Journal Report: Scotland places big bets on tidal and wave power

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What's News

U.K. output slid 1.9% in the first quarter, its biggest fall in 30 years, and Spain's jobless rate soared to 17.4%, underscoring the pain sweeping Europe as the global financial crisis takes hold. Page 8

■ **Developing nations** are pushing new IMF bonds as part of a strategy to boost their influence. Page 3

■ **European stocks** have suffered by comparison to their counterparts in Asia, but some money managers say there are still reasons to buy. Page 19

■ **Pakistan battled** Taliban near Swat, testing a truce in the valley. The U.S. is looking to expedite $1 billion in aid to the government. Page 12

■ **Several U.S. banks** are under pressure from the government to increase their capital reserves as a result of recent "stress tests." Page 22

■ **GM is intensifying** its efforts in China even as its other international units are struggling. Page 5

■ **Ford logged** a smaller-than-expected loss and said it doesn't expect to need a U.S. government loan. Page 4

■ **Volvo swung** to a first-quarter loss and reduced its forecast for sales of heavy-duty trucks in Europe and North America. Page 5

■ **Safran will buy** an 81% stake in GE's Homeland Protection unit for $580 million, furthering its diversification from jet propulsion. Page 6

■ **Clinton met** with Lebanon's president in a show of U.S. support ahead of polls pitting Western-leaning politicians against Hezbollah. Page 12

■ **South Africa's ANC won** a big majority in national elections, but was shy of the two-thirds majority it needed to govern unopposed. Page 8

■ **Iceland elected** the coalition of left-leaning parties that has been running the interim government. Page 9

■ **Partial results pointed** to a big victory for the candidate from Putin's party in a mayoral vote in the Russian city of Sochi, an election official said.

■ **Ethiopia arrested** 35 people suspected of a coup attempt allegedly backed by an Ethiopian economist now teaching at a U.S. university.

■ **An Italian cruise ship** fended off a pirate attack far off the coast of Somalia.

EDITORIAL & OPINION

Ottoman ghosts
Turkey and Armenia end nearly a century of estrangement. Page 15

Breaking news at europe.WSJ.com

Swine flu threat spreads

WHO, U.S. hold off on declaring a pandemic as Mexican death toll climbs

By Betsy McKay

Global public health officials mobilized Sunday to combat the spread of a deadly new strain of flu, as the locations of reported possible cases stretched from New Zealand to the U.S. and the death toll in Mexico rose to more than 80.

The World Health Organization and U.S. officials held off on declaring the new strain of A/H1N1 swine flu to be a pandemic, saying they need to learn more about its severity and spread. But governments intensified surveillance for the disease—which can be hard to distinguish because its symptoms are glaringly similar to those of seasonal flu—and took steps to halt its further spread.

In the U.S., the Obama administration declared a "public health emergency," with 20 cases confirmed from New York to California, and warned there are likely to be more, including possible cases of severe disease. The Centers for Disease Control and Prevention said Sunday it has sent teams to California, Texas and Mexico to assist with investigations.

It isn't clear so far why the U.S. swine-flu cases identified so far have shown mild symptoms, while Mexico has experienced severe disease. WHO and CDC officials said further testing of viruses and more surveillance is likely to yield more clues.

New evidence emerged Sunday that the disease has spread. Spain's health minis-

Please turn to page 31

Agence France-Presse

A family wearing preventive masks walked past an image of Our Lady of Guadalupe, patron saint of Mexico, at the Guadalupe's Basilica in Mexico City Sunday.

U.S. rally can't live on a diet of trash

By Tom Lauricella

Trash is king.

The biggest winners since the U.S. stock market bounced off 12-year lows in early March have been the most beaten-down names, which, in the eyes of many investors, also have the riskiest outlooks. This winners list has been dominated by financial stocks, many of which have more than doubled in value in just a month and a half.

While such a junk-stock rally after a massive selloff isn't unusual, some say the rebound is either going to have to change in character to be led by higher-quality companies or else will falter amid continuing headwinds on earnings and the economy.

At the very least, the rally caught many investors flat-footed. It had been a widely held view that the best place to be whenever stocks recovered would be high-quality companies with the resources to tough out an extended difficult economic environment. Despite missing the biggest gainers in the bounce, those with a "quality" focus say they are sticking with it.

"By far and away the strength has been in financials and consumer" stocks, notes Neil Hokanson, a Solana Beach, Calif., adviser. "And when we look at the underpinnings in both of those areas

Please turn to back page

Fear and casualties mount at epicenter

By David Luhnow and José de Córdoba

MEXICO CITY—The death toll in Mexico from the new and deadly type of swine flu continued to rise on Sunday, with as many as 81 people believed to have died from the virus and new cases reported in other parts of the country.

Mexico City, epicenter of the outbreak and home to 20 million people, looked like a ghost town as most residents took refuge indoors. Church services in the city were canceled—the first time anyone could remember that happening in this heavily Roman Catholic nation. The Mexico City archdiocese told its faithful to pray for the city and the flu victims.

Many restaurants and movie theaters closed their doors, city parks looked desolate, and normally bustling city streets had only a few dozen cars.

"The city is paralyzed, what are we going to do?" said Marta Robles, a middle-aged housewife who went to a local pharmacy to buy a surgical mask. The pharmacy was sold out.

While the death toll could be as high as 81, laboratory tests have confirmed only 20 deaths caused by the new virus so far. Government health officials are testing the rest of the cases, but believe the majority were

Please turn to page 31

Inside

Raising Bill Gates

His father describes turning an unruly child into billionaire

News in Depth, pages 16-17

Markets

	CLOSE	PCT CHG
DJIA	8076.29	+1.50
Nasdaq	1694.29	+2.55
DJ Stoxx 600	195.82	+2.26
FTSE 100	4155.99	+3.43
DAX	4674.32	+3.00
CAC 40	3102.85	+3.13
Euro	$1.3257	+1.57
Nymex crude	$51.55	+3.89

LEADING THE NEWS

IMF gets money, politically perilous tasks

Warning systems, new credit lines keep pressure on the body

By Bob Davis

WASHINGTON—International Monetary Fund officials were nearly giddy in early April when they learned that leaders at the G-20 summit backed a fourfold increase in fund resources to $1 trillion. During a press briefing, IMF Managing Director Dominique Strauss-Kahn used the phrase “the IMF is back” six times.

But at the IMF’s spring meeting this past weekend, reality set in.

THE OUTLOOK

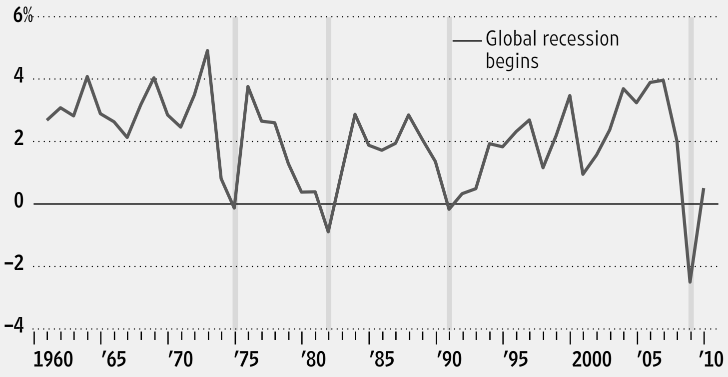
In exchange for the money, the IMF has been handed tough assignments in fighting the global recession and staving off another one. The work will require a political dexterity and willingness to stand up to powerful IMF members that the fund has rarely shown in the past.

“There’s been a huge expansion of IMF resources and huge attention to the IMF, but nothing has been done to make members fear IMF surveillance” or oversight, says Adam Posen, deputy director of the Peterson Institute for International Economics, a Washington think tank.

About $500 billion of the new funds are earmarked for the IMF’s main job of bailing out troubled countries. The IMF has introduced a credit line that doesn’t require borrowers to make the kinds of painful economic changes—cutting spending, slashing subsidies—that have turned the IMF into political poison in much of Latin America and Asia. Mexico, Poland and Colombia have signed up for the credit line.

The great recession

IMF data say the current global recession is the worst since World War II. Inflation-adjusted per capita world gross domestic product, change from the previous year:



Notes: Purchasing-power-parity weighted. Data for 2009 and ’10 are forecasts.

Source: International Monetary Fund

The new facility has won plaudits from some developing countries, but the IMF will still have to make tough political calls. Only nations ranked highly by the IMF can qualify for credit line. The IMF often forces other borrowers to cut spending or raise interest rates even if that deepens a downturn, though the IMF has taken steps to protect some programs for the poor.

The disparate treatment has prompted complaints in Turkey, Pakistan, Eastern Europe and elsewhere that the IMF is playing favorites, and it may lead to pressure on the fund to ease its standards. The World Bank has tried to reduce the effect of the budget cuts by financing infrastructure projects that otherwise might be jettisoned.

Pressure on the IMF will ramp up when it must decide whether to renew the credit lines after their one-year terms. Saying “no” would undermine a country’s economic standing; saying “yes,” if the country’s policies don’t warrant it, would undermine IMF credibility.

“Countries that have these facilities would be well advised not to use them,” said Montek Singh Ahluwalia, deputy chairman of India’s planning commission and a former IMF official. That way countries can boast that IMF credit lines give them extra resources, but they wouldn’t become too dependent on fund money.

The IMF is also taking on a politically fraught new assignment: providing early warnings of problems that could explode into another crisis. IMF economists are examining which economic indicators signal asset bubbles are forming, and they are assessing how political or economic decisions in one part of the world could produce problems elsewhere.

The fund is now conducting what it calls a “dry run” of the system, which it plans to have working by the IMF’s fall meeting in Istanbul in October. “The IMF is trying to assess vulnerabilities across [financial] instruments, across borders and across industries,” said Egyptian Finance Minister Youssef Boutros-Ghali, who heads the top IMF advisory board.

Some nations worry that the IMF will mistakenly diagnose potential problems, forcing countries to choose between ignoring the warning or adopting policies the IMF suggests, which could choke off economic growth. “If you cry wolf once and the wolf doesn’t show up, it will cost people a lot of money,” Mr. Boutros-Ghali said.

How will the IMF get its members to take its warnings seriously? Friday at the School of Advanced International Studies, Mr. Strauss-Kahn talked tough. “Early warnings must be strong, candid, credible and even-handed,” he said. “They must not shy away from naming and shaming”—citing specific countries—“where appropriate.”

But Mr. Strauss-Kahn didn’t commit to making the early-warning exercises public, and staffers say they doubt the IMF will. Instead, the IMF economists plan to deliver the news to financial officials as part of private consultations—the same formula that has led to IMF recommendations being ignored in the past.

Last spring, the U.S. Treasury shelved an IMF plan to recapitalize banks without paying it much attention. Earlier this year, the European Union blew off an IMF proposal to have struggling Eastern European countries devalue their currencies and adopt the euro. In both cases news of the IMF proposals leaked to the media well after they could have made a difference if they had been well publicized. It may take public disclosure of the warnings to get the attention of policy makers and markets, especially in wealthy nations that don’t rely on the IMF for loans.

Brazilian Finance Minister Guido Mantega says the old patterns may be breaking down because of the severity of the current global downturn, which started in the U.S., spread to Europe and then tanked developing countries. The rich countries realize they made many errors, he says, and will be more amenable to IMF advice even if it’s made privately. “Even advanced countries will submit to oversight from these [international financial] institutions,” he said.

Some nations worry that the IMF will mistakenly diagnose potential problems.

The U.S., for instance, has said it would ask the IMF to do a broad review of the U.S. financial system—after years of avoiding such a review. If that’s a precursor of a new attitude, the G-20 embrace of the IMF will have changed the global economic system perhaps even more than it expected to do.

CORRECTIONS & AMPLIFICATIONS

United Technologies Corp. Chief Financial Officer Gregory Hayes said that while orders for the conglomerate are still down, “they have stabilized across the businesses. For the full year, we still expect a better back half.” In a Corporate News article on the U.S. economy Thursday, the quote was incorrectly attributed to Chief Executive Louis Chênevert.

American Electric Power Co., **Hewlett-Packard** Co., **Home Depot** Inc. and **Tiffany** & Co. have reduced or eliminated tax reimbursements for senior executives on company-provided perquisites. A chart accompanying a Money & Investing article Wednesday detailed payments in 2008 to the chief executives of those companies, but didn’t make clear that such payments would be reduced or eliminated in the future.

INDEX TO BUSINESSES

This index of businesses mentioned in today’s issue of The Wall Street Journal Europe is intended to include all significant references to companies. First reference to these companies appear in boldface type in all articles except those on page one and the editorial pages.

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INDEX TO PEOPLE

This index lists the names of businesspeople and government regulators who receive significant mention in today’s Journal.

For more people in the news, visit CareerJournal.com/WhosNews

BRICs look to build more leverage at IMF

Offer to buy bonds is part of a strategy to have a bigger say

By Bob Davis

WASHINGTON—A push by Brazil, Russia, India and China to have the International Monetary Fund issue its first bonds has become part of a strategy by developing nations to gain a bigger say at the IMF.

At the fund's annual spring meeting, the four countries said they were willing to contribute to a quadrupling of IMF resources to $1 trillion, mostly by purchasing bonds. The bonds would be denominated in the IMF's quasicurrency, called special drawing rights, have a maturity of a year or so, and be sold only to central banks. If the so-called BRIC countries have their way, the bonds could also be sold on secondary markets to make the instruments more liquid.

The proposed purchase is meant to send a double message, said Eswar Prasad, a former IMF official who remains close with the Chinese and Indian officials: The BRIC countries are willing to contribute to the IMF, but they won't contribute heavily to longer-term fund resources until the IMF increases their voting shares substantially. "They don't want to get locked into providing more money until they get their [shares] increased," Mr. Prasad said.

The issue of voting rights and IMF bonds were at the forefront of the IMF meetings, where discussions also explored the state of the global economy and providing support for low-income countries.

In a statement Saturday to the IMF's main advisory committee, Brazilian Finance Minister Guido Mantega said the IMF "still has to address its original sin: its democratic deficit." Egyptian Finance Minister Youssef Boutros-Ghali, the chairman of the advisory group, said in an interview that he wants to get national leaders involved in remaking the IMF voting system. IMF voting shares are supposed to generally reflect global economic power but now give far greater weight to countries that were powerful after World War II, especially smaller European ones.

In March 2008, after lengthy negotiations, the IMF announced that developing nations' voting shares would increase by 5.4 percentage points and said it would look again at the subject in 2013. For Brazil, that

Voting rights and the IMF bonds were at the forefront of weekend meetings.

meant its voting share increased by 0.3 point to 1.7%. China's voting share was boosted 0.9 percentage point to 3.8%. Even those increases haven't yet gone into effect. (The voting rights for Belgium and the Netherlands equal China's, even though China is a much larger economy.)

The IMF now is committed to revisiting the issue in 2011. But the BRIC countries believe the IMF's need for funds gives them additional leverage. At the summit of leaders of the Group of 20 industrialized and developing nations early this month, British Prime Minister Gordon Brown said China was ready to lend the IMF $40 billion. But China never committed to that amount and is now balking, said IMF and other finance officials.

Instead, the Chinese are looking at contributing perhaps half that much, which would be in line with its voting share, and providing additional money through bond purchases. The latter are seen as less significant by the IMF because they are for a limited time. Brazil, India and Russia also are pushing bond purchases.

The U.S. generally backs the BRICs' effort to get greater representation. But some U.S. officials believe the BRIC bond strategy could backfire because they would be seen to have played politics rather than contributing fully to the IMF during an economic crisis. Indeed, Western European countries, which have pledged $100 billion to the IMF, are now considering boosting that amount to $160 billion, one official said, in part to help justify Europe's bigger stake in the IMF.

Nearly every IMF plan to revamp the voting structure foresees a smaller role for European counties, especially smaller ones like Belgium and the Netherlands. In an interview with Reuters, Belgian Finance Minister Didier Reynders said that the country should keep its seat on the IMF's 24-member governing board because European countries contribute heavily to the IMF.

Marketplace

Sports volley

A media executive serves up what he hopes to make a new craze: ping-pong > Page 29

CORPORATE NEWS

Chrysler debt talks benefit Fiat

Amid creditors' concessions, the Italian auto maker wouldn't need to put capital at risk

Chrysler LLC's lenders continued to soften their stance toward a debt-restructuring plan with the U.S. Treasury, concessions that lenders say are proving most beneficial to a player not even in the room: Italian auto maker **Fiat** SpA.

By Jeffrey McCracken, Kate Linebaugh and Stacy Meichtry

The lenders said Friday that they would trim their $6.9 billion in secured debt to $3.75 billion, down from a $4.5 billion offer made Tuesday. The creditors dropped their request for $1 billion of preferred stock in Chrysler and a separate request that Fiat put $1 billion of cash into Chrysler as part of an alliance between the car makers, people familiar with the matter said.

The lenders stayed firm in their request to keep 40% of the equity in a restructured Chrysler, said a person familiar with the matter. That leaves the lenders and the government still far apart on the main terms: The government wants the lenders to keep just $1.5 billion of the debt and 5% of the equity of a revamped company. The government has set a Thursday deadline to determine the auto maker's fate.

Debt holders have expressed agitation about Fiat, itself weakened by the global recession. As designed, the Turin, Italy, company would get 20% of the auto maker without putting a dollar of its own capital at risk. Fiat's main commitment to Chrysler would be to provide some technology and to share the guts, or platforms, of certain models.


Agence France-Presse

An assembly line producing the Fiat 500 in Poland

The U.S. government already has agreed to forgive the $4 billion it lent Chrysler and to inject a further $6 billion into the auto maker to finance its possible bankruptcy filing and operations. Most important to Chrysler's health, the government has negotiated a deal with the United Auto Workers union that should reduce the company's pension and health-care costs.

For the lenders, the fear is that Fiat doesn't have enough at stake in the negotiations, given it will likely assume day-to-day control of the company without putting up its own money.

Several lenders said their concern is Fiat will overcharge Chrysler for new technologies or parts. It could also make in-kind equity contributions to build up its equity stake if it does decide Chrysler has a future.

This is why lenders' proposals to the government have demanded senior management appointees, governance provisions and technology transfers that are acceptable to them. The lenders also are pushing for a board seat and rights to oversee how Fiat governs the company.

The financial stakes are greater for the lenders, the U.S. government and the UAW. Each could lose billions of dollars if Chrysler can't eventually pay its bills or its equity stake turns out to be worth little.

"Fiat is getting a good deal," said Aaron Bragman, an analyst at IHS Global Insight.

Ford targets rivals as it posts $1.4 billion loss

By Matthew Dolan

Ford Motor Co., reporting a smaller-than-expected loss for the first quarter, said it likely wouldn't need a government bailout. But it warned that an uncontrolled bankruptcy reorganization of **General Motors** Corp. or **Chrysler** LLC could change that by taking down their shared networks of suppliers and dealers.

Chief Executive Alan Mulally said "we do not expect to require a bridge loan from the U.S. government." His optimism reflects Ford's effort to remake itself as a leaner car company without government oversight.

Ford posted a net loss of $1.4 billion, or 60 cents a share, a reversal from net income of $70 million, or three cents a share, a year earlier. But the loss was lower than analysts expected and a marked improvement from the $5.5 billion Ford lost in the fourth quarter. Revenue fell 37% to $24.8 billion.

The results reflect in part Ford's strategy: Steal customers from its weakened crosstown rivals and separate Ford from GM and Chrysler in the minds of the public, investors and lawmakers.

The strategy is part of a longer-term vision that would have Ford rise above its age-old competitors to form a new, global Big Three with the two largest car makers, **Toyota Motor** Corp. and **Volkswagen** AG, people familiar with the company's thinking said.

In its earnings report, Ford offered a glimpse at the latest thrust in its strategy. The company said it will boost production of midsize sedans such as the Ford Fusion, raising its overall U.S. production estimate for the first time in 15 months. The additional cars will help step up its drive to grab customers and market share from GM and Chrysler, which are slashing production.

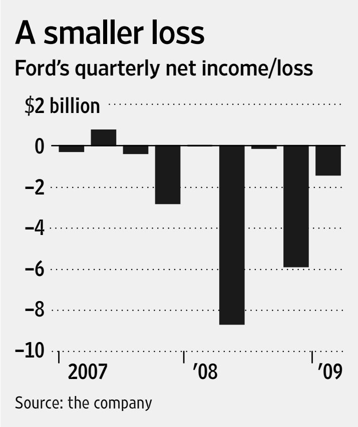
In certain U.S. markets, Ford has been offering $1,000 in "conquest cash" to customers who trade in Chrysler vehicles. Its dealers also are running ads to emphasize how it differs from the other two.

One ad placed by Chicago-area dealers argues that "Ford's progress in the past two years demonstrates why it doesn't need a bridge loan from Congress."

Chrysler and GM owners "have been defecting to Ford and Lincoln-Mercury products in great numbers since the beginning of the year," Amanda DeMouthe, a marketing manager for Ford's Northeast operations, wrote in an April 9 email to dealers.

Independent numbers seem to back up Ms. DeMouthe's assertion. In March, 48% of Ford buyers turned in cars or trucks of other manufacturers, up from 38% in August, according to Edmunds.com, an auto-shopping Web site.

Meantime, the "conquest rate" for GM's Chevrolet was 47% last month, down from 49% in August, and for the Chrysler brand the rate was 59% last month, down from 67% in August, according to Edmunds. GM said the data are consistent with its own numbers. "Regardless of the swing, Chrysler's conquest rate is 59%—the highest of the three companies—we are pleased," a Chrysler spokeswoman said.



Still, Ford isn't out of the woods. Its monthly sales have fallen year over year by more than 40% for the past three months. Since Mr. Mulally became CEO in 2006, the company pulled back from its promise to return to profitability in 2009 and has lost $31.4 billion. Ford insists it's on track to break even in its North America operations by 2011.

The fate of Chrysler, which could fall into a managed bankruptcy by this week, is another pressing concern. A similar fate hangs over GM, which has until the end of May to secure givebacks from its unionized workers and debt holders or face getting cut off from additional government loans.

Even a managed bankruptcy at GM or Chrysler could disrupt the industry's supply chain, triggering plant shutdowns, including at Ford. A person familiar with the matter said Ford has drawn up a list of critical suppliers to decide which ones it would prop up under that scenario and which ones to pull out of in favor of a more stable competitor. "The health of the supply base is probably the most critical issue as the government helps GM and Chrysler restructure," Mr. Mulally said Friday.

Just six months ago, fearful of an industry collapse, Ford appeared to be joined at the hip to its two main rivals.

In October, at a meeting of Detroit's three CEOs, Chrysler's Robert Nardelli and GM's then-chief, Rick Wagoner, asked Mr. Mulally to join them in Washington to present a united front in pleading for aid for Detroit, according to a person familiar with the matter. The Ford boss eventually agreed.

"There was a lot of debate back and forth but at the end of the day we said, 'Hey, listen, we need to show support to the industry,'" Mark Fields, Ford's president of the Americas, recalled in a recent interview.

Unlike his counterparts, Mr. Mulally didn't ask Congress for taxpayer dollars, but instead sought only a $9 billion line of credit in case the recession worsened significantly.

By late December, Mr. Mulally and his top lieutenants stopped talking publicly about their request for a $9 billion U.S. line of credit, concluding it tended to make Ford be lumped in with the more-troubled GM and Chrysler in the public's mind.

The company also realized it had to accelerate restructuring efforts to ensure Ford wouldn't have to seek a federal handout.

GM plans to junk its Pontiac brand amid cutbacks

By Sharon Terlep And John D. Stoll

General Motors Corp. is readying plans to ditch its fabled Pontiac, an 82-year-old division that last flourished selling sporty, muscle cars, people familiar with the matter said Friday.

During its heyday three decades ago, Pontiac was the launching ground for young auto designers and executives including John DeLorean. But its sales have tumbled 70% since their peak in 1978, and the unit in recent years has been a steady money loser.

GM has more than three months' supply of Pontiacs on dealer lots, according to Edmunds.com, an auto-shopping Web site. Last month, the average Pontiac sold for 22% off the sticker price, compared with the industry average of 16%, Edmunds said.

GM spokesman Jim Hopson said no final decision on Pontiac's future has been made. But he said nothing is guaranteed. "Everything has been put under review," Mr. Hopson said.

The auto maker, facing a June 1 U.S. deadline to dramatically restructure or go bankrupt, is expected to disclose this week that it will eliminate or sell Pontiac, according to several people who have been briefed on the plan. The decision comes as GM must show it can make cuts to win continued government financing.

GM had said it intended to keep one or two Pontiac models. But the Obama administration is pressuring GM to accelerate its downsizing. The auto maker is working on plans to sell or liquidate its Saturn, Hummer and Saab divisions. Each has received some interest from outside buyers, but it remains unclear whether any will survive.

GM's last automotive division to be eliminated was Oldsmobile in 2000. That decision cost GM billions of dollars in dealer-buyout costs, led to litigation and frayed many relationships with dealers and buyers.

"Disappointment is an understatement," Russ Shelton, owner of Shelton Pontiac Buick GMC in Rochester Hills, Mich., said of word of GM's decision.

Pontiac's first model was a 1926 six-cylinder roadster called the Chief of the Sixes. In following years, the brand became known for offering sporty V8 models that were cheaper than Buicks and used components from low-cost Chevrolets.

In the 1960s, the Pontiac GTO became the founding member of Detroit's horsepower wars. That car was created by Mr. DeLorean and introduced in the fall of 1963. Shortly thereafter, Ford introduced its Mustang and Chrysler its Plymouth Barracuda as responses to GM's hit coupe.

One of Mr. DeLorean's legacies—the so-called widetrack vehicle design—remains a feature of some Pontiac automobiles, and has played a role in its advertising messages.

In the 1970s, Pontiac went into decline as the Arab oil embargo drove up gasoline prices and consumers turned away from gas guzzlers. Pontiac enjoyed a brief resurgence during the 1980s when gas prices fell and GM accompanied its "Pontiac Excitement" marketing campaigns with smaller cars that had bigger engines, such as the Trans Am and Firebird.

FOCUS ON AUTOMOBILES

Volvo swings to net loss

Swedish firm lowers its truck-sales target amid weak demand

By Ola Kinnander

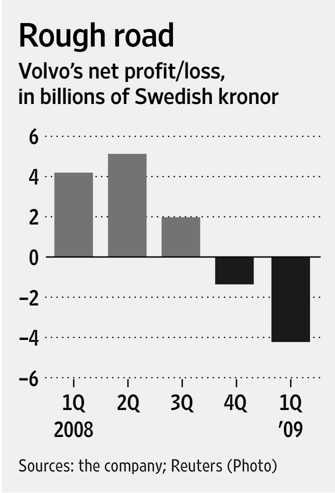
Truck maker **Volvo AB** said it swung to a first-quarter loss and signaled it doesn't expect a turnaround in the near future, in further signs that the economic downturn continues to hit the auto industry hard.

The company reduced its forecast for heavy-duty truck sales in Europe and North America, citing weak demand.

Volvo, the world's second-largest truck maker by sales after Daimler AG, posted a net loss of 4.23 billion Swedish kronor ($521.6 million), compared with a year-earlier net profit of 4.2 billion kronor. Revenue fell 27% to 56.12 billion kronor.

"Demand weakened sharply in all markets during the first quarter," Chief Executive Leif Johansson said, noting the Swedish company is slashing costs to better face the tougher market environment. "Against the backdrop of current macroeconomic conditions it is difficult to make forecasts, but taking into account the weak development at the beginning of the year, we are now reducing our forecast for markets in Europe and assess that the total market for heavy trucks will be at least halved in 2009," Mr. Johansson said.

The company had previously forecast this year's European heavy truck market to fall 40%. The North American truck market is likely to fall 30% to 40% in 2009, Mr. Johansson added.



Volvo Chief Executive Leif Johansson

The order intake for trucks "continued to be very weak" in the first quarter, Volvo said.

The company said the net order intake, which takes into account cancellations, plunged 65% from the first quarter of 2008.

In Europe, Volvo's biggest truck market, net orders for trucks dropped 71% to 7,494 vehicles. In Asia, net orders fell 70% to 5,712 trucks, and in North America they declined 49% to 2,869.

Volvo swung to an operating loss of 4.53 billion kronor from an operating profit of 6.49 billion kronor.

The company is slashing costs to better face the harsher market environment. It has given notice to 20,757 employees, temporary workers and consultants since the global financial crisis erupted last autumn. So far, 11,274 workers have left the company. It had 98,476 employees at the end of March.

The measures should save Volvo nine billion kronor annually, starting in "a few quarters," Mr. Johansson said.

Economic-stimulus packages from governments and falling interest rates should help demand recover over time, Mr. Johansson said. China's increased infrastructure investments "have led to improved demand for construction equipment there toward the end of the quarter," he said.

"Although these are positive signs, it is too early to talk about a sustainable recovery," he added.

White House tests auto workers

By Neil King Jr.

WASHINGTON—In its bid to fix **Chrysler** LLC, the Obama administration is championing a plan that exposes the United Auto Workers and its retirees to new risks.

The negotiations among the UAW, the administration and Chrysler are politically delicate for a White House that relied heavily on union support in key auto states like Michigan, Ohio and Indiana during the campaign.

Nonetheless, at both Chrysler and **General Motors** Corp., the administration is demanding sacrifices—including lower wages, significant job cuts and leaner benefits—that will probably diminish the UAW's clout in the industry and as a political force.

The UAW, particularly under President Ron Gettelfinger, has often remained silent during difficult bargaining as long as talks were making progress.

But "one of the real surprises here is that the Obama administration has taken an increasingly tough line with the union, and yet there has been almost complete silence from the UAW and the other unions," said Jonathan Cutler, a labor expert at Wesleyan University.

The Chrysler arrangement, tentatively backed by the UAW, seeks to protect retiree health-care benefits in part by granting the union a large equity stake in a restructured Chrysler. The company is expected to reorganize through Chapter 11 bankruptcy on the way to forming an alliance with **Fiat** SpA.

Ron Gettelfinger

Chrysler and the UAW agreed in 2007 that the auto maker would put $10.3 billion into a union-managed retiree health-care fund. Half of that would now be paid in equity, with the rest coming over time in cash, either from Chrysler or the U.S. Treasury Department, according to people familiar with the talks.

The deal carries significant risks for the UAW and its 255,000 Chrysler retirees. The cash payout will be in the form of a note that will come due over several years, while the equity portion can't be monetized for some time, people involved in the talks say.

"Who knows what equity in Chrysler is worth?" said one. "Regardless, there are steep cuts coming to UAW-Chrysler retirees."

The proposal to grant the UAW a large equity stake has stirred concerns among Chrysler's secured lenders. They question why the union should be given preferential treatment when bankruptcy law grants priority to the secured lenders. The administration this week offered to grant the lenders, including Citigroup Inc. and J.P. Morgan Chase, a 5% equity stake if they would cut 78% of their loans to the company.

Even less clear is what will happen on the pension front. Chrysler's pension is underfunded by about $9.3 billion, according to an estimate by the government's Pension Benefit Guaranty Corp. But it's unlikely Fiat would agree to take on those obligations as part of any alliance.

Should they fall to the federal government as part of bankruptcy or liquidation, Germany's **Daimler** AG, which owned Chrysler until 2007, could be forced to chip in $1 billion, as it agreed to do as part of its severance from Chrysler.

—Melanie Trottman and Jeffrey McCracken contributed to this article.

Kia reports profit amid weak won

By Kyong-Ae Choi

SEOUL—**Kia Motors** Corp. swung to a first-quarter net profit thanks to a weak won and domestic demand for new models.

Kia Motors—South Korea's No. 2 car maker after **Hyundai Motor** Co., which owns a 39% stake in Kia—posted a net profit of 97.4 billion won ($72.7 million), compared with a net loss of 24.8 billion won a year earlier. Operating profit fell 13% to 88.88 billion won because of higher overseas marketing costs.

Sales fell 5.8% to 3.502 trillion won from 3.719 trillion won.

Kia Chief Financial Officer Lee Jae-rok said that although the weak won and robust sales boosted profit, "market uncertainties continue to weigh on the automobile industry." The dollar rose 48% against the South Korean currency and the euro appreciated 27% in the first quarter from a year earlier, Kia said.

GM accelerates efforts in Chinese auto market

By John D. Stoll

General Motors Corp. is intensifying its focus on China as it edges closer to a bankruptcy filing in the U.S. and other international units sputter.

The auto maker, until recently the world's biggest by output, has remained a relative powerhouse in China thanks to a pair of partnerships: a joint venture with **Shanghai Automotive Industry** Corp. and a minority interest in microminivan maker **Liuzhou Wuling Motors** Co.

GM Chief Financial Officer Ray Young last week said that Wuling will eventually begin developing its own brand of ultrainexpensive passenger cars, representing a major step for a brand whose decades-old design primarily caters to Chinese farmers and other rural customers. Wuling's push into more consumer-oriented products also presents a considerable opportunity for GM, which has thus far relied on its mainstream Chevrolet brand as its low-cost car division in emerging markets.

Ray Young

Mr. Young said that even without a legitimate passenger car, Wuling's sales have increased tenfold in recent years and now represent more than a half-million sales annually, or more than all of GM's other brands combined in China. Wuling has a contract to build small Chevrolet vehicles for the Chinese market.

Mr. Young also said the auto maker is looking to expand its GM China operations beyond the nation's borders in order to boost its presence in the entire Asian-Pacific region. GM Asia Pacific President Nick Reilly in an interview Saturday said Wuling's plan to build passenger cars, which hasn't been announced officially, could be the key to making this happen.

Shanghai Automotive also owns a stake in Wuling, and Mr. Reilly said the three-way venture could be how GM plays a leading role in the government's mandate for its indigenous auto companies to become players on the global scene. "We'd rather it be us than someone else," Mr. Reilly said.

Historically, in order for outsiders to penetrate the Chinese market, they had to enter a partnership with a Chinese company. This arrangement has led to better quality and technology for Chinese auto makers and an inside track into the country's rapidly growing market for non-Chinese auto companies, such as GM, **Volkswagen** AG and **Toyota Motor** Corp., Mr. Young said.

Buzz concerning GM's China operations has faded in recent months as the auto maker has been forced to rely on $15.4 billion in U.S. loans and billions more from other governments. GM's once-thriving **Daewoo Motor Sales** Corp. operation in South Korea and its businesses in Russia and Latin America have fallen on hard times because of a global downturn. The auto maker is likely to report continued losses in each of these operations when it reports first-quarter earnings in May.

Given the hardships of GM's other units and the rapid evolution of the Chinese auto industry, GM China is now considered to be among the company's most important ventures and one of the few units in the company that could survive the current economic crisis without major damage. GM's Opel division in Europe and its Latin America operation are being considered for partnership with **Fiat** SpA and other suitors.

While other global operations struggle, GM China, in existence for little more than a decade, is growing. It is adding plant capacity, plans to increase its stake in Wuling from about a third to nearly a half and is seeking other partnerships. The company plans dozens of vehicle introductions over the next five years, and eventually aims to introduce a version of the Chevrolet Volt electric car in the country.

While GM doesn't own a controlling stake in Wuling, underestimating the unit's importance to the Detroit auto maker would be a mistake. Mr. Young said the Wuling operation is GM's "lowest-cost operation in the world" and it has become the company's global benchmark on production costs.

"To win globally, we must win in China," Mr. Young told a small audience at a Chinese business luncheon in Detroit last week. His comments came as other GM executives and leaders from dozens of other global auto makers were assembled in Shanghai for an annual auto show.

China is expected to become the world's No.1 vehicle producer this year, surpassing Japan. Mr. Young said he is starting to think China could outmuscle the U.S. this year as the No.1 market for vehicle sales. GM had been predicting China would surpass the U.S. in 2015, but Chinese sales leapfrogged those in the U.S. in the first quarter.

Maruti Suzuki India posts loss

By Santanu Choudhury

NEW DELHI—Maruti Suzuki India Ltd. posted its fifth straight drop in quarterly net profit as higher raw-material prices and a foreign-currency loss outweighed higher car sales.

Maruti, which makes one in every two cars sold in India, said net profit slid 19% to 2.43 billion rupees ($49 million) in its fiscal fourth quarter, which ended March 31, from 2.98 billion rupees a year earlier. Net sales, which subtracts India's excise duty on production from gross sales, climbed 32% to 63.08 billion rupees.

"The cumulative impact of the adverse forex-exchange movement, both direct and via vendor imports, impacted our profit," said Shinzo Nakanishi, Maruti's managing director and chief executive.

Maruti, the biggest overseas unit of Japan's **Suzuki Motor** Corp., gained from lower borrowing costs and higher demand for its Swift and A-Star small cars.

Prices of key raw materials, such as steel and aluminum, began to decline earlier this year amid the global recession, but their costs still remained high, company executives said. Maruti made a fourth-quarter provision of 1.21 billion rupees for mark-to-market loss on dollar-rupee derivatives. The rupee fell 3.9% against the dollar in the quarter.

CORPORATE NEWS

Safran to buy GE unit

Aerospace company to acquire 81% stake in security business

BY WILLIAM HOROBIN AND SCOTT THURM

PARIS—French aerospace manufacturer **Safran** SA said it agreed to buy an 81% stake in **General Electric** Co.'s Homeland Protection unit for $580 million in cash.

For Safran, the deal furthers its diversification from jet-propulsion activities into such areas as maintenance and service.

For GE, the deal is largely an exit from a business it entered following the Sept. 11, 2001, terrorist attacks but which proved disappointing.

The Homeland Protection business focuses on explosive and narcotics detection. GE entered the business with its 2002 acquisition of Ion Track Inc. for an undisclosed amount and the 2004 acquisition of InVision Technologies Inc. for $900 million.

InVision made bomb-detection equipment used in airports and reported 2003 sales of $416 million. GE on Friday said the Homeland Protection unit had revenue of $260 million last year. The deal values the unit at $716 million, roughly 20% less than GE paid for InVision alone.

A GE spokeswoman said the company had bought into the security business "at the peak" following the Sept. 11 attacks but that the market is now "more normalized." She said the valuation was relatively high compared with other recent deals in the security industry.

GE and Safran have worked together for more than 30 years, including a joint venture that produces the highly successful CFM commercial-jet engine.

The acquisition "makes Safran a pivotal player in the security market," said Safran Chief Executive Jean-Paul Herteman. He said he hoped to build the security business to 20% of Safran's revenue within a decade, from 8% now.

GE will retain a seat on the board and a 19% stake in the unit after the deal, which is expected to be finalized by midyear.

GE said the stake would allow it to swap technology between the security business and its health-care and research units.

GE also maintains the remainder of its security division, which offers alarm systems, access control and video and generates more than $1 billion in annual revenue.

GE in 2007 agreed to sell 64% of the Homeland Protection unit to Smiths Group PLC as part of a deal in which GE acquired the British company's aviation unit.

The companies abandoned the Homeland security part of the deal later that year.

Bloomberg News

Safran CEO Jean-Paul Herteman said he hoped to build the security business to 20% of revenue from 8%. Above, the company's Paris headquarters in 2006

Oil-patch profits will offer clues on cost control

BY RUSSELL GOLD

The market will get a daily reminder this week that the days of record-setting oil-industry earnings are over—for now. On successive days, beginning Tuesday, **BP** PLC, **Royal Dutch Shell** PLC, **Exxon Mobil** Corp. and **Chevron** Corp. will report results for what is expected to be the worst quarter for these profit machines in many years.

"The biggest fall in quarterly earnings on record," analysts at Barclays Capital predicted for the European oil companies. Analysts' estimate for Exxon Mobil suggests a 58% drop in profits to $4.5 billion.

But the drop in first-quarter earnings isn't a surprise, with oil prices down about 55% from where they were a year ago. What remains to be seen is how good a job the oil companies are doing in driving down costs. Analysts and industry executives will be keeping a close eye on this.

Early reports have given mixed signals. Italian oil company **Eni** SpA said it wasn't seeing any real reductions in its cost of drilling wells. But **ConocoPhillips** was much more upbeat when it reported results Thursday, indicating that costs were coming down thanks to negotiations with contractors, eliminating overhead and, ironically, lower fuel costs helping it run refineries more cheaply. Most analysts were skeptical last month when ConocoPhillips promised to shave $1.4 billion off its costs this year, but the company said it had already found $400 million in savings.

Cutting costs is a "huge issue," said Jason Gammel, analyst with Macquarie Research. If oil companies can cut costs quickly, margins "won't contract as much as we would have expected in a low commodity price."

Margins and costs matter because oil companies will keep investing to produce more oil if they believe they can get a good return. If margins are being squeezed, that will lead to fewer wells drilled, less oil and gas—and higher prices down the road. So controlling costs won't just give analysts and executives a sense of when the days of fatter profits return; it also will indicate what oil prices might look like in coming months.

CORPORATE NEWS

Xerox ekes out a profit as revenue tumbles 18%

Forecast is slashed as weakness sets in across the board

By William M. Bulkeley

Xerox Corp., which last month slashed its outlook, reported a small first-quarter profit as revenue fell 18% due to plummeting sales of copiers and printers and declining use of ink, toner and paper.

The Norwalk, Conn., company reset expectations for the year, predicting net income of 50 cents to 55 cents a share for the full year. That would be about half of last year's per-share income of $1.10, excluding charges.

"Xerox saw weakness across the board, especially in developing markets," Chief Executive Anne Mulcahy said in a conference call.She said sales in places like Russia and Latin America, which had contributed strongly to growth last year, were down more than 30% because a lack of available credit has led both customers and distributors to stop replenishing inventories of ink and paper.

For the first quarter, Xerox reported net income of $42 million, or five cents a share, compared with a year-earlier loss of $235 million, or 27 cents a share, when a $866 million lawsuit settlement hurt results. Revenue was $3.55 billion, down from $4.34 billion.

Xerox also was whipsawed by currency fluctuations which contributed six percentage points to the revenue decline. The weakening of the euro and many Latin American currencies against the dollar reduced revenue from those areas.

The strength of the Japanese yen against most other currencies also hurt Xerox, because many of its low-end office machines are made by Fuji Xerox Corp. Xerox said restructuring charges at Fuji Xerox reduced its per-share earnings by two cents.

Ms. Mulcahy said Xerox saw few signs of an upturn in business, and that it is counting on the impact of its cost-cutting measures and seasonal increases in revenue from the low first-quarter base to allow it to report bigger profit in coming quarters.

Xerox shares were ahead 3.7% at $5.95 in 4 p.m. composite trading on the New York Stock Exchange.

Shannon Cross, president of Cross Research, said investors "were happy they didn't go cash-flow negative in the quarter and that they have enough cash flow for the year to cover debt, dividends and capital spending."

She added, "The underlying fundamentals remain pretty strong. The economy just has people not printing."

Xerox said it believes it is gaining market share against most of its competitors. It said its installed base of operating machines is continuing to grow, indicating that the revenue decline reflects reduced printing because companies are doing less direct-mail advertising and have fewer employees.

Steel-industry's troubles signal a likely shakeout

By Robert Guy Matthews

Weak demand is likely to lead to increased losses in the world steel industry next quarter, which could prompt consolidation, the shakeout of marginal players and lower prices, much of the industry now predicts.

"The demand for steel is virtually nonexistent," says Dan DiMicco, CEO of steelmaker **Nucor** Corp., which reported a $189.6 million loss and said it expected a wider loss in the second quarter.

Steelmakers were hoping the first quarter would be its worst, in terms of losses, for 2009. Early signs that the housing market would pick up, that stimulus spending for projects such as bridges would boost consumption, and that an auto bailout would shore up a key steel customer were taken as clues that the steel market was headed for a turnaround.

Moreover, other commodities, including copper, have begun showing signs of life. **Freeport McMoRan Copper and Gold** Inc. said it expects copper prices to rise compared to the first three months of this year due in part to lower world inventories.

Prices of nickel and lead also appear to be firming.

To be sure, the price of all these commodities is much lower, often in the range of 50%, when compared to this time last year.

"As we have progressed from September 2008 to March 2009, we have seen business and market conditions worsen each succeeding month," Charlotte, N.C.-based Nucor said in a statement. "Entering the second quarter of 2009, both the U.S. economy and steel market conditions have continued to deteriorate."

Global crude-steel production fell in March in every major market, including China, which had increased production earlier in the year. The biggest drop was felt in North America, where production fell 52%, while Europe production fell 44%.

Nearly every major Chinese steelmaker has predicted losses for April, said Zhang Xiaogang, vice-chairman of the China Iron and Steel Association. Those losses are expected to continue, he said Tuesday.

Across Europe, steelmakers don't see an upturn anytime soon, Europe's steel association, Eurofer, said Thursday. "Orders intakes at EU steel mills are expected to be at an unprecedented low levels for the time being," Eurofer said.

GLOBAL BUSINESS BRIEFS

Randstad NV

Temporary-staffing firm posts loss amid deal costs

Randstad NV, one of the world's largest temporary-staffing companies, swung to a first-quarter loss as it struggled with the costs of a major acquisition amid the economic contraction. The net loss of €52.6 million ($69.7 million) compared with net profit of €75.1 million a year earlier, while sales rose 37% to €3.06 billion thanks to the purchase of Vedior NV in May 2008 for €3.5 billion. Randstad said that sales would have been down 28% if the companies had been combined in both years. "The markets of our clients are moving through violent patterns," Chief Executive Ben Noteboom said in a statement. But Mr. Noteboom added that demand for temporary workers is likely in the medium term, "immediately after the downsizing waves." The company said it couldn't rule out an even larger decline in like-for-like sales in the second quarter.

Eni SpA

Eni SpA, Italy's biggest oil and natural-gas company by market capitalization, said first-quarter net profit tumbled 43% amid lower crude prices and weaker hydrocarbon production. The Rome-based company said net profit dropped to €1.9 billion ($2.5 billion) in the first three months of the year, from €3.32 billion a year earlier. Net sales from operations fell 16% to €23.74 billion from €28.31 billion. Eni's hydrocarbon output for the quarter averaged 1.779 million barrels of oil equivalent a day, down 1% from the 1.796 million posted for the first quarter of 2008. Capital expenditure is forecast to be lower than €14.6 billion last year.

Ranbaxy Laboratories Ltd.

Ranbaxy Laboratories Ltd. reported a consolidated net loss of 7.61 billion rupees ($153 million) for the first quarter, hurt by currency fluctuations, a U.S. ban on some of its drugs and the global slowdown. Ranbaxy, India's largest drug maker by revenue, said excluding foreign-exchange losses and exceptional items, it had a loss of 262 million rupees for the latest quarter. It had a profit of 858 million rupees in the year-earlier quarter. The generic-drug maker, which is 64%-owned by Japanese drug firm **Daiichi Sankyo** Co., is vulnerable to currency volatility because of the high level of hedged positions on foreign-currency billings and the large size of its overseas loans.

TeliaSonera AB

TeliaSonera AB posted slightly lower first-quarter net profit amid restructuring charges. Net profit slipped to 4.44 billion Swedish kronor ($547.5 million) from 4.47 billion kronor a year earlier. The Stockholm-based operator booked 226 million kronor in charges, partly for restructuring at its mobility and broadband-services businesses. Sales rose 12% to 27.2 billion kronor. TeliaSonera said the economic downturn dragged down the average price it charged per minute in Kazakhstan, Azerbaijan and Georgia, while revenue from its operation in Turkey slipped 13%. The company said it now expects 2009 net sales to be around the same as last year when stripping out currency fluctuations and acquisitions. TeliaSonera had forecast net sales to rise this year. TeliaSonera's comments followed similar warnings from German rival **Deutsche Telekom** AG and Scandinavian rival **Tele2** AB.

Deutsche Lufthansa AG

Deutsche Lufthansa AG Chief Executive Wolfgang Mayrhuber on Friday reiterated the German flagship carrier's profit outlook for 2009, and said it needs to expand rapidly to survive in an increasingly competitive global market. Mr. Mayrhuber told shareholders at the annual meeting that Lufthansa expects its operating profit to decline considerably in 2009 from the previous year, but that it will remain "distinctively positive." He said it's difficult to give a concrete forecast for 2009, as demand for air travel and cargo continues to be weak. "However, even if the industry has forecast red figures, our aim remains a "distinctively positive [operating] result," Mr. Mayrhuber said. Mr. Mayrhuber pledged Lufthansa would continue with strict cost management and further capacity cuts.

Ingka Holding BV

Home-furnishings maker Ikea on Friday named Mikael Ohlsson as its new president and chief executive. Mr. Ohlsson will take over from Anders Dahlvig, who is stepping down on Sept. 1 after 10 years as the head of the company. An Ikea veteran, Mr. Ohlsson started out in the carpet department of a store in the Swedish city of Linkoping three decades ago, the company said. In the past 15 years he has worked as regional retail manager for southern Europe and North America. Goran Grosskopf, chairman of the group's parent company, Ingka Holding BV, called Mr. Ohlsson "a great ambassador of the Ikea culture." Founded in 1943 by Swede Ingvar Kamprad, Ikea now employs about 128,000 people and owns 262 stores in 24 countries.

Valeo SA

French auto-parts maker **Valeo** SA swung to a first-quarter net loss, forcing it to slash 2009 investment by a third and to cut the year's planned spending by €600 million, or about $800 million. Paris-based Valeo posted a net loss of €159 million compared with a €43 million net profit a year earlier. Sales dropped 33% to €1.62 billion from €2.4 billion. Cost-saving measures disclosed Friday build on a plan from the end of last year to cut head count by 5,000 people, which saved €183 million in costs in the first quarter. While reiterating that global automotive production would tumble 30% in the first half and 20% over the year, the company said the rate of decline should be less pronounced in the second quarter. Yet, Chief Executive Jacques Aschenbroich said it was unlikely Valeo could recoup in the second quarter the ground it lost in the first, making break-even results questionable.

3M Co.

3M Co. reported lower profit for the first quarter, and the diversified manufacturer cut its full-year outlook amid weak demand. Chairman and Chief Executive George W. Buckley said 3M expects the recession in the U.S. to reach its bottom by the end of the third quarter. He said Asia will likely help lead the world out of the slump. The Minnesota-based company said first-quarter net income fell 47% to $530 million, or 74 cents a share, from $1.01 billion, or $1.38 a share, a year earlier. The latest results included seven cents a share in restructuring charges. Revenue fell 21% to $5.09 billion. The company now expects 2009 earnings of $3.90 to $4.30 a share. In January, 3M had lowered its projections to earnings of $4.30 to $4.70 a share.

Honeywell International Inc.

Honeywell International Inc. reported a 38% drop in first-quarter profit, and the diversified manufacturer lowered its full-year outlook, noting slumping markets for business jets and automobiles. Dave Cote, Honeywell's chairman and chief executive, told investors on a conference call that he was "embarrassed" about the projection cut. "It's not going to happen again," he said, adding that business appears to be stabilizing. Honeywell finance chief Dave Anderson said the company's very profitable commercial aerospace and turbo units have experienced steeper-than-expected drops in demand.Net income fell to $399 million, or 54 cents a share, from $647 million, or 85 cents a share, a year earlier. Net sales decreased 15% to $7.57 billion.The company expects 2009 earnings of $2.85 to $3.20 a share, down from a previous projection of $3.20 to $3.55.

Schlumberger Ltd.

Schlumberger Ltd. said its first-quarter net income fell 30%, as oil-services revenue suffered from a sharp drop in U.S. natural-gas drilling and prices, weak activity in Russia and the effects of a stronger dollar. Producers have cut back on drilling as low oil and gas prices have left many projects unprofitable. As of early April, the number of drilling rigs in the U.S. was off by more than half from September at 975, according to Baker Hughes Inc., the first drop below 1,000 since 2003. Schlumberger reported net income of $940.4 million, or 78 cents a share, down from $1.34 billion, or $1.09 a share, a year earlier. Revenue decreased 4.5% to $6 billion. Chief Executive Andrew Gould said the company doesn't expect a significant recovery in North American gas drilling before next year. He added that Schlumberger's customers overseas are seeking and obtaining lower prices.

Beijing Airport

Beijing Capital International Airport Co., which operates the airport in China's capital, said its 2008 net profit fell 92% as operating expenses jumped. The company, listed in Hong Kong, said net profit fell to 85.3 million yuan ($12.5 million) from 1.13 billion yuan a year earlier. Revenue rose 31% to 4.62 billion yuan. Beijing Airport said earlier its operating costs rose substantially after the $3 billion third terminal at the Beijing airport started operation at the end of March 2008. Beijing Airport had agreed to pay its parent 26.9 billion yuan for the new passenger terminal and related assets, or 22% more than expected, because of revised valuation of assets and interest costs.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

U.K., Spain underscore Europe's woes

Bigger-than-expected GDP fall casts doubt on Britain's ability to pay for bailout; Spanish jobless hit 4 million

The U.K.'s economy took its worst dive in 30 years and Spain's jobless rate soared to nearly one in five, underscoring the pain sweeping across Europe as repercussions of the global financial crisis take hold.

*By **Alistair MacDonald** and **Laurence Norman** in London and **Thomas Catan** in Madrid*

Britain's economic output shrank by 1.9% in the first quarter of 2009 from the fourth quarter of last year, the government said in a preliminary report—significantly more than economists had expected and the fastest rate of contraction since 1979, when Prime Minister Margaret Thatcher came to power.

The plunge raised fresh concerns about the U.K.'s ability to handle the mounting costs of its financial and economic bailouts. Compared with a year earlier, the U.K. economy shrank by 4.1%. That cast doubt on an official projection last week that the economy will contract by only 3.5% in 2009 and rebound quickly enough to help the government get its stretched finances under control.

In Spain, the unemployment rate jumped to 17.4% at the end of March from 13.9% three months earlier, piling pressure on the government to take fresh action to stem job losses. Figures from the Spanish Statistics Institute on Friday showed that a record four million people were out of work—a level the government had repeatedly said it wouldn't reach.

"Things are looking pretty bad," said 33-year-old Alberto Zamarro, who was laid off eight months ago from an information-technology company serving Spanish banks. "I've tried finding other jobs in my field. If I don't find one soon I'll have to try anything, work waiting on tables."

The dismal news in the U.K. and Spain highlights how troubles in financial services and real estate are crippling economies that had depended heavily on those sectors for growth. The U.K., with a capital city that serves as one of the world's premier financial hubs, has depended on financial services for one in five jobs and more than a quarter of its tax revenues. Spain's construction sector swelled to account for almost a fifth of the economy.

CW-25>The worsening picture comes at a time when countries across Europe are seeing a rise in uneasiness related to economic malaise. Worker protests in France have sometimes become violent, and union leaders in Germany have warned that their country could be next if layoffs mount.

In the U.K., wildcat strikes have protested the hiring of foreign workers and anger over bankers' hefty pay packages recently materialized in an attack on the Edinburgh home of former Royal Bank of Scotland CEO Sir Fred Goodwin. In the first set of official quarterly crime figures since the recession began, the government Thursday announced personal thefts in the last quarter of 2008 rose by 25% from the year-earlier quarter and that burglaries rose by 4%.

The economic decline is taking a toll on the private charities that supplement the U.K.'s social safety net to help the poor and underprivileged. Sheila Davidson, who helps to run the Bridge Women's Education Centre, a charity in northern England, said donations are dropping off and women are no longer enrolling for courses as they tighten their belts.

"All in all, it is very dim out there," Ms. Davidson said.

The economic data from Europe aren't all bad. German business confidence improved at the start of the second quarter after hitting a record low in March, a survey from Germany's Ifo Institute showed Friday. A report from the Centre for Economic Policy Research and the Bank of Italy showed that the euro-zone economy contracted in April, but at a slower pace than in March.

Economists are also seeing some positive signs in the U.K. Banks are lending more, real-estate agents are reporting increasing inquiries about house buying, and retail sales have held up better than expected. On Friday, data showed seasonally adjusted retail sales rose 0.3% in March from February.

Still, the plunge in first-quarter gross domestic product presents a challenge for the U.K. government, which is taking on debt at a rate not seen since World War II, as it spends money to cushion the downturn and salvage its banking system.

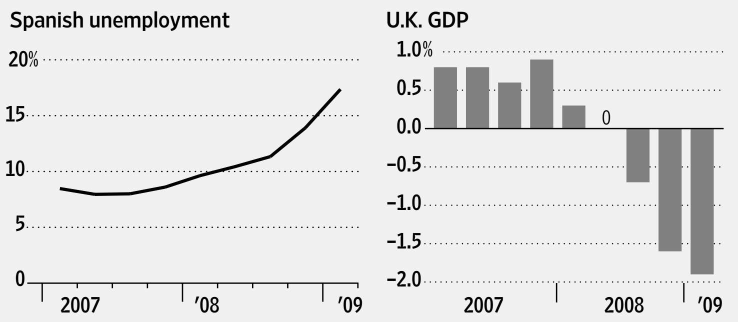
Over the next three years the government's net borrowing requirement will be £488 billion ($718 billion). Having announced limited tax rises and spending cuts last week, Treasury chief Alistair Darling is counting on a swift return to growth to bring in revenue that would help pay back the debts. Friday's data make it less likely that the economy will meet Mr. Darling's forecast of a 3.5% contraction this year, followed by above-consensus growth of 1.2% in 2010 and 3.5% in 2011.

In Spain, unions called for the Socialist government to increase spending and extend unemployment benefits. Finance Minister Elena Salgado said there are signs the government's fiscal stimulus is starting to work and predicted the rate of job losses will slow.

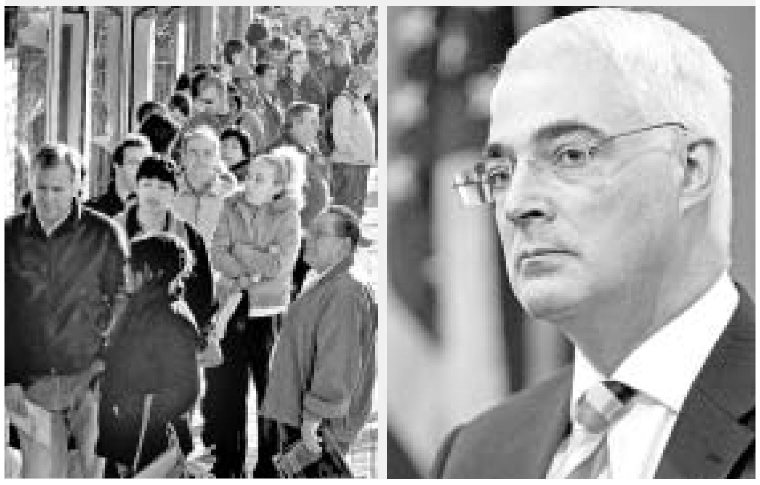
The Spanish government has put in place one of the biggest packages of tax cuts and spending in Europe relative to the size of its economy, sending its accounts deep into the red. Last week, the IMF forecast that the Spanish economy will shrink by 3% in 2009 and by 0.7% in 2010. It predicted that unemployment will rise to 19.3% next year.

Deepening gloom

Spain's jobless rate soared higher as the U.K. economy posted its largest quarterly contraction since 1979.



Sources: Spain's National Statistics Institute; U.K. Office for National Statistics



Photos: Reuters

The line at a jobless center in Madrid, and Alistair Darling, the U.K.'s Treasury chief

South Africa's ANC faces new test

BY SARAH CHILDRESS

PRETORIA, South Africa—The ruling African National Congress won a huge majority in last week's national elections on a platform that vowed to create more jobs and improve basic services. The challenge now: to deliver on those promises amid grim economic conditions and without its previous dominance in parliament.

The ANC won 65.9% of the vote, which translates to 264 of the 400 seats in parliament—just three seats shy of the two-thirds majority it needed to govern unopposed. Still, the tally is a solid victory for the ANC. Its leader, the populist Jacob Zuma, is to be sworn in as the next president in May.

Jacob Zuma

Mr. Zuma and his team will take office at a difficult time for South Africa. The economy contracted at the end of last year for the first time since 1998. It is expected to shrink again this year, by 0.3%, according to the latest projections by the International Monetary Fund. The manufacturing and mining sectors have been hit hard amid falling demand for commodities and exports. (Please see related story on page 25.)

Domestic problems abound. Many poor South Africans lack basic skills needed to compete with immigrants for scarce, lower-level jobs. Crime remains a problem, education and health care need reform, and infrastructure, particularly energy, is in dire need of investment.

The ANC has promised a massive infrastructure-spending bill, which it hopes will also help fuel growth in the economy and lure private investment. It also is counting on a boost from the mining industry's gold, diamonds and platinum operations, which haven't been hit as hard by falling prices.

Mr. Zuma lost many votes in the white and business communities, which fear a left-leaning government. Many of them voted to check his power, whittling down the ANC's tally.

The Democratic Alliance, the main opposition party, received the second-largest number of votes, 16.6%, and 67 seats in parliament. It managed to wrest from the ANC one province, which includes Cape Town. In third place, with 7.42%, was the upstart Congress of the People, formed by disgruntled ANC members who left the party late last year. The Cope party will take 30 seats in parliament.

Mr. Zuma sought to reassure these voters directly in his first address to the nation, after the results were announced on Saturday, promising to be a "president for all."

"There will be no surprises in the next administration's program of action," Mr. Zuma said. "The electorate has endorsed our call for an equitable, sustainable and inclusive growth path that will bring decent work and sustainable livelihoods."

He declined to address cabinet posts until they are officially announced—likely this week—but said he will appoint "quality people" and be "tough on performance." Whomever he appoints, Mr. Zuma will have to establish a delicate balancing act to appease the conservative business community as well as his power base, the unions and the Communist Party. His advisers are well aware of the need to cater to all sides.

Mr. Zuma is expected to ask Finance Minister Trevor Manuel to become the head of a new planning commission that would be tasked with setting economic policy. Local newspapers speculated Sunday that high-powered businessmen Cyril Ramaphosa and Tokyo Sexwale might also be tapped for the commission, a strong signal to reassure the business community and foreign investors. But Mr. Zuma also will have to incorporate members of the left.

The independent electoral commission and independent observers praised the vote as free and fair. Turnout was just more than 77%.

U.S. Treasury Chief Geithner casts a darker tone than G-7

BY DEBORAH SOLOMON

WASHINGTON — U.S. Treasury Secretary Timothy Geithner said Friday that the world's economies are beginning to stabilize but cautioned that it is "too early" to say risks have receded and that more action needs to be taken to counteract the worst financial crisis in generations.

"Financial conditions in some markets have shown modest improvement," Mr. Geithner said, adding that it would be "wrong to conclude that we are close to emerging from the darkness that descended on the global economy early last fall."

The secretary struck a more somber tone than a statement released by the Group of Seven finance ministers who gathered in Washington before weekend-long meetings at the International Monetary Fund.

In their statement, the finance ministers said "the pace of decline in our economies has slowed and some signs of stabilization are emerging. Economic activity should begin to recover later this year amid a continued weak outlook, and downside risks persist."

The finance chiefs pledged to continue efforts to shore up financial institutions across the globe, including providing "liquidity support," injecting capital into banks and taking "all necessary actions to ensure the soundness of systemically important institutions." The group also promised to "deliver the scale of sustained fiscal effort necessary to restore growth."

Mr. Geithner said the ability of other countries to shore up their economies is critical to the U.S. recovery. "Recovery in the U.S. depends significantly ... on recovery in those large and previously rapidly growing markets," he said. Some economists worry about growth in Europe.

The meeting took place the same day the U.S. released the methodology behind stress tests it is conducting on the nation's 19 largest banks. The tests are part of the U.S. response to the financial crisis, which includes capital injections into banks, efforts to help distressed homeowners and a plan to purge toxic assets from bank balance sheets.

Mr. Geithner said he "did not discuss the preliminary results" of the stress tests with his counterparts but said they all agreed to make sure there's "enough capital in the financial system." Mr. Geithner has pledged to make enough capital available so banks can resume making loans.

Germany's FDP gains amid economic crisis

By Marcus Walker

BERLIN—Around the world, the economic crisis is raising doubts about unfettered markets and leading to more state intervention in the economy. But in Germany—a country long skeptical of freewheeling capitalism—one winner amid the fallout from the crisis is a political party that believes in freer markets and smaller government.

The Free Democratic Party, whose credo is getting the state off the back of the individual, is riding high in opinion polls. It has notched up successes in recent regional elections, and has good chances of entering government in Germany's national vote this September.

The FDP is benefiting from the fact that Germany's two large ruling parties, Chancellor Angela Merkel's conservative Christian Democratic Union and its partner the Social Democrats, have backed away from business-friendly policies and shifted to the left.

"In this context many citizens find it refreshing that the FDP has remained in the center," says the FDP's leader, Guido Westerwelle, in an interview. His party currently enjoys the support of 14% to 16% of voters, according to recent opinion polls. This is up from the FDP's 9.8% support in Germany's last election in 2005.

What Mr. Westerwelle calls his party's "center" stance has long appeared to many Germans as a right-leaning economic policy of tax cuts and deregulation that would mainly benefit high earners. The FDP's image as a rich people's lobby helped keep the party's share of the vote low in the 1990s.

Today, however, many middle-class voters are concerned about the state's expanding role in the economy in response to the crisis, on top of longstanding grievances over Germany's high and complicated taxes and its jungle of bureaucratic red tape.

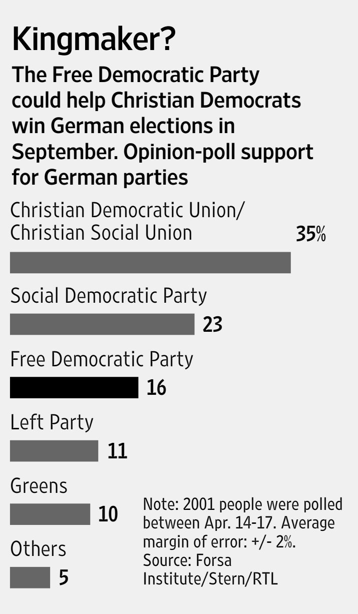
The result could be that the FDP, which aims to form a pact with the Christian Democrats, helps Ms. Merkel to win the election and to escape her awkward coalition with the left-leaning Social Democrats. A conservative-FDP coalition could tilt Germany back toward an overhaul of its tax system and welfare state, although the long recession, big budget deficits and divisions in Ms. Merkel's camp could limit the scope for cutting taxes.

Mr. Westerwelle, a youthful-looking 47-year-old trained lawyer, is expected to become foreign minister in any FDP-Christian Democrat government.

However, both parties would have to maintain their current opinion-poll support to achieve a majority in parliament. In the past two elections the Christian Democrats' support faded badly shortly before polling day, thanks partly to campaign blunders and disunity. Ms. Merkel's conservatives are still squabbling over their party's course, especially on the economy.

The FDP doesn't correspond to either major political party in the U.S., but is typical of liberal parties in Europe, where the word "liberal" denotes both free-market economics and left-leaning social policies that stress diversity and tolerance.

The FDP, for instance, supports minority rights, higher immigration and curtailing the state's powers of surveillance. Mr. Westerwelle, who would be Germany's first openly gay foreign minister, has said he would cut development aid to countries that persecute homosexuals. But what's winning the party new supporters is Mr. Westerwelle's attacks on the government for its high tax-and-spend policies.



Ms. Merkel, constrained by her coalition with the left-leaning Social Democrats, has made little progress in addressing middle-class frustration with heavy taxes and bureaucracy. Her involvement in increased state intervention in the economy during the current crisis, including costly bailouts of banks and subsidies for Germany's struggling automakers, was the final straw for many middle-class voters and small-business owners, who now say they will vote for Mr. Westerwelle.

The FDP has become the protest party for longtime Christian Democrat voters as well as moderate Social Democrats who are disillusioned with their parties' leftward drift, says Manfred Güllner, head of the Forsa Institute, a Berlin opinion-polling company. "The FDP's main strength is simply that it exists, not its specific policies or its personnel," he says.

In contrast, the economic crisis hasn't benefited German left-wing groups, such as the post-communist Left Party. Despite its questioning of capitalism, voters don't believe the Left Party has the answer, Mr. Güllner says.

Mr. Westerwelle has qualified his past deregulation rhetoric, and says he wants a "strong state" in areas where it is needed, such as banking supervision. Government has become "big in the wrong areas," he says. The role of the state should be that of a strict referee who sets and enforces clear rules, but doesn't get involved in the economy as a player.

For example, the FDP opposes the government's buying a stake in car maker Opel, the German-based unit of **General Motors** Corp. Ms. Merkel's government is under pressure from labor unions to help Opel with taxpayer money if a new private-sector investor can't be found.

"The German government should have used this crisis to do urgently necessary things like reducing bureaucracy and obstacles to investment to trigger growth," says Mr. Westerwelle. The recession is a good opportunity to cut and simplify taxes on middle and lower income earners, he says. "People who work should no longer be the fools of the nation," he says.

Iceland takes a left turn

Interim coalition duo beat conservatives ousted in February

By Charles Forelle

Agence France-Presse

Interim Prime Minister Jóhanna Sigurdardóttir, Iceland's Social Democrat leader, celebrates victory with teammates and supporters after Saturday's elections.

A coalition of left-leaning parties won elections in Iceland on Saturday, decisively beating conservatives who have dominated the island's politics for two decades and are widely blamed for the meltdown in its banking system last fall.

The Social Democratic Alliance will hold 20 seats in the 63-seat parliament, and its coalition partner the Left-Green Movement will hold 14, giving the two parties an outright majority, according to results as of Sunday afternoon from state broadcaster RUV.

Together, the two parties took slightly more than half the popular vote. The coalition has been running Iceland on an interim basis since February, when economic turmoil forced out the conservative Independence Party prime minister and his government.

Interim Prime Minister Jóhanna Sigurdardóttir, 66 years old, of the Social Democrats, will keep the top job.

"The nation is settling the score with the neo-liberalism, with the Independence Party, who have been in power for much too long," Ms. Sigurdardóttir, a former flight attendant, union organizer and long-time politician, said at an election celebration Saturday, according to the Associated Press.

The Independence Party received about 24% of the vote and 16 seats in parliament, its worst showing in at least 45 years. Since the early 1990s, the party had presided over a wave of privatizations—including in the banking sector—that energized Iceland's stodgy, state-dominated economy and created an economic boom.

But when the banks, swollen after several years of rising lending, collapsed in the credit crunch in October, public opinion rapidly turned, and voters on Saturday punished the Independence Party at the polls. Iceland's gross domestic product is forecast to contract 10% this year, and unemployment shot up to 7.1% in the first quarter, more than triple the rate a year ago.

The win by the left-wing coalition could also move Iceland closer to joining the European Union—a major goal of the Social Democrats.

The Left-Greens have resisted EU membership, but smaller, pro-EU parties also scored well in Saturday's elections; that could provide the Social Democrats with backing for an EU push.

JOURNAL REPORT: ENERGY

BP executive focuses on biofuels' future

U.S. operations chief draws on experience he gained in Russia

By Ángel González

In January, oil giant BP *PLC appointed Lamar McKay, an experienced Russia hand, to head its operations in another key energy-producing trouble spot—the U.S.*

BP runs the two largest oil fields in the U.S., and its U.S. operations account for about 40% of the company's global business. BP America is still recovering from a recent string of high-profile incidents ranging from a lethal explosion at its Texas City refinery to federal charges of propane-market manipulation and operational problems in Alaska and the Gulf of Mexico. Last month, the federal government and the state of Alaska sued BP for civil damages over two 2006 oil spills in the North Slope.

Mr. McKay also is taking the helm as a new U.S. administration seeks to give alternative energy a solid footing, an effort that creates uncertainties for fossil-fuel producers.

Mr. McKay has dealt with tough issues before. As head of BP's special-projects unit, he was key last year in defusing a dispute between BP and its Russian partners in TNK-BP, a massive integrated oil and gas joint venture.

And BP has long invested in alternative energy, including various ventures and a $500 million grant to fund the Energy Biosciences Institute, a U.S.-based research organization created in 2007.

Mr. McKay recently spoke with The Wall Street Journal about the challenges and opportunities of his new position. Following are edited excerpts:

THE WALL STREET JOURNAL: Why does the U.S. play such a big role for BP?

MR. MCKAY: One reason is heritage. We've got a portfolio that's been built over 100 years. The other reason is future opportunity. There's still a lot of potential in deep water—technology is allowing a lot of things that were not imaginable 10 years ago. We're really pleased Thunder Horse [an oil platform in the deep waters of the Gulf of Mexico] began producing last year. It's been doing tremendously well—about 300,000 barrels of oil equivalent per day. It's the second-largest oil field in the U.S. Other opportunities exist in unconventional natural gas and in Alaska [where BP operates the largest oil field in the U.S., Prudhoe Bay].

WSJ: Do you expect that role to increase in the future?

MR. MCKAY: We like the investment opportunities in the U.S. We're investing roughly $6 billion a year. We plan to continue to invest at that same level.

WSJ: Your new role coincides with an administration seriously embracing alternatives to fossil fuels. What do you think of this environment?

MR. MCKAY: We believe that the best thing for the country is a diverse energy portfolio. We're convinced there is not an either/or solution—it will take all forms of energy to make this country work.

We're investing not only to grow oil and gas production and increase the efficiency of our refineries, but also in what we think are the alternative energy technologies that are the most likely to succeed.

WSJ: Some policies to raise revenue—partly to fund alternative-energy initiatives—target oil and gas producers. What effect will the administration's proposal to repeal longstanding tax breaks for the oil and gas industry have on energy investments?

MR. MCKAY: Increasing taxes on the industry, especially at a time when it is under a lot of stress, has the potential to reduce investment and domestic energy production.

The marginal areas will be the most affected. Companies like us will, to the extent possible, try to invest through the cycles, because we have strong balance sheets, but small companies could be hurt even more.

WSJ: The Obama administration seems intent on creating a comprehensive method to reduce greenhouse-gas emissions—most likely a cap-and-trade system. How will you adapt to it?

Julian Puckett

Lamar McKay

MR. MCKAY: We favor cap and trade, but we favor cap and trade that is implemented with an understanding that it takes time. The details are extremely important. It needs to the broad and market-based, so that there's not undue distortion [in the way emissions rights are distributed]. You can't flip a switch and make this work overnight.

WSJ: Do you think it could change the economics of the oil and gas industry?

MR. MCKAY: Undoubtedly it would, in some ways, but it's hard to predict how. It could change investment patterns as we search for the most efficient reductions in CO_2 emissions. It could change consumer patterns, as citizens make more-informed choices on their carbon footprint. Those choices could transform how we balance investments in oil and gas production and refining.

This will be one of the most complicated systems ever put in place in terms of the interaction of industry, consumers and energy provision—everything will be affected. That's why taking things in steps and phases, with the ability to adjust, is an important component of whatever comes out of this.

WSJ: You had an interesting job in Russia, negotiating on behalf of BP in a tough environment. What lessons are you bringing here from that experience?

MR. MCKAY: I learned that if you have a real ability to listen, hear and understand, and the pragmatism to form some sort of agenda with common goals, people can work out virtually any problem. We have been successful in Russia; we had our problems, and we've been able to work through these things.

I see parallels with difficult issues in the United States. There are staunchly divided positions in the U.S. right now—about what's right for the country, where our energy should come from and the type of economy we want to have.

Not everything can be solved at once. One has to have the pragmatism to take things one step at a time and try to move forward together.

WSJ: What are the biggest challenges facing a company like BP in the U.S. right now?

MR. MCKAY: Being able to get the cost structure in line so that the industry can be healthy with the oil and gas commodity prices we see today.

We must also strive to match our investment patterns with changes in regulatory and legislative areas. We invest with a 10- to 15-year time horizon for the bigger projects, so anticipating and understanding the shape energy policy is going to take is important.

We must be able to [communicate] our experience in energy markets and production so that the pace of policy matches the pace of technology.

WSJ: Starting in 2005, BP suffered a series of mishaps and setbacks, ranging from a lethal explosion in its Texas City refinery to a spill in Alaska to a three-year delay in Thunder Horse, your highest-profile project in the U.S. What lessons have you learned from those incidents?

MR. MCKAY: These were terrible events that we think about every day and which are the catalyst for major change at BP. We have learned that consistency, rigor and constancy of operating standards is important and that accountability must be clear. So we are implementing a new system of processes and standards by which we operate, with better ways to identify risks, manage work in our facilities and make sure that our processes and standards are applied consistently.

The statistics [incident rates, employee surveys] show improvement as we work to ingrain this in the culture of the company. I am really proud of what has been done. But let me also be clear, we've still got a long way to go.

WSJ: A lot of people seem to have given up on biofuels, thinking that low oil and gas prices make them less competitive, and it's still very difficult to mass-produce them. Yet in February BP invested in a $45 million venture with Verenium to build a cellulosic-ethanol plant in Florida. Is it just an expensive way to kick the tires, or are you really interested in biofuels?

MR. MCKAY: We're seriously interested in biofuels. Brazilian ethanol works—we have a joint venture in Brazil that is probably going to expand to a very, very significant project over time, a world-scale kind of project. It works there because you've got adequate rainfall and land for a use that does not compete with food crops, and you've got an infrastructure and automobile fleet that uses it.

We are also working on a better molecule called biobutanol. It has higher energy density, closer to gasoline than ethanol. It is also less corrosive, easier to mix with gasoline and easier to distribute.

With Verenium, we're [building a commercial-scale plant] in Florida using feedstocks that are not competing with food. We're committed to getting that project going. We're also very serious about research at the Energy Biosciences Institute.

WSJ: Won't the automobile fleet leapfrog the biofuel stage to go electric?

MR. MCKAY: There is still a lot of mileage—no pun intended—to be gained by moving to smaller, lighter vehicles and smaller engines. That would be the most cost-effective way of saving fuel. Hybrids, running on batteries and gasoline, are also feasible. Biofuels complement both of those. We see improved technology in gasoline and the increased use of diesel, biofuels and hybrids as big pragmatic steps along the way to a less carbon-intensive fleet.

There's always future electrification, but you run into really big infrastructure issues when you cross that bridge. I don't think the leapfrog will necessarily happen, because other solutions are more cost-effective.

China targets UHV power lines

By David Winning

China wants to use melting snow on the Tibetan Plateau to power neon lights more than 1,500 kilometers away in Shanghai. And to make that vision a reality, it is dusting off a 40-year-old technology for moving electricity—ultra-high-voltage power lines.

UHV lines can not only carry more electricity than regular lines but also move it vast distances with less loss of power. That makes UHV ideal for bringing electricity from remote areas, such as hydropower projects in the foothills of the Himalayas, to China's eastern urban centers.

A number of countries gave the idea a test run decades ago, but improved technology has made it a lot more practical—and attractive. Now China is betting that UHV can solve its massive energy dilemma. Most of the nation's resources, such as coal and hydropower, are located far from the booming cities that need electricity most.

The developments are being closely watched around the world. "I would expect that the more countries use renewable energy," the more they look to UHV technology, says Daniel Assandri, senior vice president and head of the power-system division for ABB Ltd. in China and North Asia, which is working on China's UHV project.

China's proposed network will cover 90,000 kilometers and allow up to 6.4 gigawatts of power to be transmitted on each line—equivalent to nearly two-thirds of the entire generating capacity of Singapore. State Grid Corp., one of two state-owned power distributors, has said it is seeking regulatory approval to spend as much as $14.6 billion over the next three to four years to roll out UHV power lines.

It's an ambitious plan, but China is in urgent need of an upgrade. According to a 2007 report by the International Energy Agency, China needs to invest $1.51 trillion in its grid through 2030 to accommodate soaring demand for power. And the potential power sources are far from the growing eastern cities where electricity is needed.

Two-thirds of China's coal deposits are concentrated in a handful of inland provinces, more than 1,000 kilometers from the manufacturing hubs of the Pearl River Delta. Government planners want power generators to build plants closer to coal supplies and then ship their electricity via the grid.

China also wants to make better use of its renewable-energy resources, particularly hydropower, but two-thirds of its dams are located in distant southwestern provinces such as Yunnan and Sichuan. Hydropower currently accounts for nearly a fifth of China's electricity generation, but much of it is used locally rather than shipped to cities because the grid is inadequate.

The quest to transmit electricity greater distances at higher voltages dates back decades. Governments and utilities began to look seriously at the problem in the aftermath of World War II as a way to meet rising energy demand.

Conventional transmission lines, which use alternating current, can carry up to 500 kilovolts of energy from power plants to substations for distribution. But they're limited in how far they can transmit power, typically up to about 850 kilometers. And they lose a significant amount of power—about 7% of capacity—in transit.

In looking for an alternative, engineers tried a couple of different paths. One was direct-current power lines, which can transmit electricity at greater distances than AC lines, with less power loss. But many utilities felt DC lines were too expensive because they required converter stations to turn the power to AC so it could be distributed to utilities and consumers.

The other avenue of exploration was higher-voltage AC lines. They first appeared in Canada in 1965. The most progress was made in the Soviet Union. However, interest waned in the 1990s after the Soviet Union collapsed and power demand in Japan stagnated.

Improved technology has made UHV more feasible. For instance, insulators on UHV systems used to be made of porcelain. Now it's possible to use materials like silicone rubber.

China currently has only one functioning UHV line, a 1,000-kilovolt AC pilot project that represents the highest-voltage system operating commercially anywhere in the world. The line connects two big power grids: one in Shanxi province in northern China, which relies heavily on coal-powered plants, and another in the central province of Hubei, which has abundant hydropower resources, including the Three Gorges dam. The line enables power to be transferred between the grids whenever there is a shortfall in supply.

More UHV AC lines are planned, but Beijing concedes the technology isn't commercially viable yet. Suppliers haven't achieved economies of scale on core equipment, and the lines aren't yet carrying enough power to show real savings over conventional systems.