers, in the face of potential Brexit nastiness. Not even the addition of 287,000 jobs in the US in June can shift that dial. Janet Yellen has repeatedly made it clear that the US central bank is keeping a close eye on UK fallout. Hence rock-bottom US bond yields, amplified by nervy UK investors supercharging gilts. Together they are pulling down returns on pretty much everything else on the debt side.

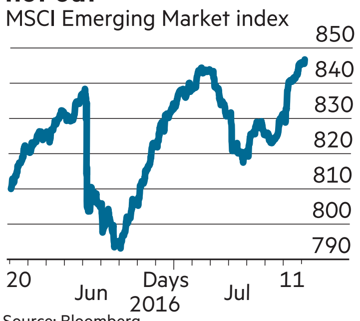
"Bonds yielding 3 per cent or more are going the way of the dodo," says BlackRock. To earn a crust, investors simply have to bulk up on riskier assets, like it or not.

It is the same phenomenon that has led to record highs in US stocks. The divergence between core yields and key stock indices is "mind-blowing . . . It's just not Finance 101", says Luis Costa at Citi.

But for now, fight it at your peril.

Down at first, but certainly not out

MSCI Emerging Market index



Source: Bloomberg

The rally in emerging markets has been the wild card in the aftermath of a very British crisis

katie.martin@ft.com

Share spikes preceded 20% of UK takeovers in 2015, watchdog reports

CAROLINE BINHAM
REGULATION CORRESPONDENT

Share prices moved abnormally ahead of one out of every five UK public takeover announcements in 2015, the highest level in five years.

Unusual trading that can be a sign of market abuse occurred before 13 of the 69 takeover announcements in 2015, according to the Financial Conduct Authority's annual report released yesterday.

The levels remain far below the peak hit in 2009, when unusual trading preceded as many as 30 per cent of takeover announcements. But they are up significantly from the low of 14.3 per cent in 2014 — a statistic corrected upwards from 13.9 per cent after the FCA said yesterday it had made a previous reporting error "due to a mistake in the manual update of an Excel file".

The FCA is already known to be scrutinising unusual movements in the share price of Premier Foods in April, at the time it became the subject of a £537m bid from McCormick, and in 2015 the watchdog confirmed it was looking into leaks and abnormal share price rises before Aviva's £5.6bn merger with Friends Life, announced in 2014.

The overall rise in suspicious trades in 2015 "was driven by an increase in abnormal pre-announcement price movements (APPMs) during the first two quarters followed by a decline in APPMs in the last two", the FCA said.

"Given the small number of takeover announcements and APPMs in 2015 (69 and 13 respectively), it is difficult to draw meaningful inferences from year-on-year changes of the size we observed."

The rise coincides with a dearth of new high-profile prosecutions of insider trading, which carries a seven-year maximum sentence. The first big jury trial of an alleged ring of insiders in almost four years concluded in May, with a jury convicting two men and acquitting three others after an investigation dubbed "Tabernula". Three other men had previously pleaded guilty.

By contrast, 2015 and 2014 saw only a few individuals plead guilty to the offence and no headline-grabbing arrests or trials as the FCA's enforcement team concentrated on the rigging of Libor and foreign-exchange benchmarks.

Abnormal trading

UK deals that were preceded by suspicious share price moves (%)

FT graphic Source: FCA

Brexit adds to pressure on hard-hit pension schemes

UK companies' pension deficits grew by £89bn in June to a record £383.6bn. The plunge in equities, sterling and bond yields after the vote to leave the EU put more strain on schemes already under pressure from a prolonged period of low interest rates.

Report and Lombard ▸ PAGE 20

AMC zooms in on cheap sterling to snap up Odeon cinemas for £921m

JOSEPH COTTERILL
AND MURAD AHMED

China's wealthiest man has taken advantage of the fall in sterling to make a bet that Brexit's real-life drama will not stop Britons from watching movies, with the £921m acquisition of the UK's Odeon cinema chain.

AMC, the US chain owned by Wang Jianlin's Dalian Wanda, will become the world's biggest cinema operator after the acquisition, which will also provide an exit from a 12-year investment for Guy Hands' Terra Firma buyout group.

The proposed deal values Odeon and UCI cinemas at £921m ($1.2bn), including £407m of net debt, to be paid in a mixture of cash and equity in AMC.

Adam Aron, AMC's chief executive, said "currency rates are highly favourable" for the deal with the pound falling to a three-decade low against the dollar. He called it a "once-in-a-generation opportunity to acquire Europe's leading cinema chain and create the world's biggest and best theatre operator".

The Odeon deal is the first significant sign of overseas bargain hunters in the UK, though analysts predict the currency turmoil after the EU vote may attract more Chinese buyers already striking deals across western markets.

Acquiring Odeon, which operates 244 cinemas in the UK and Europe with over 2,200 screens, would take AMC's total to more than 7,600 screens worldwide.

Mr Wang's entertainment conglomerate has been on a debt-fuelled cinema-buying spree this year to create the world's largest operator, having offered in March to buy Carmike Cinemas for $1.1bn in a deal to create the largest US chain. AMC said yesterday it was working to save that deal but added that some shareholders had "an unrealistic view as to Carmike's value to AMC".

Wanda, which bought AMC for $2.6bn in 2012, also added the Legendary Entertainment studio to its US film stable in January in a $3.5bn deal.

The Odeon sale is also a much-needed boost for Terra Firma, which last month abandoned an expensive lawsuit against Citigroup over its collapsed takeover of the music group EMI in 2007.

Lombard page 20

Companies / Sectors / People

Banks

JPMorgan to lift basic pay by a fifth

US bank joins national campaign for $15 an hour minimum wage

BEN MCLANNAHAN — NEW YORK

JPMorgan Chase has promised to lift basic hourly pay for 18,000 of its lowest paid US workers by at least a fifth by 2019.

The bank's move is in line with a nationwide movement known as "Fight for $15", which calls for a raise to $15 an hour for the 42 per cent of the American workforce that earns less.

The cities of San Francisco, Seattle and Los Angeles have enacted gradual increases of their minimum wages to that level, while in New York state, governor Andrew Cuomo is seeking legislative support to raise the wage there to $15 by July 2021. Californians may vote on a similar proposal in November.

"A pay increase is the right thing to do," wrote Jamie Dimon, chairman and chief executive of JPMorgan, in an opinion piece published in the New York Times yesterday. "Wages for many Americans have gone nowhere for too long. Many employees who will receive this increase work as bank tellers and customer service representatives. Above all it enables more people to begin to share in the rewards of economic growth."

The move puts Mr Dimon at the centre of a debate over pay in the US. The argument pits those who say that workers need higher salaries to boost their living standards against those who believe companies cannot afford to put up pay.

Bank profits have been under pressure in recent years, squeezed by ultra-low interest rates and the effects of turbulent markets.

Until now, big banks have mostly shied away from the low-pay debate — even as pay for top executives has spiralled — allowing much smaller lenders to take up the cause. Last summer, Amalgamated Bank, the largest union-owned lender in the US, raised pay for workers to a minimum of $15 an hour — well clear of the hourly median for tellers of $12.70, according to the US Bureau of Labor Statistics.

Of the nearly 1.7m people working in retail banking in the US, almost one-third are in jobs with median hourly wages below $15, according to a 2014 government study.

JPMorgan's minimum wage is currently $10.15 an hour (plus benefits), about $3 above the current national minimum. Over the next three years, the bank will raise that to between $12 and $16.50 an hour for full-time, part-time and new employees.

Rob Nichols, head of the American Bankers Association, described the JPMorgan chief's article as "timely" and "extremely thoughtful".

Keith Mestrich, chief executive of Amalgamated Bank, said: "Kudos to JPMorgan for doing the right thing; now it's time for Citi, Goldman Sachs and all the rest.

"If the largest bank in the country can figure out how to do it, to give a modest increase to the people who work the hardest, then they surely can too."

The New York-based bank, which has about $4bn in assets, has been vocal about its drive to push up wages, recently paying for a four-week advertising campaign on the city's subway.

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Technology. Smartphone sales

Change of strategy reverses Samsung's fortunes

The South Korean company is still enjoying high margins while rivals cope with slowing demand

SONG JUNG-A — SEOUL

Just when smartphones were starting to look like dumb, commoditised devices in the tech industry's search for a new growth star, Samsung Electronics has forecast its best quarterly results in more than two years, defying the sector's slowing sales.

The South Korean company has estimated its operating profit for the June quarter at $7bn, the highest since the first quarter of 2014. It is the only smartphone maker still enjoying high margins, while Apple, LG Electronics and Chinese rivals struggle to cope with slowing demand.

Its strong guidance indicates the world's largest smartphone maker has found a way to reverse its fortunes, after seeing profits and market share squeezed over the past two years by competition from Apple and Chinese competitors. Analysts estimate Samsung's operating profit from the mobile division topped Won4tn ($3.5bn) in the second quarter, accounting for more than half of Samsung's total operating profit.

> 'Samsung and Apple are copying each other's successful strategy while they compete head on'

"At the beginning of this year, no one expected this kind of reversal, as Samsung's mobile business seemed to be losing steam just like other Android phonemakers," says Peter Yu at BNP Paribas. "But Samsung has made a surprising comeback, defying the consensus that smartphones were getting commoditised."

Samsung's latest flagship Galaxy S7 has led the turnround, as a simpler product line-up helps the company cut costs at a time when global smartphone sales growth is forecast to halve to about 7 per cent this year, according to research firm Gartner.

Samsung is believed to have shipped 16m Galaxy S7 phones in the second quarter, following on from 10m units in March when the model debuted, with its pricier curved-screen version outselling its flat screen counterpart. "Obviously, they learnt a lesson from two years of struggle. They have seen a big improvement on the cost side and product mix," says Daniel Kim at Macquarie.

Customers try out Samsung's latest Galaxy S7 smartphone
SeongJoon Cho/Bloomberg

Samsung used to roll out as many models as possible to see what would work. However, the company is now pursuing a different Apple-like smartphone strategy, streamlining its product offerings, just as Apple is grappling with slowing sales and widening its range of products in search of growth.

"Samsung and Apple are copying each other's successful strategy while they compete head on," says Mr Yu. "Samsung's efforts to simplify its line-up are bearing fruit as it makes the most of economies of scale, while Apple is looking for opportunities in the mid-end market given the high-end market saturation."

Smartphone market share has seesawed between Samsung and Apple in recent years. After Apple ruled with the iPhone, Samsung started fighting back in 2010 with large-screen Galaxy phones. But the company had trouble as Apple launched larger-screen iPhones in 2014, stealing the Galaxy phone's main selling point.

The Galaxy S7 proved an unlikely blockbuster this year in the absence of strong competitors, as its curved-edge look offered an effective differentiating factor in addition to convenient features such as resistance to water and dust. Samsung also saw strong growth in its cheaper lines such as the J series.

"Samsung is the only company to make profits in the mid- to low-end market with operating profit margins of 10 per cent in the segment," CW Chung at Nomura said in a recent report. "Going forward, we expect high-end smartphone innovation to come from display technology, which Samsung is a leader in."

Although there are questions over whether Samsung's momentum is sustainable, with Apple expected to launch its new iPhone in September, analysts are upbeat on the longer-term outlook, citing Samsung's advanced technology in key components such as display and chips.

"Its earnings from the mobile division could be lower due to seasonal factors in the second half, but . . . its component business will give it a leg up," says Kim Dong-won at Hyundai Securities.

Analysts expect only incremental changes to Apple's new iPhones. Mr Yu predicts Samsung will become the leader in next-generation devices, given its dominance in OLED display panels and 3D Nand memory chips that are indispensable to high-end smartphones. It is expected to become a big supplier of displays for new iPhone models scheduled for release next year, while Samsung is likely to introduce foldable smartphones as early as 2017.

"Samsung is well-positioned to evolve earlier than others, as it has all the enabling components," says Mr Yu. "It will be able to enjoy above-industry margins for a long time."

Samsung's share price rally reflects such optimism. The stock has gained nearly 20 per cent to date, while Apple shares have fallen 8 per cent this year. "It is not just about smartphones. Samsung's other new products are also well received by the market," says Mr Kim. "It is encouraging to see that Samsung has become a pioneer, not just a follower, in some segments such as OLED, 3D Nand chips and solid state drives."

INSIDE BUSINESS
ASIA

Henny Sender

Raising salaries and changing incentives helps steel turnround

When Wei Zhang, founder of Yuanhao Capital, a Shanghai based investment firm, visited Shanghai Pujiang Cable a few years back, the state-owned enterprise was in dismal shape, unable to pay back its bankers the money it had borrowed from them.

But Mr Zhang's driver was impressed. "I asked him why he thought this company was so impressive," Mr Zhang recalls, surprised the man had a view at all. "He told me, did you see the parking lot where the management park their cars? There are at least 20 luxury cars there!"

Where the driver saw prosperity, his employer saw a symptom of the general dysfunctionality of most of China's state-owned enterprises. At the time, the top tier of Shanghai Pujiang's staff earned only about Rmb3000 ($450) a month. It was predictable then that virtually every big supplier to the manufacturing company was headed by a relative of senior management; almost everyone in a position to engage in related party dealings did so and padded their expenses generously. Nobody gave a thought to the fact that customers often did not pay their bills for years, let alone made an attempt to collect the money owed.

"Everyone cheated, many receipts are fake," Mr Zhang remembers. "You can even find diaper receipts among business expense claims. Everyone was ripping off the company."

Today, the seemingly intractable lack of profitability of the state-owned enterprises, particularly in heavy industries such as steel, is giving rise to widespread despair.

Steel is among those sectors that generate returns below their cost of capital, according to a study on Chinese productivity from McKinsey Global Institute. Chinese "steel production has become completely untethered from real market demand and is now more than double the combined production of the four next leading producers", says a recent report from the EU Chamber of Commerce in China, giving a sense of the magnitude of the problem. Europe's steel industry, including ArcelorMittal, the world's largest steel company, has been among those suffering from the excess capacity of mainland steel firms.

Even the news that two of China's largest and most modern steel producers — Shanghai Baosteel and Wuhan Iron & Steel — may merge in an effort to rationalise production has not dispelled investor gloom.

> Wei Zhang gave his managers much less motivation to rip off the company

Mr Zhang, however, is not among the hand-wringers. His experience after buying Shanghai Pujiang is instructive. By raising salaries and changing the incentive structure, he gave his managers much less motivation to rip off the company. "Everyone steals," he says. "They needed to understand that they are stealing from themselves."

Mr Zhang had much to work with as he sought to turn round the company. The group was good at its core business of making cables for bridges that span both China's rivers and those outside the country. Shanghai Pujiang won the international contract for the restoration of the San Francisco-Oakland Bay Bridge, handily defeating Nippon Steel, partly by citing a price that was 30 per cent lower but also because its quality was sufficiently high.

Mr Zhang is a rare creature, an optimist about mainland prospects on both a macro and micro level. He believes that before President Xi Jinping's anti-corruption drive, misbehaviour and self-dealing were rampant. The private sector firms in which he invested were barely profitable because they spent so much money on banquets for officials and under-the-table red envelopes of cash, he says. Now, such behaviour has ceased.

Yet few business people in China today feel as positive as Mr Zhang. They fear that what started as something laudatory has descended into witch hunting and persecution reminiscent of the Cultural Revolution. Perhaps it is because so many fortunes started in irregular ways that do not bear exposure to the sunlight. Fear of being seen to be corrupt has also made government and party bureaucrats more reluctant to take decisions, making it harder for businesses to move ahead with their plans. The impact has been devastating for China's already slowing economic growth. And there is still little consistency in how rules are enforced — who is allowed to take money out of the country and who is not, who gets a loan and who does not — these things remain unfathomable to people in the system and to those outside it. But the story of Shanghai Pujiang is at least heartening whether it is exceptional or not.

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Banks

UniCredit to sell stake in Poland's Bank Pekao

HENRY FOY — WARSAW
MARTIN ARNOLD — LONDON

UniCredit will sell up to 10 per cent of its Polish subsidiary as the struggling Italian lender's new chief executive wastes no time in pushing ahead with efforts to strengthen its balance sheet.

The sale of the stake in Bank Pekao, Poland's second-largest lender, could raise around €800m, and was announced just hours after UniCredit said it had raised €328m through a placement of a 10 per cent stake in online broker FinecoBank.

The news as Jean-Pierre Mustier took over from Federico Ghizzoni as chief executive and underlined his rush to start filling what analysts estimate is a capital shortfall of as much as €10bn at Italy's biggest lender. Weighed down with €80bn of bad debts and sagging profits, UniCredit shares have fallen two-thirds in the past year. But they rose 13.5 per cent yesterday on optimism about Mr Mustier's arrival in a positive day for European banking shares.

Mr Mustier on Monday launched a strategic review to "reinforce and optimise the group's capital position".

Analysts expect him to overhaul the bank's top management, sell non-core businesses — such as its smaller central and eastern European businesses and its Turkish operation — and raise billions of euros in capital from shareholders. He may also attempt an outright sale of Pioneer Investments, UniCredit's fund management arm, which has been stuck for more than 20 months attempting to agree a complex €5.3bn merger with the asset management operations of Spain's Santander.

UniCredit said in a statement that it had launched a placement of as much as 10 per cent of Pekao via an accelerated bookbuilding offered to institutional investors. "The placement will enable UniCredit to further strengthen its capital position while retaining a controlling shareholding in the company," it said. UniCredit owns 50.3 per cent of Pekao.

The sale comes amid pressure on Polish bank valuations after moves by the country's populist government to increase taxes on lenders and increase the level of control over the sector.

Morgan Stanley, Citigroup, UBS and UniCredit are acting as bookrunners.

See Lex

Banks

Norway's DNB hit by rise in bad loan losses

MARTIN ARNOLD — BANKING EDITOR

Shares in Norway's biggest lender DNB fell sharply after it revealed a rise in problem loan losses, marking a faltering start to the quarterly earnings season for European banks.

Net profit at DNB fell 10 per cent to NKr4.57bn ($537m) in the three months to June after the bank almost quadrupled its provisions for bad loans, mostly due to the impact of lower oil prices on its corporate lending book.

Analysts at Citigroup said the bank's profits were 8 per cent below their forecast and pointed to a drop in its net interest margin — the difference between what it charges on loans and pays out on deposits — owing to lower interest rates.

Shares in DNB were down more than 7 per cent at a three-month low of NKr94 in afternoon trading in Oslo yesterday.

European bank stocks have been hit in recent weeks by the UK's vote to leave the EU. But lenders were facing tough conditions before the referendum as profits were being squeezed by low or negative interest rates, subdued oil prices, sluggish economic growth, and weak capital markets and trading activity.

DNB recorded NKr2.3bn of impairments on loans and guarantees in the second quarter, up from NKr667m in the same period of 2015 and almost as much as it took in the whole of the previous year.

The bank blamed the increase on loans made to large corporate and international customers in the shipping, offshore and energy sectors. Those sectors, a big part of Norway's economy, accounted for more than half the total impairments in the quarter.

The bank said "a negative trend in the offshore supply vessel and rig markets and an increase in collective impairment during the first half of the year" meant that impairment losses would total NKr18bn over the next three years.

More than NKr6bn of the impairments are expected this year. Rune Bjerke, chief executive, said he expected the oil price to end the year at about $50 a barrel, up slightly from current levels.

The bank said: "There are no signs of negative spillover effects from the situation in the oil-related industries in the other credit portfolios."

Investors aim to curb surge in executive pay

Critics of boardroom excess have gained political support as the growth in US rewards outpaces that of Europe

LAURA NOONAN — LONDON
BEN MCLANNAHAN — NEW YORK

Enjoy it while it lasts. That's the message from investors who have been watching the rise in chief executive pay across the biggest banks and are determined to put a stop to it.

Disgruntled shareholders have gained some political firepower, particularly in the UK where Theresa May, David Cameron's heir-apparent as prime minister, used her first public appearances to promise investors a binding say on pay and sweeping changes to boards.

Growing calls to curb corporate excess come after a bumper year for chief executive pay. Overall earnings for the 20 best-paid chief executives at western banks rose an average of 7.6 per cent last year — almost twice as fast as a 4.2 per cent rise in the net income of their companies, according to analysis by the Financial Times and Equilar, the remuneration data firm.

This 2015 increase marks a rapid escalation on the modest 0.5 per cent rise banks paid their chiefs in 2014 — and has caused concern among investors worrying about whether the money is being well spent given evidence that shareholder returns lag behind the growth in remuneration.

"Shareholders are being let down time and time again by boards of directors who are not looking after their interests," says one London-based investor, who asked not to be named because "if there's a problem with your marriage I personally don't like advertising it in Hello! magazine, I'd rather discuss it privately with the individual".

Rising manager pay is a subject that European investors are toiling on behind the scenes, he says, pointing to the Investment Association's working group on executive remuneration as a more high-profile effort to improve practices across UK companies.

Some shareholders are already making their disapproval known more publicly, particularly in the US where the $20.7m paid on average to bank chief executives is almost twice the $10.4m average package for their peers in Europe.

A third of investors voted against Lloyd Blankfein's $23.4m package at Goldman Sachs this year, while a similar number voted against Michael Corbat's 31 per cent pay rise at Citigroup.

In Europe, more than half of shareholders voted against Deutsche Bank's latest remuneration plan for managers, which was criticised for lacking transparency. The vote was non-binding, however, and did not cover the payments made to the two co-chief executives in 2015.

Non-binding votes are also still standard in the UK, but this could change if Mrs May, the next UK prime minister, gets her way. She has promised to strengthen investor rights, put worker representatives on main boards and impose tighter control on executive pay.

Investors also have other concerns about pay practices. Isabelle Cabie, London-based global head of sustainable and responsible investments at Candriam, the investment group, says the "replacement awards" offered to incoming chief executives are particularly problematic.

Relative remunerations Bank chiefs' earnings v share price and group income

Pay includes salaries, bonuses awarded for the year's performance, pensions and other pay.
* 2015 salaries have been annualised for BBVA, Barclays, Credit Suisse, Deutsche Bank and Standard Chartered. 2015 figures for Standard Chartered, Credit Suisse and Barclays include large 'replacement awards' given to their new chief executives.
Where there has been a change in CEO, 2014 figures are for the CEO who was in place at the time. Net income and salaries for all banks have been conveted to US$ using average annual exchange rates.
Sources: Equilar; SNL; FT

The awards, among them the SFr14.3m ($14.5m) paid by Credit Suisse to Tidjane Thiam, are designed to compensate the new chief executives for the loss of deferred bonuses at their previous employer.

But Ms Cabie says the system "undermines the justification of long-term schemes" that aim to encourage executives to achieve long-term targets. "They also undermine the very idea of retention."

US banks led the surge in chief executive pay rises last year, with three of the biggest awarding increases of more than a fifth.

Brandon Rees, deputy director of the office of investment at AFL-CIO, the umbrella federation for dozens of US labour unions, notes that rising pay at the big banks ran against the overall trend at S&P companies last year, where average pay for chief executives dropped about 8 per cent to $12.4m.

"I'm sure bank CEOs would say their job is much harder due to the regulatory constraints, and the hoops they're required to jump through these days to ensure a safe and sound financial system, but an investor would say that should always have been part of the job," he says.

> 'Many investors view [pay] as a very complex issue, with lots of moving parts. That is probably at the heart of it'
> Mike McCauley

But investor dissatisfaction has not delivered many notable scalps. Mike McCauley, a governance officer for the Florida State Board of Administration, the state-backed investor, points out that only a handful of pay votes in the US failed to pass so far this year.

"Many investors view [pay] as a very complicated issue, with lots of moving parts. That is probably at the heart of it," says Mr McCauley, whose institution manages $178bn in assets.

"But some investors are also very deferential to management. It can take a very egregious set of circumstances to push them to vote against a management-recommended item."

Analysis by Keefe, Bruyette & Woods, an investment broker, shows how patchy the relationship between pay and performance can be.

Between 2010 and 2015, JPMorgan had the highest CEO compensation bill of the 21 US banks analysed by KBW at $120m. But the bank's total return to shareholders at 48 per cent was in the middle.

> FT
> **Interactive guide**
> Historical breakdown and comparison of bank chiefs' pay, alongside CEO profiles
> ft.com/bankpay

Goldman Sachs shouldered the third-highest chief executive cost — at $108.3m — but the second-worst rate of return at minus 6 per cent. Bank of America also returned minus 6 per cent — but its chief executive compensation bill was $60.6m over the five-year period. "There is strong evidence that size has been the key driver of bank executive compensation since the financial crisis," the KBW analysts wrote.

KBW concluded that the relationship between bank size and bank pay could discourage bosses from doing financially sensible things such as splitting up groups, since smaller banks could mean smaller pay packages.

Bank sources stressed that shareholder return figures were very dependent on the starting share price, however, and not a good proxy for pay.

Banks will be under pressure to curb any signs of excessive remuneration in future even if for now shareholders have let companies off the hook, according to investors.

Yari Wajid, director of research at Mirador Capital Partners in San Francisco, says he would "have more concern if these compensation levels were to persist despite shareholder dissent".

"Based on the say-on-pay votes, shareholders generally seem to approve," he adds. "This is income that would have accrued to shareholders, so their willingness to pay it out to executives suggests that they feel it is necessary in order to generate even mediocre returns."

Fred Cannon, KBW's head of research, says the US has historically "tended to tolerate higher pay than Europe has tolerated". But, he says, this could easily change.

"It's the land of capitalism," he adds. "[But] the tolerance will go down the longer these big banks trade under tangible book value . . . the more shareholders will see that their interests aren't aligned with management's."

Banks

Masters quits Santander's US business

MARTIN ARNOLD — BANKING EDITOR

Blythe Masters has quit as chairwoman of Santander Consumer USA, the subprime auto loans provider, after less than a year in a move that adds to the uncertainty about the Spanish bank's US operations.

Last month, Banco Santander's US business became the first bank to fail the Federal Reserve's stress tests for the third year running, an ignominious result that has raised questions about the future of its operations.

Ms Masters, a former JPMorgan Chase executive who now runs a financial technology start-up, is switching to a new role at Santander as a senior adviser on blockchain — the technology underpinning bitcoin. She is also joining Santander's international advisory board and becoming a director of Openbank, its online lender.

Ms Masters declined to comment on the move but those familiar with her thinking said that she was finding it hard to free time for the role given her other commitments.

She has been replaced as chair of Santander Consumer USA (Scusa) by Bill Rainer, a non-executive director who chairs its audit and regulatory and compliance committees. He is a former chief executive of the OneChicago futures exchange and a former chairman of the US Commodity Futures Trading Commission.

Ana Botín, executive chairman of Santander, said: "I am very excited that Blythe and Bill have agreed to take on new roles for Santander."

She added that Ms Masters had done "an outstanding job" and she was "looking forward to her focusing on our global efforts in digital banking".

Blythe Masters' move adds to uncertainty about Santander in US

Santander owns a controlling stake in Santander Consumer USA (Scusa), which is separately listed in New York and has been in regulators' crosshairs for several years amid multiple probes into its lending practices.

Last month, the Fed criticised Scusa's parent company, Santander Holdings USA, for having "broad and substantial weaknesses" in its capital planning as well as shortcomings in the way it manages the data needed for risk management.

Earlier this year, Ms Botín set a deadline of 2018 to "fix the US bank" adding that it "would not be in shareholders' interests to sell it now". The US business represents about 8 per cent of Santander's overall profits and 10 per cent of its loans.

Ms Masters had been juggling the role at Scusa with her full-time position as chief executive of Digital Asset Holdings, a blockchain company that uses cryptographically secure distributed ledgers to track and settle financial assets. She has been travelling regularly to Australia to oversee a crucial contract for Digital Asset Holdings to use blockchain technology to speed up the settlement of trades on the national stock market, according to people familiar with her business.

Financial services

Brookfield infrastructure fund backed

HENNY SENDER — NEW YORK

Brookfield is poised to announce it has raised a $14bn fund to invest in infrastructure, which is believed to be the largest single commitment to the sector of its kind.

The Toronto-based asset manager, which has $250bn under management and last year bought the owner of London's Canary Wharf, is seeking to capitalise on growing investor interest in less traditional assets.

Brookfield, which is listed on the New York and Toronto exchanges, recently raised a $9bn property fund and has boosted its public profile.

The fundraising is something of a coming-out party for a group that got its start more than 100 years ago as a Brazilian builder and operator of electricity and transport infrastructure. Since then it has developed into one of the world's largest managers of infrastructure, property and renewable energy projects.

"They have taken a cyclical conglomerate and turned it into an investment juggernaut with scale in assets that everyone wants to own," says Charles Kantor of Neuberger Berman, a long-time investor.

Historically many institutional investors have been skittish about the infrastructure and property assets in which Brookfield specialises, but low interest rates and negative bond yields are forcing them to look further afield.

"Real estate and infrastructure are less developed asset classes," said Bruce Flatt, Brookfield's chief executive. "They are also hard work. You need real operating platforms."

The new Brookfield fund hopes to tap insurers and other long-term investors who are willing to sign up to the long-term commitments necessary for infrastructure projects.

The Canadian asset manager co-owns London's Canary Wharf

To reassure those who might be nervous about greenfield construction projects, which can take decades to complete, Brookfield says only about 10 per cent of its investments are of that type. Sixty per cent of Brookfield's investment money goes to projects in developed markets; the remaining 40 per cent goes into emerging markets, which offer both greater potential upside and greater risks.

For example, Brookfield's projects to expand transmission lines in Chile made back three to five times the original investment depending on whether it acquired or built out the operation. In 2013, it acquired an integrated system of railroads, ports and inland terminals in Brazil and is now investing $7bn to expand the port and terminals, a move few rivals would consider.

The group also seeks to be countercyclical, buying during distressed periods. "We like to invest when the money is not flowing," said Mr Flatt.

Brookfield's partners include some of the world's biggest sovereign wealth funds, such as Singapore's GIC and the Qatar Investment Authority, its partner in the purchase of Canary Wharf.

Airlines

Airbus clinches $12.6bn deal with AirAsia

Order of 100 passenger aircraft is welcome boost for subdued industry

PEGGY HOLLINGER — FARNBOROUGH

Airbus yesterday clinched a $12.6bn deal to sell 100 A321 single aisle passenger jets to low-cost carrier AirAsia, delivering a welcome burst of good news to an industry subdued by the prospect of a slowdown in orders.

Tony Fernandes, chief executive of the region's largest budget airline, said the deal was "another big step forward for AirAsia".

After a "tough 2015" the Malaysian-based airline had "proved many doubters wrong", he added.

It returned to profit in the fourth quarter and was ready to resume expanding its fleet by roughly 15 aircraft a year, he said.

Air Asia currently operates 171 Airbus aircraft, and the most recent narrow-body order means that it has 575 jets on order with the European aerospace group.

Although the deal is valued at $12.6bn at catalogue prices, the aircraft are likely to have been sold at a big discount as is normal in the industry.

AirAsia's recent difficulties led some analysts and investors to doubt its financial stability last year and sparked questions about the robustness of its orders with Airbus.

But Mr Fernandes said the orders had been deferred but never cancelled. He said the carrier was now so confident about potential growth in India and the rest of Asia that it was even discussing buying more Airbus aircraft, including smaller models than the A321, which will seat 236 passengers.

He refused to give details of which aircraft and when any order might be placed.

Fabrice Brégier, chief executive of Airbus Commercial, said the latest order from AirAsia was "another strong endorsement for the largest member of our single aisle family".

The new generation of the A320 single-aisle family has been taking market share from Boeing's 737 narrow body range since its was unveiled in late 2010.

AirAsia's announcement was the biggest order to come out of the UK trade show so far, and it came just after Airbus won a pledge from Indian low-cost carrier Go Air to buy 72 A320neo single aisle aircraft worth $7.5bn at list prices, doubling its existing order to 144. However, this promise was not yet a firm commitment.

With one more day to go, the orders placed during the Farnborough show still lag last year's tally at the Paris air show of 752 aircraft worth some $107bn at list prices.

Both Boeing and Airbus have admitted that orders are slowing down in the short term after a six-year boom, but each insists that over the medium- to long-term they remain confident that demand for aircraft will continue to grow as passenger numbers rise around the globe.

Nevertheless, Dennis Muilenburg, chief executive of Boeing, said the group remained on alert over a "hesitancy" in orders for widebody aircraft.

This was in part due to slower sales of cargo aircraft at a time when global trade growth is sluggish. "We are mindful there are some challenges in the wide-body market," he said in a briefing with journalists.

Media. Revenue sources

YouTube streaming out of tune with music labels

Despite surge in videos, online site's effective payment rate for content use has halved

ANNA NICOLAOU — NEW YORK

The amount of revenue YouTube paid to music labels relative to the number of streams of their content halved last year, translating to potential lost revenue of $755m for the industry, according to new research.

The online video site, which shares advertising revenue from music videos with artists and labels, paid $740m to music rights holders last year — a 15 per cent rise from the prior year, according to Midia Research.

But, at the same time, streams on YouTube and Vevo, a music site controlled by Sony and Universal Music Group, grew 132 per cent to a record 751bn.

This surge in videos streamed halved YouTube's effective payment rate per stream from $0.002 in 2014 to $0.001 in 2015, Midia said, based on data from the IFPI trade body and YouTube announcements. Had the payout rate remained the same, music labels would have made slightly more than double, $755m on top of the $740m they were paid, the research showed.

An executive from a large record label said the effective rates they receive from YouTube are even lower. The findings come as the biggest labels, plagued by years of shrinking album sales, are in a stand-off with YouTube as they look to hammer out new licensing deals.

While Spotify pays music rights holders a minimum per stream regardless of the revenue they earn, YouTube and Vevo pay as a share of revenue, which is subject to a volatile global ad market. As ad inventory prices dropped last year, weighed down by weakness in emerging markets, YouTube's ad revenue growth slowed even as streaming boomed.

"YouTube is an ad business, first and foremost," says Mark Mulligan, an analyst at Midia Research. "But labels are not used to being paid based on how profitable the company is." YouTube and Vevo pay music rights holders 55 per cent of music video revenues, while Spotify paid 83 per cent of its 2015 revenue to content holders.

A streaming boom has helped drive the first rise in year-over-year global music revenue in nearly 20 years. But while streaming soars, record labels and artists say they are being short-changed by YouTube, and that it is exploiting copyright law to pay below market rates. "There's no doubt [the revenues paid per stream] are plummeting," says one executive.

YouTube does not disclose yearly ad revenue payments, although a person close to the company said the $740m figure for 2015 is "understated".

Discord: stars such as Taylor Swift have called on the US to reform the 1998 Digital Millennium Copyright Act, alleging it has allowed technology companies to profit at the expense of artists
Kevin Mazur/WireImage

"Thanks to advertising, YouTube has transformed the promotional cost of the music video into a new source of revenue that has generated $3bn for the music industry," said Robert Kyncl, YouTube's chief business officer, pointing to the company's paid-for-subscription service, YouTube Red, as another source of revenue for rights holders.

Labels and musicians have hit at YouTube, which has grown into the biggest streaming music platform. At issue is the 1998 Digital Millennium Copyright Act, which gives online video services "safe harbour" from prosecution for hosting unauthorised content. Last month, stars such as Taylor Swift called on the US to reform the DMCA, alleging that it allowed technology companies to profit at the expense of artists.

Musicians have also complained to the European Commission that YouTube is "unfairly siphoning value" away from artists and songwriters.

"YouTube takes advantage of the dysfunctional DMCA to do less about piracy than it could and pay unfairly low royalty rates," says Cary Sherman, chief executive of the Recording Industry Association of America. "It doesn't have to be like this." YouTube licenses music from Vevo and has separate deals with Sony Music, Universal Music and Warner Music. YouTube users also upload unlicensed music on the site.

> 'Labels are not used to being paid based on how profitable the company is'
> Mark Mulligan, Midia Research

YouTube's Content ID technology system finds unauthorised videos uploaded by users and gives labels the option of either taking them down or advertising on them. But, the industry alleges Content ID is letting too many unauthorised videos slip through.

Sony Music said in a filing to the US copyright office that "untold millions in revenue" would "never be realised by Sony due to plays of Sony Recordings that Content ID does not identify".

YouTube has rejected the labels' claims and points to what it says is Content ID's 99.5 per cent success rate in identifying music, with most videos left online by choice. Ultimately, thanks to Content ID, unauthorised videos enabled by safe harbour are no longer the threat they once were, Mr Mulligan says. Rather, the fight over the DMCA is about power in licensing talks, he says, adding that even if the labels refuse to give YouTube licences, they cannot stop the site's users from uploading the music illegally, giving the video site more leverage.

Retail & consumer

Ikea to recall 1.7m dressers in China after giving way to netizen power

GABRIEL WILDAU — SHANGHAI

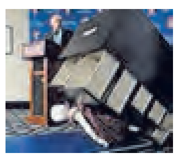
Ikea will recall 1.7m dressers sold in China, bowing to pressure from regulators and netizens who had complained that China was receiving unequal treatment after the Swedish retailer announced a recall in North America.

The official Xinhua news agency lambasted Ikea in an editorial on Sunday for "arrogance" and irresponsibility after the company initially declined to extend the North American recall to China.

In late June, Ikea announced a recall of 29m chests of drawers from its Malm line, after US regulators found that at least six children had died since 1989. When not anchored to the wall with screws, the chests can topple over and crush children, the US Consumer Product Safety Commission found.

But Ikea initially declined to extend the recall to China, the EU and elsewhere, saying the products conformed to local standards. The decision sparked outrage among Chinese netizens, despite Ikea's offer to provide free replacement hardware to anchor the dressers, free home installation, and an optional refund. Ikea also launched a campaign to inform customers of the need to attach dressers to the wall.

China's General Administration of Quality Supervision, Inspection and Quarantine said yesterday that Ikea had submitted a recall plan following a meeting with the agency.



Ikea's China product recall affects 1.7m Malm dressers that were sold between 1999 and 2016

The recall affects 1.7m Malm dressers sold between 1999 and 2016.

"The potential danger to household safety from furniture toppling over is a serious problem for the entire homewares industry. Ikea promises to serve as a model in responding to this challenge," Ikea said in a statement on its Chinese language website.

"This is a great case of a company technically following the letter of the law but doing a poor job of protecting its brand image," said Benjamin Cavender, senior analyst at China Market Research Group in Shanghai.

"Foreign firms operating in China should at this point expect that they will be under a great deal of scrutiny when it comes to handling product safety issues. Chinese consumers are highly attuned to consumer rights and also are concerned about double standards."

Foreign companies have faced a series of brand image problems related to product safety in recent years.

Apple chief executive Tim Cook apologised in 2013 after state media slammed the company as "greedy" for selling warranties on Chinese iPhones that were less comprehensive than those sold elsewhere.

In the same year, Volkswagen was pushed into a recall of 380,000 vehicles after an expose by state broadcaster China Central Television about gearbox problems. And McDonald's and Carrefour apologised to Chinese consumers in 2012 after the TV station had accused both of selling expired chicken.

Additional reporting by Jackie Cai and Ma Nan

Oil & gas

Cairn Energy seeks $1bn in stake disposal wrangle with India

AMY KAZMIN — NEW DELHI

Cairn Energy, the UK-based oil explorer, is seeking $1bn in compensation from New Delhi after the Indian revenue department barred a sale of the group's Indian assets because of a bitter tax dispute.

The compensation claim came as part of Cairn Energy's filings in an international arbitration case relating to New Delhi's demand that the group pays $1.6bn in tax.

This is one of several high-profile cases of multinational companies contesting demands from Indian officials for payment of retrospective tax.

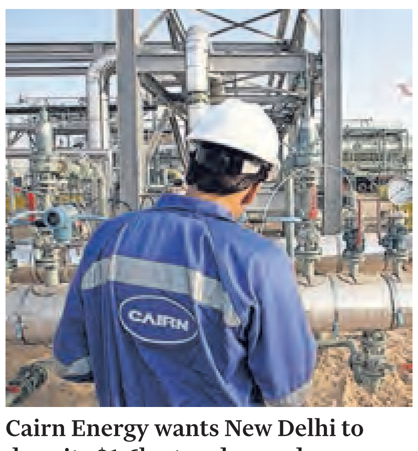
Edinburgh-based Cairn Energy's tax dispute has its origins in a 2006 restructuring of its Indian subsidiaries before the flotation of Cairn India, through which the group tapped its lucrative oil reserves in the state of Rajasthan.

Cairn Energy then sold a majority stake in Cairn India to Vedanta Resources for $6.5bn in 2011.

In 2014, the Indian revenue department barred Cairn Energy from selling its residual 10 per cent stake in Cairn India, citing potential tax liabilities.

The department issued the $1.6bn tax demand against Cairn Energy last year.

Cairn Energy said in the arbitration filing that New Delhi's January 2014 order stopping the sale of its stake in Cairn India violated India's investment treaty with the UK, which is supposed to protect against expropriation of assets.



Cairn Energy wants New Delhi to drop its $1.6bn tax demand

In levelling the $1.6bn tax demand on Cairn Energy, Indian officials cited a contentious 2012 law change.

This was pushed through India's parliament after the country's supreme court ruled in favour of Vodafone in its long-running dispute with the revenue department over capital gains tax that it attempted to levy on the UK telecoms group's $10.9bn acquisition of Indian mobile operator Hutchison Essar in 2007.

The 2012 law, which essentially overturned the supreme court ruling in the Vodafone case, allowed for the reopening of tax investigations of corporate deals dating back to 1962.

In its claim to an international arbitration panel — which is expected to start hearing evidence next year — Cairn Energy seeks an order that India withdraws the $1.6bn tax demand, and provides the group with $1bn in compensation, plus accrued interest, for the financial losses it says it has suffered.

In the event the arbitrators do not make such an order, Cairn Energy is seeking compensation of $5.6bn, which is what it says it would cost the group to comply with the tax demand and cover its other losses.

The company, which carries out high-risk oil explorations in emerging markets, said it has been badly affected by its inability to sell the 10 per cent stake in Cairn India.

Cairn Energy says the inability to cash out forced it to scale back its global investment plans, and lay off some 40 per cent of its workforce.

COMPANIES

Banks

Osborne intervened in HSBC investigation

Chancellor feared effect of money-laundering charges on stability, says report

BEN MCLANNAHAN — NEW YORK

UK chancellor George Osborne sought to help HSBC avoid criminal charges in the US for money laundering by warning that a heavy-handed approach from authorities could plunge the global financial system into turmoil, says a new report.

Details of the intervention emerged on Monday in a House committee report prepared by Republicans, which sheds new light on the decision in December 2012 by the US Department of Justice to fine the UK lender for laundering cash for drug lords and terrorists, and also for facilitating sanctions-busting by regimes such as Iran.

According to the 228-page report, the DoJ had been considering criminal charges on top of the fine that it levied in December 2012, but faced resistance from Mr Osborne, who worried what a criminal case against the country's biggest bank could do to the economy.

If HSBC had been found guilty of the potential charges, the US government would have been required to review and possibly revoke its licences to do business in the US.

Questions over HSBC's continued ability to clear US dollars "would risk destabilising the bank globally, with very serious implications for financial and economic stability, particularly in Europe and Asia", wrote Mr Osborne in a letter to Ben Bernanke, then the Federal Reserve chairman, and Timothy Geithner, the then Treasury secretary.

The then UK banking regulator, the Financial Services Authority, also

'It is not my intention to interfere with criminal or regulatory action and procedures in the US'

"weighed in very strongly" against a criminal prosecution, according to an email from a senior Treasury department staffer.

The advice caused a "firestorm" that led the attorney-general at the time, Eric Holder, to overrule the advice of his own prosecutors and not push for criminal action, according to the report.

The HSBC settlement intensified a broader debate over whether big banks are so vital to the global economy that they are "too big to jail".

HSBC declined to comment on the report. A spokesperson for Mr Osborne could not be reached for comment. The DoJ did not immediately respond to a request for comment.

In his letter to Mr Bernanke, dated September 10 2012, and copied to Mr Geithner, Mr Osborne noted that New York's Department of Financial Services had recently taken action against Standard Chartered for money-laundering abuses, prompting shares in the London-headquartered bank to drop almost 30 per cent in a single day.

"It is not my intention to interfere with criminal or regulatory action and procedures in the US," he wrote.

"Going forward, however, I would appreciate your assistance in ensuring that enforcement action does not have unintended consequences."

On September 11, the DoJ indicated that its senior leadership was still "very strongly considering a prosecution", but wanted "to better understand the collateral consequences of a conviction/plea before taking such a dramatic step".

Three months later HSBC signed a five-year deferred prosecution agreement, agreeing to pay a $1.26bn penalty to the DoJ and a further $665m to other US regulators. It admitted it allowed itself to be used by money launderers.

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Retail & consumer. Corporate governance

Burberry's inventive approach in the boardroom falls under the spotlight

Alarm bells are raised by some over luxury goods group's management shake-up

SCHEHERAZADE DANESHKHU AND MARK VANDEVELDE — LONDON

Burberry is living up to its creative image on the catwalk with a similarly inventive approach to its boardroom set-up.

On Monday, the luxury goods group replaced Christopher Bailey as chief executive, but gave him the new role of president, alongside his remit as chief designer.

The sweeping management shake-up, including a change of finance director, is aimed at tackling a poor financial performance against the backdrop of a sharp slowdown in demand that has unsettled the luxury industry.

"Burberry used to outperform other luxury goods players but they no longer are. That has been the concern," says Thomas Chauvet, an analyst at Citi.

The group is expected to report a 5 per cent fall in like-for-like quarterly sales, according to consensus forecasts, when it announces figures today.

At most luxury goods groups, the chief designer is paid less than the chief executive to whom they usually report, the main exception being when the designer is also the company founder, such as Giorgio Armani or Ralph Lauren.

Mr Bailey will report to the chairman, as will Marco Gobbetti who is to join Burberry as chief executive next year from Céline, the French fashion house that is part of LVMH. And, initially at least, Mr Bailey will be paid more than Mr Gobbetti, thanks to a more generous annual allowance.

"Titles have never been profoundly important to me," said Mr Bailey on Monday.

Sir John Peace, who has chaired Burberry since 2002, has drawn criticism for presiding over the initial decision in 2013 to give Mr Bailey the job of chief executive, in addition to his role as chief design officer. That decision is regarded by a number of investors as having been flawed.

As one top 20 investor said this week: "It has been a two-year experiment that was never going to work. The chief executive is responsible for the business and managing people, whereas the creative person is looking at building an image for the brand. They are quite different roles — and Bailey's talent was on the latter."

At issue now is whether Burberry is swapping one ill-fitting corporate management structure for another.

According to Burberry, Mr Gobbetti will focus on company strategy and culture, while Mr Bailey will head brand and design. But it is not clear who will be in charge.

"We are both the boss," Mr Bailey said, emphasising that he would remain involved in business decisions as an "equal partner" with Mr Gobbetti.

That assertion has rung alarm bells with some corporate governance experts.

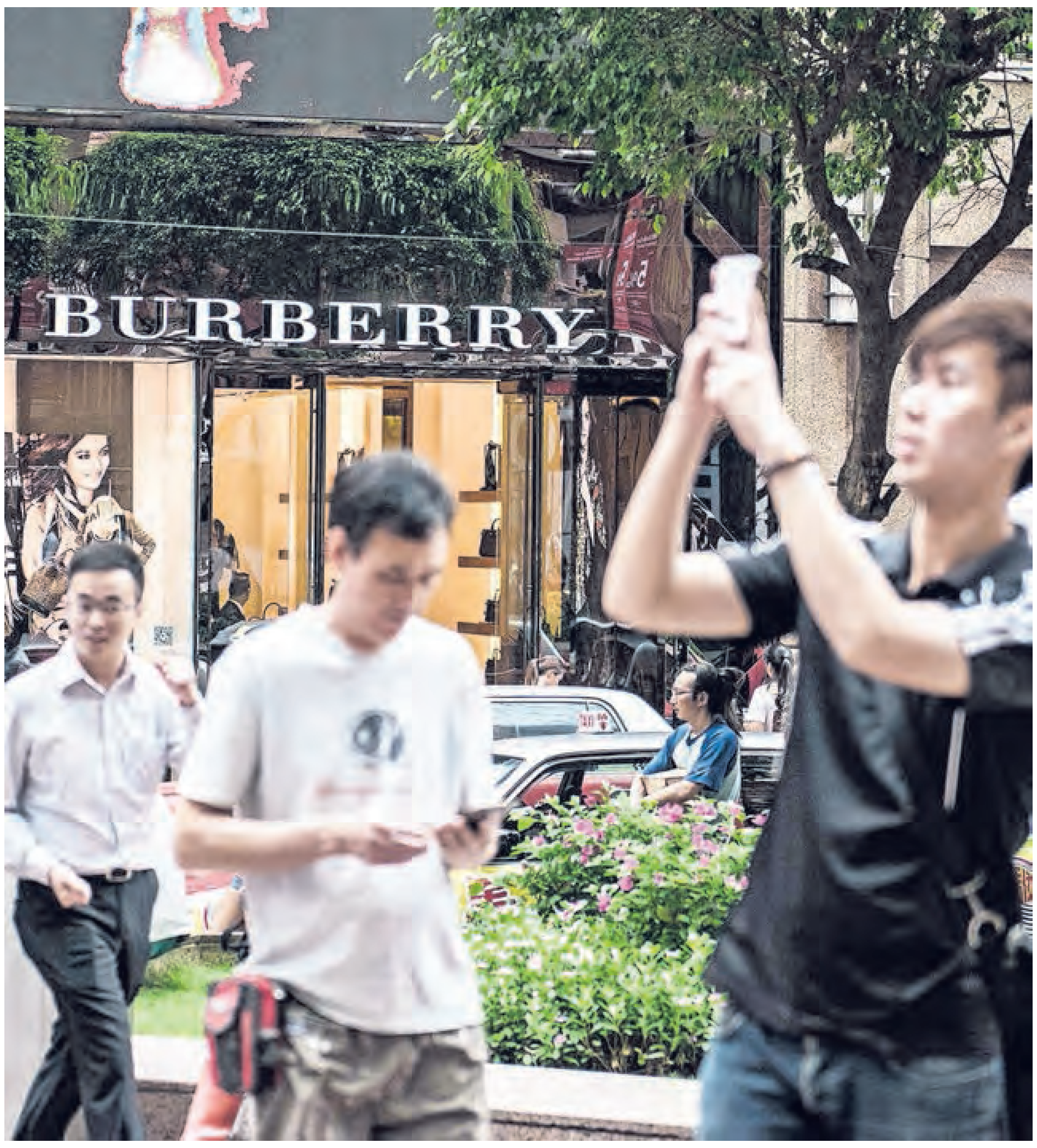
"They've tried this in football and it just doesn't work," says Alex Edmans, a professor at London Business School. "In every form of organisation, from corporations to football clubs, you have one person at the end of the day making the decisions."

But others say that an unconventional approach may be warranted in a company that profits as much from brand aura as business logic.

Kevin Morrell, a professor at Warwick Business School, is among the supporters of Burberry's new structure.

"Instantly demanding that they should have little boxes around each other which help us draw an org chart isn't necessarily the best way for this company to go," he says.

Mr Chauvet says the new structure appears to be the price that had to be paid to keep Mr Bailey — something that Sir John seemed to acknowledge when he said Mr Bailey was "more likely to remain" at Burberry under the new structure.



Burberry is expected to report a 5 per cent decline in like-for-like quarterly sales
Xaume Olleros/Bloomberg

"The slowdown in the luxury goods industry means that the designer becomes particularly important in terms of differentiating and reinforcing the brand's image and sales performance," says Mr Chauvet. "Burberry could not afford to lose Christopher Bailey at a time like this."

Referring to the structure that prevailed when Angela Ahrendts was chief executive before leaving for Apple in 2013, Mr Chauvet adds: "The title of president is precisely that — it's a title.

"What matters more is that we are back to a more healthy and logical management structure, as existed previously under Angela Ahrendts, of a CEO, a chief creative officer and a chief financial officer/chief operating officer."

The splitting of Mr Bailey's roles and injecting new management blood have lifted the shares, which initially advanced 6 per cent on Monday before partially falling back.

Yesterday, the shares closed down 0.6 per cent to £12.03.

Guillaume Gauvillé, an analyst at Credit Suisse, says: "These are positive management changes for the long term. [But] Gobbetti is at least a year away from joining.

"This adds some near-term uncertainty about the execution and the outcome of the current strategic plan."

Additional reporting by David Oakley

'They have tried this in football and it just doesn't work'
Alex Edmans

Food & beverage

McDonald's struggles to lure bidders for Chinese franchise

DON WEINLAND — HONG KONG
LINDSAY WHIPP — CHICAGO

McDonald's sale of its China and Hong Kong franchise is struggling to attract the calibre of bidders the US fast-food empire envisioned, according to people familiar with the situation.

With the auction, announced earlier this year, the company is seeking to reduce its direct exposure to China, where food supply scandals have hurt its share price, and to halt capital expenditure in the region.

But McDonald's is also looking to fortify its reputation with the sale, which has moved into a second round of bidding and could fetch $2bn-$3bn, according to people briefed on the deal.

Pressure from investors for better quality control in Asia has been reflected in the terms of the deal, said these people, who say some of the conditions, such as keeping management intact for two years and a restriction on taking the franchise public, are onerous.

"They aren't getting the top-tier companies they wanted. They have had to turn down a lot of the [unqualified] bidders," one person briefed on the McDonald's auction said.

McDonald's said: "We are making solid progress as we look for long-term strategic partners with local relevance who have complementary skills and expertise."

The shortlist includes some Chinese groups that have shot to fame after aggressive buying sprees, but which have little to no experience in fast food.

Sanpower Group, which has struggled to manage the UK department store House of Fraser, which it bought in 2014, said it had made an offer in partnership with state-owned Beijing Tourism Group.

State-owned ChemChina, which agreed in February to pay $44bn for Swiss agrochemical company Syngenta and owns a chain of noodle shops in China, was also an early bidder, though it is unclear if the company has made it into the next round. China Cinda Asset Management, a state-owned bad-debt manager, and dairy company Beijing Sanyuan Foods have also lodged bids, Bloomberg has reported.

McDonald's share price has risen more than 23 per cent over the past 12 months, since Steve Easterbrook took the reins and outlined a turnround effort. The plan for Asia involved one or more local partners taking over the China and Hong Kong franchise of 2,800 outlets for 20 years while paying royalties to McDonald's.

But some investors are uneasy about handing over the franchise and McDonald's brand reputation to a Chinese group, particularly after a food safety scandal there in 2014 that hit sales.

"There has always been a massive disconnect between what is happening here and what the company in the US thinks is going on," said Ben Cavender, principal at China Market Research, which advises multinational chain restaurants in China.

Dieter Waizenegger, executive director of CtW Group, which is affiliated with a federation of unions holding more than $250bn in assets including 0.2 per cent of McDonald's, wrote to the company in March expressing concern about the idea of an master franchising strategy for Asia. CtW said the royalties McDonald's receives from the owner of its Latin America franchise, Arcos Dorados, have declined 23 per cent over the past two years.

Pharmaceuticals

Shire to go head to head with Allergan over dry-eye treatment

DAVID CROW — NEW YORK

The US drugs regulator has approved a treatment for dry eyes made by Shire, putting the Anglo-Irish drugmaker in direct competition with Allergan, which makes the bestseller.

Roughly 16m US adults suffer from the condition, which can cause inflammation that has the potential to damage the surface of the eye.

Analysts predicted the drug, Xiidra, could become a blockbuster medicine with peak annual sales well in excess of $1bn a year, after the Food and Drug Administration said the eye drops were suitable for a larger group of patients than expected.

The FDA said Xiidra could be prescribed not just to those patients with the symptoms of dry eyes, such as difficulty producing tears, but also to those with "signs" of the condition. People with signs of an illness do not realise they have it, but are diagnosed after being examined by a doctor or optician.

"The approval of Xiidra marks a new day in treatment options for patients with dry-eye disease, with the only prescription eye drop approved in the US specifically to treat both the signs and symptoms of the condition," said Flemming Ornskov, Shire chief executive.

Shares in Dublin-based Shire, which is listed on the London Stock Exchange, were up 3 per cent yesterday lunchtime.

The broader label from the FDA should give Shire an edge over Allergan, which makes Restasis, a drug that is only recommended for patients who are struggling to produce tears, according to Andrew Baum, an analyst at Citi.

Mr Baum estimated Xiidra would reach $2.5bn in global annual sales by 2030, making it one of Shire's bestselling medicines.

Jason Gerberry, an analyst at Leerink, said Shire had "scored several victories", pointing out that the FDA had approved the medicine ahead of schedule, and that the drug appeared to work more quickly than Restasis — within a fortnight compared with six to eight weeks for Allergan's drug.

About 16m adults in the US suffer from problems with dry eyes

Mr Gerberry said Xiidra would be priced at about $300 per prescription in the US, roughly the same as Restasis.

Allergan generated $1.3bn of revenue from sales of Restasis last year, making it the company's second most lucrative drug behind wrinkle treatment Botox.

Shares in the company were down 0.3 per cent in New York at midday.

However, some analysts said that the introduction of Xiidra could increase awareness of the condition and boost sales of Allergan's drug too

Umer Raffat, an analyst at Evercore ISI, said the entry of the Shire treatment would "grow the overall pie", and suggested Allergan could offset lower volumes with price increases.

He also said Allergan could enjoy a short-term boost in sales if Shire were to price its own drug at a premium to Restasis. "In my view, Allergan's near-term numbers on Restasis may be driven by Shire's pricing," he said.