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THE WALL STREET JOURNAL.

DOWJONES FRIDAY, JANUARY 3, 2003 ~ VOL. CCXLI NO. 2 ~ ★★★★ $1.00 * * * * * * WSJ.com

Uneasy Peace

U.N.'s Long Stay, Power in Kosovo Stir Resentment

After 3 Years, Mission Aimed At Self-Rule Still Issues Laws and Postage Stamps

Cops Who Drive 'Coca-Colas'

By Yaroslav Trofimov

PRISTINA, Yugoslavia—Here in the Balkan province of Kosovo, Michael Steiner of the United Nations can jail any local resident by "executive order." He can change the province's temporary constitution and veto any decision of the elected authorities. He has the final say on the budget, foreign affairs, security and the vast network of state-owned companies. Kosovars send mail with U.N. postage stamps, drive with U.N.-issued licenses and show U.N. travel documents when abroad.

It has been more than three years since a U.S.-led military campaign evicted Serbian forces from Kosovo, and more than a year since the Kosovars elected their own fledgling government. Yet virtually all power in the Balkan province continues to reside with the thousands of United Nations administrators who arrived in 1999 to restore order and promote self-rule.

Michael Steiner

Now as their stay lengthens, resentment of them is rising. Many Kosovars accuse the U.N. of excluding locals from key decisions, sheltering U.N. officials suspected of misdeeds and hobbling Kosovo's new elected institutions.

Even some U.N. representatives offer a sobering assessment of its record here so far. "Kosovo is still a long way from having truly functioning democratic institutions and a society where minorities can fully participate," said Ole Peter Kolby, a Norwegian diplomat, at a news conference last month after leading a U.N. fact-finding mission to Kosovo.

Mr. Steiner, the chief U.N. official in Kosovo, points to the improved stability

and safety residents now enjoy, along with the $2.4 billion of international aid they have received so far. Kosovo is "maybe the biggest success story of the U.N.," Mr. Steiner says.

But as U.S. officials draw up postwar scenarios for Iraq, Kosovo shows how hard it can be for international bureaucrats to nurture back to normalcy a war-shattered land. And the U.N. administrators have had the advantage in Kosovo of dealing with a predominantly Muslim populace that is much smaller and more pro-Western than Iraq's.

Kosovo has seen continual friction between Serbs and the mostly Muslim Albanians for more than a century. The Serbs took control of the provincial administration in 1989 and remained in charge after the 1995 Dayton Accords ended the five-year Balkan War, even though ethnic Albanians make up some 90% of the population of two million. Violence surged in the province after the ethnic-Albanian Kosovo Liberation Army organized a pro-independence uprising in 1998. Thousands died as

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What's News—

Business and Finance

J.P. MORGAN SAID it would take a $1.3 billion charge for the fourth quarter, largely to settle litigation over its involvement with Enron Corp. Included in the charge is $400 million that the nation's second-largest bank said it would swallow to settle a lawsuit with its insurers over who should pay $1 billion in costs related to Enron's demise.

(Article in Column 5)

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■ **Blue chips surged** 265.89 points, or 3.19%, the third-biggest opening-day percentage gain ever. The rise was accompanied by a wide Treasury-bond selloff.

■ **Manufacturing activity rose** sharply in December, surprising economists and signaling the sector may be starting to recover.

(Articles on Pages A2 and C1)

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■ **Senate Republicans are** ready to boost the SEC's budget nearly 20%, doubling the increase first proposed by the White House.

(Article on Page A3)

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■ **Guidant said** its purchase of Cook Group is unlikely to go through after tests of a drug-coated stent fell short of targets.

(Article on Page A3)

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■ **Retail gasoline prices are rising** in the U.S. as the strike by Venezuela's oil industry drives a decline in crude-oil inventories.

(Article on Page A3)

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■ **Lucent settled** a lawsuit with a former executive, averting a public trial and possible disclosures about questionable sales tactics.

(Article on Page A12)

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■ **The average U.S.-stock fund** declined 22% in 2002, exceeding mutual-fund declines in 2001 and 2000, preliminary figures show.

(Article on Page C1)

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■ **Fiat shares rose** nearly 10% on news of Roberto Colaninno's rescue bid, though a turnaround would entail serious challenges.

(Article on Page C1)

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■ **Home Depot cut** its forecast for fiscal-year earnings, saying same-store sales could fall 10% for its fourth quarter ending Feb. 2.

(Article on Page A8)

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■ **Walt Disney plans** to merge its television-animation unit with the Disney Channel to boost series production for its networks.

(Article on Page A8)

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■ **Despite Martha Stewart's woes**, her new recipe magazine, Everyday Food, has attracted big advertisers, including GM and Kraft.

(Article on Page A7)

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■ **The NFL's television ratings** rose 5.5% this season, but high costs are pushing networks to reassess their coverage of the league.

(Article on Page A7)

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■ **A former H&R Block employee** and three others were charged in a federal complaint with conspiracy to commit mail fraud.

(Article on Page C7)

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■ **Three big media companies** asked federal regulators to scrap current media-ownership rules, seeking to ease mergers.

(Article on Page A8)

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■ **Fidelity is expanding** its work in managing employee benefits to counteract the risks of dependence on the stock market.

(Article on Page A7)

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■ **U.S. music sales fell** for the second year in a row, hurt by downloading, scarce hits and competition from videogames and DVDs.

(Article on Page A8)

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—Markets—

Stocks: NYSE vol. 1,225,780,830 shares, Nasdaq vol. 1,276,781,186. DJ industrials 8607.52, ▲ +265.89; Nasdaq composite 1384.85, ▲ +49.34; S&P 500 index 909.03, ▲ +29.21.

Bonds (4 p.m.): 10-yr Treasury ▼ -1 29/32, yld 4.055%; 30-yr Treasury ▼ -3 2/32, yld 4.972%.

Dollar: 120.03 yen, +1.27; euro $1.0361, -1.39 cents against dollar.

Commodities: Oil futures $31.85 a barrel, ▲ +$0.62; Dow Jones-AIG futures 113.105, ▲ +2.829; DJ-AIG spot 148.551, ▲ +3.717.

World-Wide

■ **BUSH PREPARED to unveil Tuesday his plan to revive the economy.** The three main elements include cutting taxes on corporate dividends, accelerating effective dates for previous tax cuts and giving companies more lucrative write-offs on equipment purchases. Aides are still tinkering with the mix to reduce criticism from Democrats that the administration unfailingly caters to the rich. The president, speaking to reporters in Texas, dismissed all such talk as "class warfare." (Page A3)

Bush, who so far resists direct negotiations with North Korea in the crisis over its nuclear-arms program, delivered a sharp rebuke to Kim Jong Il, saying he has "no heart for somebody who starves his folks."

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■ **South Korea rejected** the North's call for solidarity against the U.S., and urged Pyongyang to stop saber-rattling. Seoul asked China to help rein in North Korea's nuclear-arms program, and is sending an envoy to Russia today. China is uniquely situated to play peacemaker, but would have to shift diplomatic gears in uncharacteristic haste. (Page A6)

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■ **The Army ordered** engineering, intelligence and air-defense troops to the Persian Gulf in a growing build-up. Germany denied an Iranian newspaper report that its foreign minister told his Iranian counterpart the U.S. is trying to arrange Saddam Hussein's overthrow to prevent a war. Bush warned Hussein that his "day of reckoning" is drawing near.

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■ **Israel was asked** by the U.S. to suspend military sales to China because of the threat to Taiwan. An Israeli poll found a Likud scandal is costing Sharon's party significant support as Jan. 28 elections approach.

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■ **Venezuela's Chávez asked** Brazil's President Lula da Silva to send oil technicians to break a month-old general strike. He wants the oil industry running at capacity in 45 days, but many doubt he can pull that off.

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■ **Pakistan detained** a border guard who wounded a U.S. soldier Sunday in a clash that has fanned anti-American fervor in the area. The U.S. is donating 300 vehicles to Pakistan to help in patrolling the Afghan border.

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■ **The Air Force pressured** two pilots into taking amphetamines that may have impaired their judgment in dropping a bomb that killed four Canadian soldiers in Afghanistan in April, an attorney for one pilot said.

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■ **Gephardt has decided to explore** seeking the 2004 Democratic nomination. Sen. Edwards said he'll do the same. It would be the Missouri House leader's second presidential attempt.

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■ **The federal government is** reviewing the University of California's contract to run Los Alamos after the nuclear lab's top officials quit amid a fraud and theft inquiry. (Page A4)

* * *

■ **Turkey should reconsider** its hard-line Cyprus policy and end unconditional support for the Turkish Cypriot leader, the leader of Turkey's ruling party declared in a major shift.

■ **Turkey's parliament passed** measures to advance the nation's EU membership bid. They include toughening laws against torture and making it harder to ban political parties.

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■ **Nigeria's president apologized** for an October 2001 army massacre in which 200 people died in the state of Benue. Until now, he had suggested the army acted in self-defense.

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■ **A North Sea tanker accident led** to only minor spillage, but the situation is being monitored. The vessel, hauling kerosene, hit the wreck of a luxury-car carrier that sank Dec. 15.

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■ **A Frontier mechanic was charged** with sabotaging a 737 in Denver New Year's Day. He threw a wheel chock into an engine to prevent a takeoff, arguing he felt it wasn't airworthy.

* * *

■ **The West Antarctic Ice Sheet has** been melting for 10,000 years and may disappear in 7,000, a study in the journal Science found. That could raise ocean levels by 16 feet.

—Online Today—

WSJ.com **The Macro Investor:** Economists who guessed right on GDP ended up wrong on the Dow. Steve Liesman explains what's behind the forecasting disconnect.

* * *

■ **Work & Family Mailbox:** Sue Shellenbarger suggests 12 books that can help you assess whether you're spending time on things you value.

* * *

■ **Anti-Identity Theft:** A new law lets Californians protect their credit records, but the benefit has pitfalls.

Rebellion Takes Root: More Women Eschew The Daily Shampoo

* * *

Stressed Tresses Need Rest, Not Gunk, They Find; Hair Care to Dye For?

By Sally Beatty

Kathy Reilly has a beauty secret.

Like millions of other women, the 37-year-old Harvard MBA grew up washing her hair every day. "Lather, rinse, repeat, just like they told us," says Ms. Reilly.

Then Ms. Reilly had a hair epiphany. About seven years ago, the New York-based marketing executive had her blond hair blown out professionally. But instead of washing it the next morning as usual, she waited several days to preserve her hairstyle. That's when she realized her hair actually looked better without a daily shampoo. Now, Ms. Reilly lathers up just once every two or three days.

Kathy Reilly

Ms. Reilly is part of a quiet rebellion against daily shampooing. The idea isn't to create the look of unkempt dirty hair—which became a grungy fad about a decade ago—but instead to create healthier, more manageable hair.

As more women color and chemically treat their hair, many have discovered an unsightly side effect: dry and brittle locks. Some women say the best way to counteract these damaging effects is to shampoo less often, since washing removes hair's natural oils.

But slacking off on shampoo is a radical notion that many are too embarrassed to admit. Rachael Keys, a marketing assistant in Hollywood, shampoos her chemically straightened hair every three days. Still, she says, "it took me a long time to feel like I wasn't dirty because I didn't wash my hair."

Today nearly 60% of American women color their hair regularly, up from 40% in 1976, according to L'Oreal, the hair-care and cosmetics giant. But by dousing their hair with chemicals, drying it with hot air and ironing it straight, women have set off a dry-hair epidemic. Symptoms include split ends, ragged hair cuticles and the dreaded straw-like halo effect known as the "frizzies."

"Frizz is a national obsession," says Michael Gordon, a stylist and founder of the Bumble and bumble salon in New York.

Women with curly hair realized long ago that hair is often more manageable when shampooed less often. And dermatologists and hair stylists have long warned women that frequent shampooing washes away essential oils that help protect hair. "Obviously, the less you shampoo the better," says Dr. Walter Unger, a professor of dermatology at Mt. Sinai Medical School.

Dr. Barney Kenet, another dermatologist in Manhattan, says Americans "overwash everything," including hair. What's more, those most prone to shampoo daily are the least likely to need it. Daily shampooers are "white-collar workers—they don't have dirt under their fingernails," says Dr. Kenet.

Women often break free of daily washing by accident. Dawn Stroupe, a 37-year-old TV producer in Los Angeles, grew up washing her hair every day. When she hit 31, she began coloring her hair, and before long, her hair began to dry out.

Then one morning three years ago, Ms. Stroupe overslept. Running late, she skipped a shampoo and prepared herself for the proverbial "bad-hair day." She quickly realized "my hair actually looked better than it did a day before"—when

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—Notice to Readers—

The Marketplace section is included in the first section of today's Wall Street Journal.

Looking Up

Inside a Shaky Economy, Signs of a Rebound Emerge

War Clouds Could Still Derail Pent-Up Spending Plans On Factories, Technology

T.G.I. Friday's Iraq Scenario

By Greg Ip

In November, John Dillon, chairman of the Business Roundtable, said a survey of the group's 125 blue-chip members found most planned to freeze or cut capital spending in 2003. Yet Mr. Dillon's company, International Paper Co., isn't one of them—and it could be in the vanguard.

After paring capital spending by a third over the last four years, the company expects to boost it 10% to 15% in 2003 from last year's level. "During hard times, you can cut back on capital" improvements, Mr. Dillon, International Paper's CEO, says. "But over time you have to spend to improve your competitiveness." With cash flow rising, the company overhauled machinery in Arkansas that makes juice containers and plans to upgrade its online-order-management system to speed answers to customer queries.

A resilient economic expansion may be in the making, starting in the same place that the slump began: corporate boardrooms. The U.S. economy of 2002 may be remembered for its resemblance to the economy of 1992: stuck in a rut, depressed about its prospects, damned by Democrats—yet poised for an impressive takeoff.

A business-spending bust drove the economy into recession in March 2001 and has hobbled the recovery ever since. But now, the pieces required for a rebound are falling into place: Profits are recovering. Balance sheets are stronger. Investor panic is subsiding. And perhaps most important, businesses are finding it harder to keep postponing new investment.

Just yesterday, a closely watched survey found that manufacturing activity rebounded in December, as new orders surged to a nine-month high, according to the Institute for Supply Management. The news helped send stocks soaring on the first trading day of the new year.

Capital spending is "nowhere near peak levels," says Diane Swonk, chief economist of Bank One Corp., the big Chicago-based banking company, "but the momentum has shifted."

Across the economy, profits are up 12% from a year ago by government measures. Free cash flow, a better measure of financial health than profits because it reflects capital outlays and excludes noncash charges, is even stronger. It has doubled to 6% of sales since early 2001, well above the

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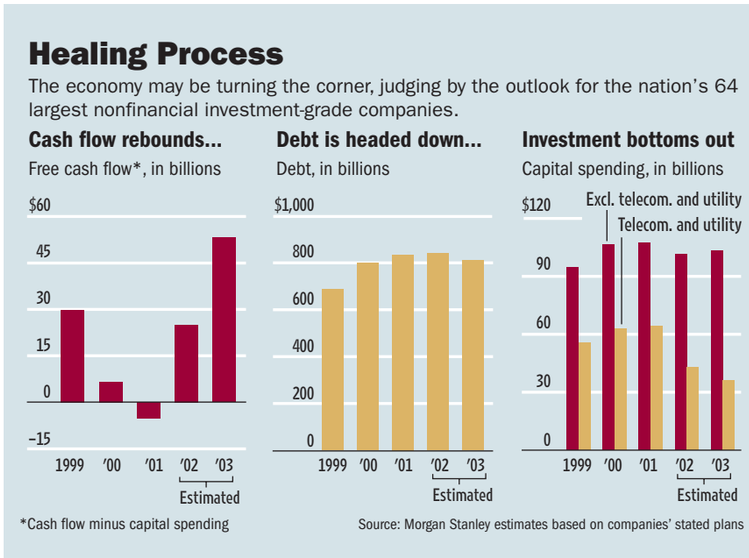

Enron Deals Cost J. P. Morgan; Bank Takes $1.3 Billion Charge

By Christopher Oster And Randall Smith

J.P. Morgan Chase & Co. said it would take a $1.3 billion charge for the fourth quarter largely to settle litigation over its involvement with Enron Corp., the latest sign of the huge bill Wall Street is paying for its role in the energy firm's debacle.

Included in the charge was $400 million that the nation's second-largest bank said it would swallow to settle a lawsuit with its insurers over who should pay $1 billion in Enron-related losses.

J.P. Morgan and other Wall Street firms have been accused of financing deals, often using complicated off-the-books arrangements, that helped disguise Enron's true financial condition. The bank has long maintained it bears no responsibility for the energy firm's collapse.

The Enron fallout for Wall Street isn't over. Financial institutions including Morgan itself, Citigroup Inc., Merrill Lynch & Co., as well as Enron's former law firm, Vinson & Elkins, are defendants in a class-action lawsuit in Houston brought by Enron shareholders. That lawsuit is expected to go forward, despite the Morgan settlement.

J.P. Morgan has suffered perhaps more than any other Wall Street bank because of its close ties to Enron. Since Enron's collapse, J.P. Morgan has already written off roughly $500 million in loans and other exposure to the Houston energy trader. Investors saw yesterday's move as a step forward for the bank, because many feared it would absorb an even bigger financial blow.

Word of the agreement with its insurers, reached the same day the month-long trial was expected to go to the jury, helped send J.P. Morgan shares up $1.78, or 7.5%, to $25.44 in 4 p.m. New York Stock Exchange composite trading. That helped spur a broad Wall Street rally. Richard Strauss, an analyst at Goldman Sachs Group Inc., said the outcome for J.P. Morgan was "far better than the worst-case scenario."

At issue in the lawsuit was a complex series of trades involving Enron and Morgan. Morgan paid the insurance companies to provide guarantees that some of the trades would go through. In the U.S. District Court for the Southern District of Manhattan, the insurance companies argued that the circular flow of money from these trades—from Enron to another company called Mahonia to J.P. Morgan and back to Enron again—meant that the arrangements weren't trades at all, but disguised loans. The insurance companies also claimed that they were defrauded into guaranteeing a trade that was really a loan.

The charge announced by Morgan will effectively wipe out the company's expected fourth-quarter profit. In announcing the settlement, the bank said its 11 insurers would cover 60%, or just over $655 million, of its just more than $1 billion in claims. In addition, the bank said it would set up a reserve of an additional $900 million to pay for other litigation and regulatory issues. Some, but not all, of those relate to Enron.

The fourth-quarter charge, which is pretax, follows a $1.5 billion aftertax charge announced last month by Citi-

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INSIDE TODAY'S JOURNAL

A Bank-Branch Collector

The man who transformed Salomon's mortgage-trading unit has a new passion: using a REIT to buy property from consolidating banks. **Deals & Deal Makers, Page C1**

Pair Behind the Throne

Bush's inner circle has dwindled to two: Vice President Cheney and master strategist Karl Rove, much of whose advice generates suspicions of political motivations. **A4**

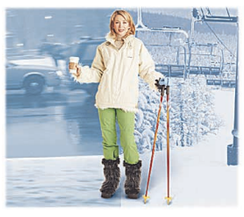
The Lesson of North Korea

To the question, 'Why battle Iraq when Pyongyang is more dangerous,' Journal Publisher Karen Elliott House has this answer, 'Get real': North Korea is nuclear and Iraq is not, yet. Pyongyang teaches us the consequences of appeasement. **Opinion, A10**

Monday Night Volleyball?

Great NFL ratings this year mask deep discontent at some networks that are losing money on football. Can they live without it? **A7**

WEEKEND JOURNAL.



Does the New Ski Wear Cut It on the Slopes?

Supermarkets Get In the Restaurant Game

Historic Home Replicas Are In Again

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Manufacturing-Activity Gauge Increases More Than Expected

By JON E. HILSENRATH

In a tentative sign that the nation's hard-hit industrial sector is beginning to heal, a widely watched indicator of manufacturing activity expanded in December for the first time since late summer.

The Institute for Supply Management said its December index of manufacturing activity rose to 54.7 from 49.2 in November, the largest increase since June 1991 and a much larger rise than economists were expecting. Readings above 50 indicate expansion of activity in the manufacturing sector, while readings below 50 denote contraction. The index was 48.5 in October and 49.5 in September.

Norbert Ore, chairman of the institute's survey committee, said it was "difficult to explain" the magnitude of the December increase. Although economists have been forecasting a pickup in business activity, few indicators have yet to point in that direction. The Commerce Department, for instance, reported recently that orders for durable goods declined in November for the third time in four months.

Nevertheless, the ISM report, which is one of the more important monthly economic indicators because it provides an early reading on business activity, could be taken as one small signal of stabilization for manufacturers after the economy hit what Federal Reserve Chairman Alan Greenspan has described as a "soft patch" in late 2002.

"It is an encouraging sign, but the overall array of information on the industrial sector is still mixed," said Richard Rippe, an economist with Prudential Securities. The December ISM index was well above the 50.0 level expected among economists surveyed by Dow Jones Newswires and CNBC ahead of the release.

The biggest surprise in the report was

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A Brighter Year Ahead?

The Institute for Supply Management's index tracks growth in the manufacturing sector. Sub-indexes track areas including new orders, employment, inventories, production, prices and supplier delivery times.

Source: Institute for Supply Management

Delay on Jobless Benefits Takes a Clear Toll

Senate-House Discord Over Extending Payments Intensifies Pain in Ohio and Michigan

By GARY FIELDS

STEVE SHOUSE of Batavia, Ohio, has turned the thermostat down to 55 degrees, sold his beloved electric guitar, dropped long-distance telephone service and canceled all but liability insurance on his 1998 pickup truck.

"You put on some sweatpants and a sweatshirt, and it's not bad," the unemployed factory worker says.

He's also considering moving in with his elderly mother and renting out his own house—if the job picture doesn't improve soon or Congress doesn't act swiftly to extend federal emergency unemployment benefits.

Mr. Shouse, who is single and has no dependents, figures he's better off than most people left hanging over the holidays when the House and Senate adjourned without agreeing on how to extend emergency jobless benefits. Those federal benefits expired on Dec. 28, cutting off aid to 780,000. In addition, an estimated 95,000 people will exhaust their 26 weeks of state unemployment each week, according to the Center on Budget and Policy Priorities. Even before the Dec. 28 cutoff, one million people had exhausted their 13 weeks of extra federal emergency help.

Quick Action Is Predicted

When Congress returns next Tuesday, one of the top issues will be extending federal unemployment aid. But it faces a number of hurdles, including a short turnaround time. Next week, lawmakers return for only three days before adjourning again until later this month, and in those three days must approve a continuing spending resolution.

Rep. Rob Portman, an Ohio Republican who is close to the White House, predicts quick action. "There now seems to be a consensus that we need to have a seamless extension of unemployment insurance benefits, and Congress is poised to do that," he says. Similarly, an aide to House Speaker Dennis Hastert of Illinois says the benefits are "on a fast track."

President Bush has added to the sense of urgency, scolding both the House and Senate in a radio address last month. "The last Congress left behind some unfinished business," he said. "The House and Senate passed different bills extending unemployment benefits. However, no final bill was sent to me extending unemployment benefits for about 750,000 Americans."

Mr. Bush's father faced a similar challenge in 1992. Although President George H.W. Bush signed three extensions of jobless benefits, his White House's threat to veto the last one quickly became a part of Democratic charges that he was clueless about the depth of the recession and insensitive to the plight of workers.

The current president is determined not to allow that to happen again. Still, Democrats and unions say the president's focus seems to be only on restoring benefits to those who lost them on Dec. 28, not on extending them to those whose payments had run out.

New Senate Majority Leader Bill Frist (R., Tenn.) is widely expected to reintroduce last year's Senate bill, which was sponsored by Sen. Don Nickles (R., Okla.) and Sen. Hillary Rodham Clinton (D., N.Y.). It carries a price tag of $5 billion and would provide a 13-week extension for workers who have already exhausted 26 weeks of state benefits and 13 weeks of federal benefits.

House Democrats have indicated they plan to introduce similar legislation. A House Republican proposal now under discussion would resume benefits for workers who were cut off on Dec. 28. Unemployed workers in 16 states where unemployment rates exceed 5.5% would be able to receive an additional nine weeks of benefits. Yet another Republican proposal would scrap the current 13-week federal extension and replace it with 19 weeks of federal payments. Seven states with high unemployment would get additional payments.

House GOP's Rationale

A House Republican staff member, now in the thick of discussions about the benefits, says it is unreasonable to extend benefits nationwide when unemployment rates in 24 states are below 5%, and rates in 40 states are below the 6% national average. The plan, the staff member says, is to provide relief for people whose benefits were cut off Dec. 28 and offer extended benefits only for states with high unemployment rates.

For Mr. Shouse and others who haven't been able to find new jobs, state unemployment rates aren't topmost on their minds. Mr. Shouse, a 45-year-old quality-assurance inspector at Tri-Star Refractory in Newton, Ohio, was laid off in April from a job that paid $682 a week. His unemployment benefit amounted to $303 a week. Over the months, he has drained his savings, and ended up selling his Ibanez guitar and Fender amplifier for $350. He says he'll sell his aluminum fishing boat in the spring, hoping it will fetch a better price than it will during the winter. "Maybe I'll get a house note payment for it," he says. "I see everything I have in terms of a house note payment or

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Unemployment Proposals

Several proposals have been discussed in recent months for extending the federal payments, including the three below: Most states pay up to 26 weeks of unemployment benefits before the federal emergency funds, known as Temporary Extended Unemployment Compensation, kick in.

- **Proposal One:** Resume payments for all recipients who were cut off Dec. 28. Workers across the country who had already exhausted the 13 weeks of federal emergency funds would be eligible for another six weeks of payments. Workers in seven high unemployment states, defined as 4% adjusted insured unemployment, would get 13 weeks of additional benefits.
- **Proposal Two:** Resume payments for all recipients who were cut off Dec. 28, allowing them to receive the rest of their payments, up to 13 weeks. Workers in 16 high unemployment states, defined as 5.5% total unemployment rate for the past three months, who exhaust the 26 weeks of state payments now would be eligible for an additional 9 weeks of payments.
- **Proposal Three:** Resume payments for all recipients who were cut off Dec. 28. In addition, this proposal would extend the time of those payments to 26 weeks as opposed to the current 13. In addition 13 high unemployment states would get an additional 7 weeks.

Inside a Shaky Economy, Signs of Rebound Are Starting to Emerge

Continued From First Page

long-term average of 4.4%, according to Vadim Zlotnikov, a strategist at brokerage Sanford C. Bernstein & Co.

He warns, though, that some big-spending sectors, such as utilities and telecommunications, remain under pressure to pare debt or shore up pension plans rather than invest. Indeed, even optimists don't expect a repeat of the late 1990s when a rocketing stock market and booming investment lifted annual growth above 4% for three straight years.

Lots could still go wrong—beginning with a prolonged war with Iraq. The prospect of hostilities there combined with turmoil in Venezuela have driven oil over $30 a barrel. If a war with Iraq seriously disrupts oil supplies, crude prices could head even higher and stock prices could tumble. Those events could seriously undermine consumer spending, which has carried the economy so far, as could a terrorist attack, or falling home values.

Construction of buildings and factories is still falling. An October upturn in orders for capital goods was reversed in November, the Commerce Department reported on Christmas Eve. Recent stirrings in business equipment are "an improvement, to be sure, but not necessarily the beginnings of a vigorous recovery," Federal Reserve Chairman Alan Greenspan cautioned recently. U.S. factories are operating at just 74% of capacity, well below the long-run average of 80%. A few industries—airlines, telecommunications and industrial real estate—could take years to recover from the investment excesses of the 1990s and subsequent collapse in demand.

But investment has fallen so far there are a shrinking number of examples of such excess left. An upturn in sales could quickly boost manufacturers' use of their current production capacity to more normal levels. "We do not have a debilitatingly large overhang of capital stock from overbuilding of plant and equipment," Mr. Greenspan said. "What we do have is a very large degree of uncertainty," much of which he pins on "geopolitical risks" such as the threat of war with Iraq, tensions over North Korea's nuclear program and terrorism risk.

Shrinking Stock

For the first time in 50 years the stock of installed equipment and software in U.S. business is shrinking because it's wearing out faster than it is being replaced, says Martin Barnes, editor of the Bank Credit Analyst, a Montreal-based forecasting journal. The U.S. economy has become more capital-intensive in the last decade because of the spread of information technology, which turns obsolete quickly and requires continuing investments. Technology now makes up half of all business investment. "Companies have actually under-invested, so there should be enormous pent-up demand for capital spending," says Mr. Barnes.

The first signs of a turnaround in capital spending are beginning to show. Shipments of capital goods, excluding the volatile aircraft and defense industries, sank 18% in the 14 months through November of 2001, but have been edging higher ever since. Despite the November 2002 decline, shipments were still 3.2% higher than in the same month the year before. The growth is more impressive in volume terms; falling technology prices mean each dollar of investment buys more than it did last year.

A Morgan Stanley analysis of 64 of the largest high-quality corporate bond issuers found that though utilities and telecommunications companies are still planning cutbacks, other companies' capital budgets are expected to grow 2% in 2003 after falling 5% in 2002. Despite idle factory excess in some firms, 44% of manufacturers plan to boost capacity in 2003, while just 12% plan to reduce it, according to a recent survey of purchasing managers by the Institute for Supply Management.

Both the Fed and the White House see a revival in capital spending as critical to the economy's near-term health, in part because American households, their stock portfolios shrunken, may not be able to keep the economy going single-handedly. So the Fed has cut interest rates, and the President is preparing a new round of tax cuts, including some aimed at kick-starting business investment.

The picture is remarkably similar to 1992. More than a year after a recession ended in March 1991, unemployment continued to rise and the recovery was in constant danger of fizzling. "Our economy is struggling and the American dream is in trouble," then-candidate Bill Clinton declared in Detroit in August 1992. Weakened by bad loans, banks were starving the economy of credit. That December, the purchasing-managers survey found manufacturers planning to increase capital investment a paltry 2% in 1993.

Things turned out much differently. At the end of 1993, manufacturers had actually boosted capital spending 9%. An eight-year investment boom that would fuel the longest U.S. expansion on record, driving unemployment and inflation to 30-year lows, began just as Bill Clinton was attacking the first President Bush for overseeing a sick economy.

"Once we get past a couple issues, like the threat of war, I think we have that kind of expansion in front of us again," says Norbert Ore of Georgia Pacific Corp., who oversees the Institute for Supply Management survey.

Even industries hit hardest are showing signs of life. Between 1996 and 2000, easy financing and an economic boom prompted thousands of trucking operators to expand fleets and lured others into the business. Monthly heavy-truck production responded, nearly doubling to over 25,000 a month between 1996 and 1999, says A.G. Edwards & Sons' analyst Donald Broughton. When recession and rising fuel prices hit two years ago, trucker bankruptcies soared and truck production fell 50%.

Higher Rates

The disappearance of scores of struggling trucking companies is finally allowing survivors to push up shipping rates. "A lot of capacity has gone out of the market place," says Chris Lofgren, chief executive of Schneider National Inc., one of North America's biggest truckers. "For the ones left standing, the supply demand mix has tightened up." For the first time since 1999, Schneider, a closely held company based in Green Bay, Wis., expanded its fleet in 2002, adding about 1,000 trucks to its 12,000-unit fleet. In 2003, it plans to complement that with more trailers.

Truck and engine manufacturers anticipated that sales would fizzle after new emissions guidelines boosted engine prices after Oct. 1. In October, Caterpillar Inc. said it would lay off up to 3,270 employees in anticipation of a sharp drop in orders for heavy-duty engines. But orders have held up better than expected. Caterpillar says not all those workers had to be laid off after all, and December's seasonal plant shutdowns were one to two weeks shorter than planned.

Improved profit margins are allowing Schneider to budget 25% to 50% more in 2003 to upgrade its computer and information systems which will, among other things, enable it to keep better track of its trucks and thus keep them fuller going to and from railway terminals.

Capital spending is vital to the economy's long-run health. The more businesses invest, the standard economic textbook predicts, the faster productivity—or output per hour of work—will grow. The 1990s boom in investments in new technology, from computerized machine tools to supply-management software, contributed to a surge in productivity that led many economists, Mr. Greenspan among them, to mark up their estimate of how fast the economy can grow over time without driving up inflation—typically to about 3.5% a year from about 2.5%.

Increased productivity lets businesses pay higher wages and earn more profits without raising prices. For now, the late-1990s productivity revival appears to be intact: Productivity grew faster over the past 12 months than any time since 1973.

But for it to continue, businesses will have to resume investing. That is starting to happen, as it becomes harder to postpone investment. Like their counterparts elsewhere, many midlevel managers at Bank One have been stretching their computers' lives. They figured, "Sure, the PCs are a little old, but they've been getting the job done, I'll wait another year to buy new PCs," says Austin Adams, chief information officer.

But at the same time, the bank has become ever-more-dependent on technology. It now has 85 personal computers per 100 employees, up from 54 in 1998. In 2002, the bank decided it would save money and boost productivity by adopting a companywide policy of replacing each computer every three years. Since many are already more than three years old, Mr. Adams figures he will have replaced 40% of the bank's PCs by the middle of 2003.

Ultimately, business executives will spend if they're confident their customers will, and many are now finding it harder to justify cutbacks. At Carlson Cos., a closely held group whose properties range from T.G.I. Friday's to Radisson Hotels & Resorts, jobs and salaries were cut when tourism and business travel fell off dramatically after last fall's terrorist attacks.

"But this last quarter, it's started to ease up because some of our groups are growing," says Marilyn Carlson Nelson, chief executive of the Minneapolis company. Hiring has picked up at restaurants and hotels. Last year, in cruise bookings, "everyone took salary decreases because we couldn't use the number of people serving on the ship," says Ms. Nelson. But as of the third quarter, "they're now back at full salary because cruise bookings are up." Meanwhile, Stephen Brown, Carlson's chief information officer, says the budget for new "strategic" technology projects is rising to $16 million this year from $6 million last year, in part because profits have improved.

Carlson isn't ignoring the storm clouds. It has built several scenarios for war with Iraq into its plans, ranging from a war lasting a few days to one lasting more than six months. In the best case, all of 12 strategic technology projects planned for next year can go ahead. In the worst case, the four most-important projects will still proceed.

Coming Back

Capital goods shipments, excluding defense and aircraft, percentage change from previous year

Source: Department of Commerce

CORRECTIONS & AMPLIFICATIONS

IN THE DEC. 11 initial public offering of **Seagate Technology**, shares were priced by the company's underwriters at $12 apiece, a dollar below the estimated range of $13 to $15 a share. A Money & Investing article yesterday incorrectly reported the offer price as $11 a share and the intended range as $12 to $14 a share.

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UNDERWRITING RANKINGS in the Year-End Review published yesterday contained incorrect information about leading bond underwriters in 2002. A corrected table appears on page C5.

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TOTAL CASH COSTS for mining an ounce of gold at **Newmont Mining** Corp. have fallen to $184 in 2001 from $220 in 1996. An article yesterday incorrectly reported that cash costs were $184 in 2002.

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A PAGE ONE ARTICLE Tuesday on energy trading misstated the names of two restaurants. The correct names are Pappas Bros. Steakhouse and Zula, not Pappa's Bros. Steakhouse and Zula's.

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THE MAJOR STOCK INDEXES table published yesterday contained incorrect data on 52-week highs and lows. A corrected table appears today on page C2.

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THE AMERICAN ASSOCIATION of Airport Executives is a professional organization for airport operators. A Marketplace article Tuesday on background checks in the transportation industry incorrectly referred to the group as the American Association of Airline Executives.

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