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BUSINESS & FINANCE 19

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Goldman backlash in Europe

Goldman Sachs Group Inc. is in danger of losing business with a key group of clients as a result of the fraud

By **Marcus Walker** in Berlin and **David Enrich** in London

allegations it faces: governments in Europe and the U.S. Politicians in the U.K. and Germany are starting to call on their governments to cut

ties with Goldman, which has long been one of the top financial advisers to European policy makers.

U.K. Liberal Democrat leader Nick Clegg, riding high in opinion polls less than three weeks before national elections, said Tuesday that Goldman "should now be suspended in its role as one of the advisers to the government until these allegations are properly looked into." His

comments follow Prime Minister Gordon Brown's recent characterization of Goldman's alleged behavior as "morally bankrupt."

"We should let the business relationship with [Goldman] rest until the allegations are cleared up," lawmaker Frank Schäffler of Germany's Free Democratic Party, part of Chancellor Angela Merkel's governing coalition, told German newspaper Handelsblatt

on Tuesday. Mr. Schäffler's office confirmed the comment.

The New York-based bank denies allegations by the U.S. Securities and Exchange Commission that it committed fraud by withholding important information from investors to whom it sold mortgage-related securities.

But the political backlash in Europe and the U.S. threatens to damage the network of political ties with policy mak-

ers that the bank has carefully built up on both sides of the Atlantic over two decades.

Goldman declined to comment on the European politicians' remarks. In a message to employees on Sunday, Lloyd C. Blankfein, Goldman's chairman and chief executive, said the bank was "taking all appropriate steps to defend the firm and its reputation."

Fair or not, the growing perception in Europe that

Goldman used cutthroat tactics to turn a profit could make it an unpalatable partner for politicians who are facing voter pressure to clamp down on risk-taking by the financial sector, analysts say.

The firm is among the

- Goldman's profit surged 91% in first quarter 3
- Goldman splits from pack on stock buybacks 36



An Icelandair plane takes off Tuesday from Glasgow International Airport traveling to Reykjavik in Iceland, as many flights resumed after volcanic ash disrupted air travel.

Airports reopen amid caution

By **DANIEL MICHAELS** AND **STEVE MCGRATH**

As planes began flying again across much of Continental Europe, airlines and airports ramped up calls for government help to offset massive financial losses they have suffered since a cloud of volcanic dust left planes grounded for five days.

European terminals began restoring service Tuesday, one day after European regulators agreed to a plan to reopen much of Europe's airspace. Britain's government late Tuesday announced a plan to reopen U.K. airports,

including London's Heathrow, at 9 p.m. local time Tuesday.

Eruptions of Iceland's Eyjafjallajökull volcano that started Thursday have left clouds of fine ash in the atmosphere, resulting in days of airspace closures across most of northern and central Europe. Some analysts said pressure from hard-hit airlines and stranded passengers had prompted regulators to venture into uncharted territory by allowing commercial operations in remnants of the volcanic cloud.

Some aviation officials expressed concern about allowing jetliners to fly without

more extensive analysis of the risks. "What's missing is some sort of standard, based on science, that gives an indication of a safe level of volcanic ash," said Bill Voss, president of the Flight Safety Foundation, a global nonprofit organization. "Lacking that, we're going to be trapped in a difficult debate."

Airlines, several of which in recent days have probed atmospheric conditions in test flights and said they found no problems, said they would fly only where conditions were deemed safe by national governments. European regulators agreed Mon-

day to divide each country's airspace into three zones—designated no-fly areas, buffer zones around them where flights are restricted and open airspace where flying is deemed safe.

Eurocontrol, which coordinates flights across 38 European countries, said almost 50% of flights operated across Europe on Tuesday. Since Saturday, flights had been running at around 30% of normal levels and more than 95,000 flights had been canceled, Eurocontrol said.

Pressure to restart flights was increasingly intense. More than eight million pas-

sengers have been affected and up to 313 airports closed, according to the Airports Council International Europe, a trade group in Brussels. Airline analysts estimate that European airlines' profits—already expected to be negative this year—are being reduced by more than \$100 million each day. European airports have collectively lost roughly €200 million (\$270 million), the Airports Council said.

- Bans hit world economy, turn Spain into a hub 6
- Passengers' dilemma: who wants to fly first? 7

U.K. data and volcano affect vote

New economic data scheduled to be released this week and the effects of the Icelandic volcano on voters could add more fuel to an already volatile British election battle.

On Tuesday, the Office for National Statistics said U.K. prices rose an annual 3.4% in March, up from 3.0% in February. That could put pressure on the Bank of England's view that inflation will ease later in the year.

Wednesday, March unemployment numbers are released and on Thursday, the ONS reports the final month of public-finances data from the 2009-10 fiscal year.

Tuesday was also the deadline for Britons to register to vote and to apply to vote by mail. Some travelers stranded overseas lost their opportunity to register.

If the disruption continues, some may not receive their absentee ballots or won't be able to return them on time.

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Editorial & Opinion

In man vs. the volcano, the smart money isn't on Eyjafjallajökull. Page 13

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PAGE TWO

Supreme Court ruling could spark deluge of non-U.S. class actions

[Agenda]

By BILL JAMIESON

Can U.K. and European investors gain legal redress through U.S. courts for corporate malpractice committed by a non-U.S. firm in America? And might charges brought by the U.S. Securities and Exchange Commission against Goldman Sachs unleash a cascade of such class actions by non-U.S. investors?

The case with potential watershed qualities that is being closely followed in international legal circles isn't in fact Goldman Sachs. It's an appeal that was heard in the U.S. Supreme Court last month. Judgment is due soon. It has important implications for non-U.S. shareholders and international public companies.

The case, *Morrison v. National Australia Bank*, marked the first time the Supreme Court accepted a case that involved transnational securities fraud and the extraterritorial application of U.S. securities laws.

"The Morrison case", says Thomas A. Dubbs, senior partner in New York legal firm Labaton Sucharow who has been leading the action, "focuses on the rights of non-U.S. citizens to invoke the protection of the U.S. law when alleged fraud occurred in U.S. territory."

"The decision in this case will obviously have implications that will be far reaching for such examples as the U.S. action against Royal Bank of Scotland," he said.

This week Mr. Dubbs together with senior representatives of the firm were in the U.K. meeting with institutional investors and pension funds in London and Edinburgh to explain the importance of the appeal and its implications for British investors.

The Morrison case was first



The Supreme Court in Washington, which agreed to an appeal over HomeSide.

brought by Australian investors in 2003 against NAB, based in Melbourne, Australia, and its Florida subsidiary HomeSide Lending.

HomeSide was at one time the sixth-largest mortgage-service provider in the U.S. with a \$186

A case with potential watershed qualities is being closely followed in international legal circles

billion mortgage book. Discovery of accounting fraud at HomeSide forced NAB to announce a A\$3.05 billion (\$2.8 billion) loss on the carrying value of HomeSide's operations, badly hitting the NAB stock price.

The case was originally dismissed by the federal court in New York City, which said it lacked jurisdiction. An appeal to the Court of Appeals Second Circuit won the support of the SEC, but was also dismissed on the grounds that the publication of false numbers by NAB in Australia was more central to the fraud than HomeSide's activities of "cooking the books" in Florida.

Labaton Sucharow then

appealed on behalf of foreign holders of NAB stock to the Supreme Court and an appeal hearing was agreed to this past November.

The case attracted no less than 18 supporting briefs filed by various governments, corporate entities and shareholder-rights organizations. The governments of Australia, France and the U.K. filed briefs supporting NAB. They argued that the appeal was an attempt at "f-cubed" litigation—a foreign investor buying a foreign security on a foreign exchange—and that private claims under U.S. securities laws should be limited to U.S. citizens who bought the stock on a U.S. exchange. The case for the appeal was that the "f-cubed" objection failed a critical legal test: Where was the fraud committed?

The U.S. government has put in a submission largely supporting the appeal. Through its lawyers it argued for a "substantial and material" test by which both U.S. and non-U.S. citizens could sue under the American securities laws provided that substantial conduct that was material to the fraud occurred in the U.S. The North Yorkshire Pension Fund and the Scottish Widows Investment Partnership also took this line in supporting briefs to the court.

The decision by the U.K. government to put in a submission opposing investor rights of non-U.S. citizens was particularly disappointing for Britain's local-authority pension funds. Its action may have been governed by concern to protect its interest in Royal Bank of Scotland where it has an 84% shareholding.

But events of the past week over Goldman Sachs may cause it to have second thoughts.

The allegations by the SEC against Goldman may well inspire class-action suits and could also spark a separate legal action from RBS itself, which took an \$840.9 million hit on the CDO portfolio through its acquisition of ABN Amro in 2007.

Resort to class actions isn't as well developed in U.K. law. Professor Rachael Mulheron, of Queen Margaret University, London, cites a number of reasons, including procedural difficulties, lack of private enforcement, judicial inefficiencies and overburdened courts. Adding on European classes to U.S. class actions are also plagued with problems.

Plans to give U.K. consumers greater powers to sue unscrupulous banks through class-action law suits in the U.K. were abruptly shelved by City Minister Lord Myners this month in a move to rush the Financial Services Bill through the House of Commons before the election.

The practice, known as "wash up," saw a series of proposals dropped because of a lack of time for scrutiny, and there is no certainty at present that the proposals will be presented again in the foreseeable future.

In the meantime, keen attention of institutional investors and big companies with U.S. operations will be focused on the Supreme Court ruling, expected in May or June.

—Bill Jamieson is executive editor of the Scotsman

What's News

■ **A panel of U.S. lawmakers** took aim at Lehman Brothers and federal regulators for the investment bank's collapse at the height of the financial crisis in 2008, accusing one of manipulation and the other of negligence. 9

■ **A successful short-term bond auction** by Greece soothed some market concerns, but a jump in 10-year yields underscored continued fears about the country's re-financing ability. 27

■ **The IMF said** Greece's upheaval may herald a "new phase" in the financial crisis, one of escalating concerns about sovereign debt. 10

■ **Swiss drug giant Novartis** is cutting about 20% of its U.S. headquarters staff and reorganizing how it sells drugs in the U.S. 21

■ **Polish investigators** warned against assuming any cause in the April 10 crash of the presidential jet, though Russia cited pilot error. 4

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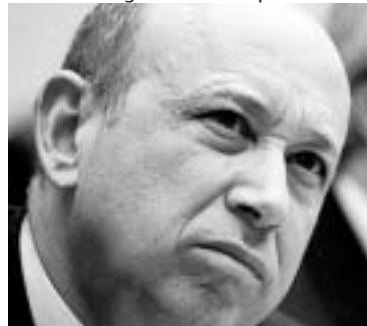
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Reader comment

europa.wsj.com/community

"Truth be told, without Goldman, we never could have had this miracle stock-market rally."

Reader Steven Gladston after Goldman Sachs earnings trounced expectations



Continuing coverage



Airports began to reopen as authorities relaxed restrictions. See the latest news at europa.wsj.com

Question of the day

Vote and discuss: Who would you vote for in the U.K. general election?

Vote online at wsj.com/dailyquestion

Previous results

Q: If given the chance, would you fly in Europe now despite the threat of a volcanic ash cloud?

Yes

30%

No

70%

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SEC V. GOLDMAN SACHS

Amid storm, Goldman profit surges

Net jumps 91% on strong trading and bond underwriting; Blankfein thanks clients, shareholders for support

By JOE BEL BRUNO
AND NATHAN BECKER

NEW YORK—Goldman Sachs Group Inc. may be facing complications from the political and legal storm over its business practices, but the Wall Street bank's first-quarter financial results continued a pattern of trouncing even optimistic expectations.

Goldman, the subject of civil-fraud charges that the government brought Friday that rocked the bank and Wall Street, reported that its profit in the first quarter soared 91% from a year earlier to \$3.46 billion.

The results, driven by strong trading and bond underwriting, helped deliver a much-needed boost amid the controversy swirling around the firm since last week.

Lloyd C. Blankfein, Goldman's chairman and chief executive, alluded to the Securities and Exchange Commission's complaint only once in the company's earnings release.

"In light of recent events involving the firm, we appreciate the support of our clients and shareholders, and the dedication and commitment of our people," he said in a statement.

Goldman's staff was paid well for its support. Compensation rose 17% to \$5.5 billion from \$4.7 billion a year earlier.

Still, compensation declined as a percentage of the company's net revenue, to 43% from 50%.

Goldman reported a profit of \$3.46 billion, or \$5.59 a share, up from \$1.81 billion, or \$3.39 a share. Revenue jumped 36% to \$12.78 billion.

The most recent consensus fore-



Soaring profits

Goldman Sachs may be facing complications from a political and legal storm over its business practices, but the Wall Street bank reported that its profit in the first quarter soared 91% from a year earlier to \$3.46 billion

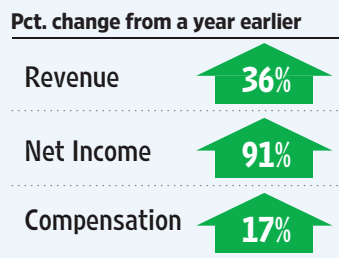
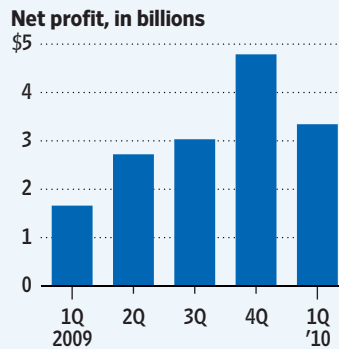


Photo: Reuters Source: the bank

A pedestrian passes offices of Goldman Sachs in London

cast of analysts polled by Thomson Reuters was that the New York investment bank would report earnings of \$4.01 a share on \$11.07 billion in revenue.

Despite the strong results, Goldman shares were down 2.1% in late trading Tuesday. The stock fell

nearly 13% Friday after the SEC filed its complaint.

Goldman has posted impressive results recently as it has pulled ahead of rivals that are struggling to overcome the credit crisis. But a cloud has developed in the past few days as the SEC accused the com-

pany and one of its executives of defrauding investors by peddling a mortgage-related financial product it knew was doomed to fail as the housing market collapsed. Goldman maintains it did nothing wrong and is fighting the charges.

In a conference call that lasted

more than an hour, most of analysts' questions dealt with the legal entanglements facing the company.

Goldman's co-general counsel, Greg Palm, said during a conference call that the investment bank wouldn't intentionally mislead clients and would "be the first" to condemn any employees that went against that credo.

Mr. Palm said "our responsibilities as a financial intermediary require it, and our commitment to integrity and the firm's business principles demand it." He added that the case is heading toward a trial at this point, but that there is certainly the possibility that Goldman could settle if both sides come into agreement.

In the SEC complaint, Goldman executive Fabrice Tourre was accused of defrauding investors by peddling a financial product the investment bank knew was doomed to fail. Mr. Tourre is currently out on indefinite leave; he hasn't been suspended by Goldman.

The company's total trading and principal investments, which accounted for most of its revenue, rose 43% in the quarter to \$10.25 billion. Fixed income, currency and commodities revenue, which is part of total trading and principal investments, rose 13%.

Investment-banking revenue increased 44%, though it dropped 28% sequentially.

Mr. Palm raised Goldman's estimate of losses on the transaction being investigated by the government to upward of \$100 million from the previous estimate of about \$90 million.

"We don't know how this case is going to unfold at this point. It's very early on," he said.

Goldman backlash builds among politicians

Continued from first page
leading arrangers of government bond issues in Britain, Germany and many other European countries, and has played a prominent role in privatizations in both countries.

In the U.S., the poisonous atmosphere surrounding Goldman Sachs has done more than just provide fodder for "Saturday Night Live." Anger toward Goldman was at play when the Treasury Department selected a manager to oversee the sale of the government's \$32 billion stake in Citigroup Inc.

Career officials at the Treasury chose Morgan Stanley to manage the account, and said the decision was based on the firm's ability to do the work. But at the time of the decision, an administration official said there was recognition inside the government that choosing Goldman, which has similar expertise, could trigger a firestorm.

The SEC probe has resonated in Europe because the Goldman transaction in question led to write-downs at British and German banks that later needed taxpayer bailouts. Royal Bank of Scotland Group PLC of the U.K. lost \$841 million on the deal, while IKB Industrie Bank AG of Germany lost \$150 million, according to the SEC. RBS and IKB declined to comment.

With the U.K. in the midst of a heated election campaign, the

charges against Goldman have made the bank an attractive target.

Mr. Clegg, speaking at a news conference in London, called the SEC's allegations against Goldman "extremely serious" and a sign of "how reckless and greedy the global banking industry had become" in the run-up to the 2008 financial crisis.

The Conservative Party also joined in, seizing on Mr. Brown's criticism of Goldman.

"Why is he still using them as advisers?" asked Mark Hoban, a top Conservative finance official.

U.K. Treasury chief Alistair Darling rejected calls to ostracize the U.S. bank. "I don't think you can stop doing business with a firm because an individual is accused of doing something," Mr. Darling said in an interview with Bloomberg News. Mr. Darling's spokeswoman confirmed the remarks.

Conservatives and Liberal Democrats are competing to oust Labour leader Mr. Brown from power in elections due May 6.

In Germany, Bavarian conservatives also said government dealings with Goldman should be put on ice.

The German finance ministry said it will examine the SEC case against Goldman before deciding on what steps, if any, to take. A finance ministry official said it was "completely open" whether possible steps might



British Liberal Democrat leader Nick Clegg said Tuesday that Goldman should be suspended as a government adviser.

include dropping Goldman as an adviser or securities underwriter, because Berlin is still waiting for information about the case from the SEC.

Chancellor Merkel's spokesman Ulrich Wilhelm said over the weekend that Germany might take legal action, depending on its assessment of the allegations against Goldman. German authorities are waiting for further information from the SEC, officials in Berlin said Tuesday.

Goldman has already faced criticism in Europe this year for a series of transactions with Greece that exploited loopholes in EU accounting

rules and had the effect of understating Greece's budget deficit. The transactions, which took place nearly a decade ago, have helped to undermine financial markets' confidence in Greece's official statistics, contributing to a debt crisis that has pushed Greece to the verge of a bailout by the European Union and the International Monetary Fund.

Analysts at BNP Paribas said last week's SEC accusations are "a massive blow" to Goldman's reputation, "which was already under pressure due to the Greek swap episode and other issues."

Goldman's Mr. Blankfein drew ire

from U.S. and European officials late last year by quipping that the bank does "God's work." The head of Goldman's German operations, Alexander Dibelius, sparked more controversy in January by saying banks "do not have an obligation to promote the public good."

Bankers from rival firms have complained in recent months that Goldman's worsening public image is adding to the political momentum behind a regulatory clampdown on the whole sector.

—Margot Patrick and Deborah Solomon contributed to this article.

EUROPE NEWS

Polish crash probed

Investigators warn against assuming pilot error caused tragedy

BY MARYNIA KRUK
AND MARC CHAMPION

WARSAW—Polish investigators warned against assuming any cause for the crash of the president's Tupolev-154 on April 10 in Russia, in remarks that differed from Russian statements last week that pilot error was likely at fault.

Prosecutor-General Andrzej Seremet and other Polish crash-investigation officials said at a news conference Tuesday it was likely to be weeks or months before any conclusion on cause is reached. They said Russian and Polish investigators would make separate analyses. Aviation investigations are normally lengthy and difficult, experts say.

Ninety-six people died, including President Lech Kaczynski and the entire command of Poland's armed forces, when the plane crashed in fog on approach to Smolensk airport in western Russia. The passengers were on their way to commemorate the 1940 Katyn massacre of 22,000 Polish officers and intellectuals.

The Polish officials said Tuesday the process was taking longer because the evidence wasn't in Poland. Polish experts had to wait for Moscow to process data before they received it, one investigator said.

The Polish officials warmly praised cooperation from Russian investigators and offered no criticism. However, reaction in some Polish media—which speculated over whether Russia was holding back to delay the process—underscored the potential of the dual probe to produce tension between Warsaw and Moscow, historical rivals who so far have been driven closer by the tragedy.

"At this stage all versions of the causes of the catastrophe are being



The pilot, Capt. Arkadiusz Protasiuk

taken under consideration. None of them is the dominant version, none of them is being rejected," said Col. Zbigniew Drozdowski, who sits on the Polish Defense Ministry commission in charge of investigating plane accidents.

Russian investigators haven't made formal conclusions, but have indicated pilot error was the most likely cause, and said there is no evidence to date of technical failure.

Polish prosecutors have said the black box tapes show that those on the plane knew before they crashed that they were going to die. In a question-and-answer interview published Tuesday in the *Gazeta Wyborcza* newspaper, the spokesman for Poland's chief military prosecutor said investigators were having difficulty identifying voices in the cockpit and synchronizing that tape with the black box that records the plane's technical operations.

Asked if any voices recorded were talking to the pilots from the

passenger cabin, the spokesman, Col. Zbigniew Rzepa, said that couldn't be ruled out, given that the voices hadn't yet been identified.

Early focus on pilot error led to widespread speculation in Poland's media that President Kaczynski might have pressured the pilot to land, or that the pilot, a captain in the Polish air force, decided to land the plane despite warnings from the control tower to divert.

Capt. Arkadiusz Protasiuk, however, wasn't that kind of pilot, according to colleagues who flew with him. "He was very cool-headed" and experienced, said his commanding officer, Lt. Col. Ryszard Raczynski, head of the 36th Special transport aviation regiment, in an interview.

Col. Raczynski said it would be normal procedure, if an airport isn't closed but the control tower is advising diversion, for a pilot to make one approach to the runway just below the cloud floor to check the conditions. Russian investigators say the Tupolev made only one approach to the runway at Smolensk.

According to the Russian company that overhauled the Tupolev in December, it was equipped with a system that should have warned the pilots they were dangerously close to the ground. It is unclear why the equipment didn't prevent the crash.

Capt. Protasiuk had trained on Yak-40s, small Russian-built passenger jets, Col. Raczynski said. As the presidential Tupolev-154 took off from Warsaw on April 10, Capt. Protasiuk had 2,937 hours of flight-time under his belt, the colonel said.

Capt. Protasiuk knew Smolensk Airport well, according to Col. Raczynski. On April 7, Capt. Protasiuk flew as co-pilot on the flight that carried the Polish prime minister's delegation to Smolensk for an ear-



A procession for victim Krzysztof Putra heads to a Bialystok cemetery Tuesday.

lier Katyn commemoration. The Russian military airport didn't have a precise guidance system to help planes land—although at one point in the past it did, Col. Raczynski said. The Tupolev was equipped with the second-best of three grades of Instrument Landing System, requiring 300 meters of visibility to land safely, the colonel said.

Asked if he would have taken the decision to land in the same situa-

tion, Capt. Grzegorz Pietruczuk, a colleague who in 2008 drew President Kaczynski's wrath by refusing to land the presidential plane in Tbilisi during Georgia's brief war with Russia, said he didn't know.

"I wasn't in the cockpit," said Capt. Pietruczuk. "The information is in their heads."

—Daniel Michaels in New York and Gregory L. White in Moscow contributed to this article.

Scandal harms the pope's Europe mission

BY VANESSA FUHRMANS

BERLIN—The sexual-abuse scandal roiling the Roman Catholic Church is threatening one of the pope's core missions, a Christian reawakening in Europe.

Pope Benedict XVI has made reversing the decline of Catholic influence in Europe a central goal of his papacy. But as clerical abuse scandals spread across the Continent, they threaten to hasten a growing movement away from the Catholic Church in an increasingly secular Europe.

A survey published last week in the German magazine *Focus* underscores that threat. Some 56% of 613 Germans polled by researchers at Zeppelin University in Friedrichshafen, Germany, said they had no confidence in the church; one-quarter of the survey's Catholic respondents said they were mulling leaving the church.

"This is a real danger for Benedict," said David Gibson, author of "The Rule of Benedict," a biography of the pope. With alienation hitting the very places that could be the seedbeds for the pope's push, Mr. Gibson said, "his great project could be cut off at the roots."

On Monday, Pope Benedict marked the fifth anniversary of his papacy by lunching with cardinals in

the frescoed interiors of the papal palace. Also on Monday, the Vatican published a letter from Cardinal Claudio Hummes, head of the Vatican's Congregation for the Clergy, to priests world-wide noting that the church "is determined to neither hide nor minimize" sexual-abuse. Sexually abusive priests, the cardinal wrote in a letter dated April 12, "must answer for their actions before God and before tribunals, including the civil courts."

It was just five years ago this month that a freshly elected Pope Benedict explained before thousands of pilgrims gathered in Rome's St. Peter's Square the inspiration for his papal name: One was Benedict XV, the pontiff who guided the church through the turbulence of World War I. The other was St. Benedict of Norcia, a sixth-century monk who, amid the ashes of the Roman Empire, retreated to the hills south of Rome to found a monastic movement that would become the bedrock of European Christian culture in the centuries to follow. His namesake, the pope declared, "is a powerful call to the irrefutable Christian roots of European culture and civilization."

Even countries with small Protestant or Catholic church attendance, such as Denmark and the Netherlands, observe Good Friday, Ascen-



Pope Benedict XVI stands in front of the coffin of late Cardinal Tomas Spidlik during a funeral in St. Peter's Basilica Tuesday.

sion Day and Pentecost as public holidays. Germany and Italy are currently governed by church-friendly center-right coalitions.

Yet in daily life, Europe has become increasingly irreligious, a shift rooted in part in its post-war prosperity and the growing chasm between European social mores and the church's moral teachings on issues such as contraceptives, divorce and homosexuality.

Even before recent months' clerical abuse allegations, church atten-

dance in Europe was at historical lows. In Spain, a traditional Catholic stronghold, fewer than 20% of Spaniards attend Mass regularly, down from more than 30% in the 1980s, according to a 2008 nationwide study. In Germany, fewer than 14% of Catholics attend church regularly, compared with 29% three decades ago. In the U.S., by comparison, some 42% of Catholics say they attend church regularly, according to Gallup Poll data.

Between 2000 and 2008, the

number of priests in Europe declined about 8%, based on the most recent Vatican figures. The church's aging clergy signals a more precipitous drop ahead: In Ireland, for instance, 36% of its priests are over the age of 65, while only 4% are 34 or younger.

Benedict's approach to reinvigorating the church has been less about broadening its appeal among the less ardent multitudes and more focused on cultivating a core of traditional believers in church doctrine. Last fall, the Vatican stepped up its courtship of traditionalist Anglicans uneasy with their church's female priests and openly gay bishops.

Some Church observers say the scandals ultimately could lead to reform and renewal within the church, given that surveys consistently show the majority of Europeans say they still identify with Christian messages and values.

"But that requires a thorough reflection on the church's part on how it transitions into modernity," said Peter Huenermann, retired professor of theology at the University of Tübingen in Germany, where Pope Benedict, then Joseph Ratzinger, taught theology during the 1960s. "I don't know if the pontiff has the will to carry out such a change."

—Stacy Meichtry contributed to this article.

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EUROPE UNDER THE VOLCANO

Volcano turns Madrid into hub

Spain becomes clearinghouse for travelers headed elsewhere in Europe; rail and bus service expands as demand rises

By SARA SCHAEFER MUÑOZ
AND JONATHAN HOUSE

MADRID—The air-traffic snarl from the Icelandic volcano has transformed Spain's capital and its airport into Europe's unofficial hub, as travelers grow desperate to reach their destinations.

Spain's airports were affected less than other major European destinations by the giant cloud of volcanic ash that grounded flights this week. Madrid-Barajas Airport and others in the country were able to accept some rerouted flights, allowing travelers to reach continental Europe and then search for alternate ways home.

Since Monday, airlines have made 290 special flights to or from Spanish airports for passengers from around the world whose travel plans were disrupted by the volcanic eruptions, Spain's aviation authority said Tuesday.

At the same time, the U.K. hammered out plans with Spain to route more marooned British travelers through here and get them home by bus, train or other means. Spain will grant the travelers entry only if there are concrete plans for them to reach their final destinations, according to a spokeswoman for Spain's development ministry. An agreement could come as early as tomorrow.

The British government said U.K. airports—including London's Heathrow—would reopen Tuesday, according to news reports.

On Tuesday a British Navy battleship rescued about 700 stranded Britons—280 "vulnerable" civilians and the rest military service person-



A British Royal Marine looks on as stranded passengers board the Royal Navy ship HMS Albion in Santander on Tuesday.

nel—from the Spanish city of Santander, said the U.K. foreign office. Two additional naval ships could make their way to the Spanish coast to collect more travelers this week.

Airlines have been flying European vacationers in the Canary and Balearic islands, who can't return to their home cities, to Barcelona and Madrid on the Spanish mainland. Low-cost carrier **Ryanair Holdings PLC**, for example, Tuesday said it was flying its passengers from the

Canary Islands to Madrid to allow them to make return journeys to the U.K. by road, rail or ferry at the passengers' own expense.

Spanish airline Iberia said it has rerouted 4,000 passengers. It has hired 115 buses to move people to their destinations and has put up an additional 5,000 people at hotels.

A spokeswoman for Spain's ministry of development, which handles transportation, said it will ensure that airports stay open for rerouted flights. The ministry said the coun-

try's rail service has added thousands of additional seats on trains and that buses have stepped up service to meet demand.

Some companies have hastened to market to marooned travelers: Private shuttle service **resorthoppa.com** ran online advertisements for £399 (\$609) bus trips from Spain to the U.K.

The contingency plans haven't kept up with the ranks of the stranded. On Tuesday afternoon, Madrid's Barajas airport was full of

frustrated travelers trying to get home. Many had gotten stuck after landing there en route from overseas.

"We saw on the computer this morning that our flight was OK, but by the time we got here it said 'canceled' on the screen," said David Brown, 40 years old, of Essex, England, who has been stuck in Madrid since Friday with his wife, young son and elderly parents as they returned from a vacation in South Africa. He said trains and ferries are difficult to book and the 20-hour bus ride would be too much for his parents, who are in their 70s.

Others say that buses, trains, ferries and rentals cars are expensive and overwhelmed by demand. Ferry passages from Santander to the U.K. through Brittany Ferries, for example, are booked until April 29. One-way rental cars from Madrid to Paris can cost €800 (\$1,076) before gas and tolls.

Nearby, Walter and Sigrid Berggren, of Sweden, turned away from the Iberia customer-service window after waiting for three hours and being told they couldn't get a flight to Copenhagen for nearly a week.

From there, the couple, who are in their 50s, were hoping to get to their town of Kristianstad in southern Sweden. They had flown to Madrid and been stuck there since Sunday after completing the 220-mile pilgrimage route to the Spanish city of Santiago de Compostela on foot.

"We have tried everything," said Ms. Berggren, gesturing around the airport. "This has been more tiring than that walk."

—Santiago Perez
contributed to this article.

Flight ban ripples through global economy

By JOHN W. MILLER

The impact of the European flight ban continued to ripple through segments of the global economy, interrupting supply chains, spurring a boom in videoconferencing sales and delaying mail.

The ban has hit producers and traders of perishable goods hardest. High-tech and pharmaceutical companies, which also rely on air supply chains, have been less affected. **Toyota Motor Corp.** and **Honda Motor Co.** said on Tuesday that the Iceland volcano's eruption hasn't caused logistical problems.

AstraZeneca PLC and **Roche Holding AG** also said they weren't

concerned about shortages. "We're in a position to implement alternative shipping arrangements, if necessary," an AstraZeneca spokesman said. "It could be by road, rail or by air from different places that aren't affected."

Some economists said the effects have been much less severe than feared. "Just how much time is there in 'just in time' manufacturing? A lot than we might have thought before the volcano," said Simon Evenett, an economist at the University of St. Gallen in Switzerland.

However, **Nissan Motor Co.** said on Tuesday it had to suspend part of its domestic production lines because it was unable to import pneumatic sensors, which are used in three models that Nissan exports to the U.S., from Ireland.

Germany's **BMW AG** said Tuesday that the ban will delay production at three plants in Germany and one in Spartanburg, N.C., affecting more than 7,000 vehicles, because it had run out of certain electrical components.

"If the air-traffic situation does not improve quickly, we could have shortages later this week, and stop production," said Robert Hitt, a spokesman for BMW in the U.S.

Some businesses have been planning for the worst if the flight ban continues. **GlaxoSmithKline PLC** is busy identifying "medically critical products" whose supply could be



An employee of BMW, which is delaying production, polishes a car in Germany.

cut off if the flight interruptions continue, says spokesman Stephen Rea.

Communication businesses said they were thriving. Skye said calls were up, although it didn't specify by how much. **British Telecommunications PLC** said demand for teleconferencing had gone up 35% since the volcano erupted.

The U.S. Postal Service is experiencing delays in getting mail to some European destinations, said

spokesman Dave Lewin. "We've suspended the guarantee for express mail international to Spain, the U.K. and France. It's a major service disruption."

Deutsche Post DHL AG, meanwhile, has set up "an alternative and decentralized road-based network," said spokesman Jörg Wiedemann. "We are progressively re-establishing our air network, as flight bans are being lifted throughout Europe." Perishable fruits and vegetables,

especially in the developing world, remains the most-affected sector. The European Union has granted favorable tariff rates to many developing countries in the past decade, especially for fruit and vegetables it doesn't grow, such as pineapples, mangoes and passion fruit.

Countries like Kenya, Ghana and the Ivory Coast have developed farms, and packagers depend on regular freight flights to Europe. They were forced to destroy crops in the past few days and tell workers to stay home while they seek alternate routes into Northern Europe.

Economists warned the shutdown could have a pernicious long-term effect on research and development. Two economists at the University of Colorado in Boulder, Nune Hovhannisyann and Wolfgang Keller, studied business travel from the U.S. to 75 countries from 1993 to 2003. They found a correlation between the most frequently visited countries and patent applications in those countries.

"You can have Julia Child's cookbook, but it's easier to re-create a recipe if there's a Julia to help you cook it," said Mr. Keller. "You need people traveling to transfer technology and help innovation. If we're right, the travel disruptions will have an impact on innovation."

—Yoshio Takahashi
and Jeanne Whalen
contributed to this article.

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EUROPE UNDER THE VOLCANO



Agence France-Presse/Getty Images

A Lufthansa airplane takes off from the airport in Düsseldorf, Germany, on Monday, heading for Chicago, as planes began to fly again across much of the Continent.

Stranded passengers face a dilemma

As safety experts and airlines debate the merits of restarting flights, impatient travelers wonder whether to fly

By PAUL SONNE
AND JAVIER ESPINOZA

LONDON—Passengers desperate to get home are facing a tough question: Do they want to be the first to get on a plane amid a divisive debate over the safety of the post-volcano skies?

That is the quandary facing Tina Poyzer, a 43-year-old disability service manager from London, who last week took off for a short vacation to Iceland with her son. A volcanic ash cloud emanating from the island has trapped Ms. Poyzer and her 10-year-old. They are running low on funds and are worried that a second and more threatening volcano on the island could erupt.

Ms. Poyzer, who has had six flights canceled since Thursday, is desperate to leave—but concerned that it remains unsafe to fly. In recent days, air-traffic officials and others calling for caution have clashed with airlines pushing to reopen airspace.

"I'm afraid to fly now. It has become a real political issue," Ms. Poyzer said Tuesday in a phone call from Reykjavik. She is worried that airlines may be pushing safety limits because they are losing so much money. "The whole thought just hor-

rifies me, to be honest," she added. Still, she said she would take the first flight out if she could.

Travelers are caught between the desire to get on with their lives and the unclear debate over how much of a safety threat is posed by flying jets through the ash cloud. That debate has grown louder in recent days, as European airlines such as Air France-KLM SA and British Airways PLC began operating test flights—flying planes without passengers—and reporting all clear.

The International Air Transport Association, a trade body, lashed out at European governments on Monday for mishandling airspace restrictions and using faulty theoretical models. Giovanni Bisignani, director general and chief executive of the IATA, criticized European governments for issuing "blanket closures of airspace" and causing "missed opportunities to fly safely."

Such pressure on regulators to open airspace has raised red flags among some stranded travelers. Industry experts and risk specialists have expressed concern as well.

"I'm shocked to see the industry lobbying so hard on an issue that's so sensitive and safety-related," says Carter Stewart, managing director of London-based aviation consultancy



Stranded British passengers at Barajas airport in Madrid on Monday.

Trans World Consulting Ltd. "The industry cannot self-police. This is up to the FAA and the EU and all these aviation regulatory bodies."

George Gray, director of the Center for Risk Science and Public Health at George Washington University, criticized scientists for not giving the public a better sense of how much ash was in the atmo-

sphere. "People are deciding to fly and get on private planes because they have come to the conclusion that the benefits are greater than the risks," he said. "But we haven't really given people a feel of how great the risk is."

Some analysis of the cloud is based on complicated modeling, and scientists aren't necessarily sure

how much ash is in the sky or how the wind may move the cloud. Grant Allen, a researcher at the Centre for Atmospheric Science at the University of Manchester, said test flights don't prove the risk has been ameliorated. "The big problem at the moment is that nobody actually knows what concentration of hazardous ash is in the clouds," he said.

Anthony Concil, a spokesman for the IATA, noted that it wasn't airlines' interest for them to push the limit on safety regulations. "The cost of an accident is enormous, in terms of reputation, in terms of a company's future, in terms of immediate expense," he said. "In that sense the airlines and government are completely aligned."

Many stranded passengers remain jittery, but for most, the imperative to get home has come to outweigh the fear of uncertain conditions. Clémentine de Crécy, the owner of Clementine Communications Ltd., has been stuck in Martinique since Thursday and is considering taking a private jet. Ms. de Crécy trusts that if the airport is open, it's safe to fly. "Safety is obviously a concern but that's why a jet would fly me wherever is safe in Europe. We won't fly to London if the airports are still closed," she said.

Airports reopen amid caution

Continued from first page

Three airline associations representing dozens of European carriers Tuesday called on governments and EU officials to "give a firm commitment to support airlines affected by the crisis." The associations noted that governments had closed airspace, and that European Union passenger-protection rules force carriers to provide food and communications to stranded passengers already in transit, at great expense.

"Airlines need further support to assist them with this huge task," said the statement from the European Low Fares Airline Association, the European Regions Airline Association and the International Air Carrier Association. "European governments cannot shirk their responsibility to passengers affected by their decision."

The calls for financial support echoed fierce lobbying by the U.S. airline industry in the wake of the Sept. 11, 2001, terrorist attacks. Congress approved a \$15 billion support package less than two weeks later, with many airlines claiming they

faced bankruptcy after U.S. airspace was closed for three days.

Citing that post-9/11 aid, British Airways PLC and easyJet PLC said they were talking to the U.K. government about possible help. Air France-KLM's Dutch unit, Belgium-based Brussels Airlines, Poland's

The European Commission will consider updating state-aid rules in the wake of the volcanic eruption to clarify how airlines can benefit from government help.

LOT Polish Airlines and Air Berlin PLC, Germany's second-largest airline, also said they would look at requesting aid once they had dealt with the immediate effects of the crisis.

Financially strong Irish budget carrier Ryanair Holdings PLC said Tuesday it expected a €6 million hit to its projected net profits of €310

million this year from the closure. But it said it opposed government intervention. "We do not feel state aid is warranted," said a Ryanair spokesman. However, he called for a re-examination of rules that require airlines to cover the cost of caring for stranded passengers.

The European Union's executive body, the European Commission, said Monday it would consider updating state aid rules in the wake of the Icelandic volcanic eruption to clarify how airlines affected by flight cancellations can benefit from national government help.

The commission has rules that could be applied to compensate airlines in exceptional circumstances and allow member states to compensate companies for damage caused by natural disasters, said spokeswoman Amelia Torres.

Under the current rules, which were clarified in the aftermath of the Sept. 11 attacks, compensation can be paid on a nondiscriminatory basis to all affected airlines within a member state. The aid must be limited to the actual cost to the airline of the interrupted traffic.

Cancellations roil carriers across Asia

SINGAPORE—Flight cancellations continued to take a toll on most Asian airlines Tuesday due to lost bookings and the cost of accommodating stranded passengers.

By Costas Paris,
Joanne Chiu
and Santanu Choudhury

Among those most affected in Asia, Singapore Airlines Ltd. has been incurring losses of at least four million Singapore dollars (US\$2.9 million) a day since flight bans were introduced Thursday, a person familiar with the situation said.

"First estimates show a loss of a minimum S\$4 million a day if you include no new bookings to affected destinations in Europe and accommodation costs for stranded passengers. But it could be higher," the person said.

Singapore Airlines has said it has yet to address its loss from canceled

flights, concentrating instead on ways to move stranded passengers to their destinations.

It operates 25 flights to and from Europe daily, with more than 20 being canceled since Thursday. The only two airports where it could fly were in Rome and Athens.

The carrier makes around 25% of revenue from flights to Europe. It flies the Airbus A380 super jumbo to hubs like London, Zurich and Paris, which were all affected by the volcanic ash cloud.

Cathay Pacific Airways Ltd. said the impact of the disruptions has been significant, but declined to give estimates on the financial cost. As of Tuesday, Cathay Pacific had canceled 75 passenger flights to Europe and delayed nine others.

Australia's Qantas Airways Ltd. on Monday said flight cancellations were costing it about 1.5 million Australian dollars (US\$1.38 million) a day.

EUROPE NEWS

New data give clues to poll

Price and growth indicators shine light on economy, could influence voter's choices

BY LAURENCE NORMAN

LONDON — An already volatile British election battle could take a further twist as new data give a fresh view of the state of the economy's recovery from a deep recession.



U.K. Election 2010
WSJ.com/UK Election

The economy has been at the heart of the election campaign, with the opposition Conservative Party attacking the government over the public sector's surging debt, while Labour Prime Minister Gordon Brown insists that cuts to public spending this year could push the economy back into recession.

This week, the Office for National Statistics releases several numbers that could directly affect the vote, which takes place May 6.

On Tuesday, the Office for National Statistics said prices rose an annual 3.4% in March, up from 3.0% in February. That could put pressure on the Bank of England's view that inflation will ease later in the year. On Wednesday, March unemployment numbers are released and on Thursday, the ONS reports the final month of public finances data from the 2009/10 financial year.

But potentially the most significant figure will be released Friday, when the ONS publishes its first estimate to growth in the first quarter. A robust number would give Mr. Brown an opportunity to burnish his economic credentials. But a weak reading would raise fresh questions about the durability of the recovery. "I think the numbers are hugely important," said Andrew Hawkins, chairman of polling firm ComRes. "If we go back to the core Labour message, which is don't let the Conservatives put the recovery at risk, there has got to be a recovery to risk."

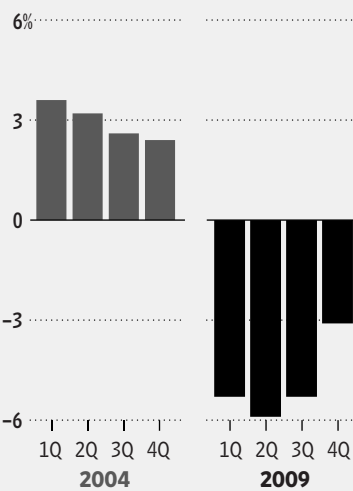
The economic releases come at a pivotal moment in an extraordinarily volatile election campaign. After months in which the Conservative Party held a solid lead over the governing Labour party, the smaller opposition Liberal Democrats have



Former Prime Minister Tony Blair (left) in 2005, and Prime Minister Gordon Brown and his wife, Sarah, Tuesday.

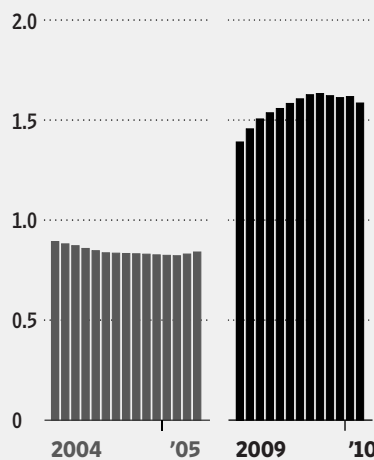
Then and now | The economic landscapes have shifted since Britain's last elections.

Gross domestic product change from prior year



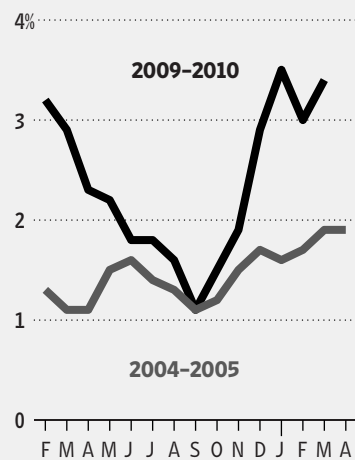
Source: U.K. Office for National Statistics

Number claiming jobless benefits in millions, seasonally adjusted



Photos: Agence France-Presse (Blair); Press Association (Brown)

Consumer-price index change from prior year



jumped into the race with a strong performance by leader Nick Clegg in Britain's first-ever televised leaders debate. One poll Sunday put Mr. Clegg's party in the lead.

Most economists surveyed expect the data to be reasonably positive.

The claimant count measure of unemployment is seen falling 15,000 in March—the fourth drop in five months—with the jobless rate staying at 4.9%. The public finance data is expected to show massive net public sector borrowing of £22 billion. But that will likely leave the full-year net borrowing close to the £167 billion predicted by Treasury chief Alistair Darling in his budget last month.

And after the economy grew 0.4% in the fourth quarter of 2009—ending an 18-month recession that chopped 6% off U.K. output—the economy is estimated to have expanded 0.4% again in the first quarter.

However economists say the preliminary first-quarter growth data are hard to call.

Simon Hayes, U.K. economist at Barclays, says he believes the economy expanded 0.5% in the first quarter. But he notes that "a number of factors" make the first quarter highly uncertain, including the worst winter snowstorms on record in January, the end of the car scrappage program and the return of the Value Added Tax rate to 17.5%.

"It is also worth bearing in mind that recent revisions suggest the ONS has particular difficulties estimating growth around turning points," Mr. Hayes said.

That was certainly the case in the fourth quarter of 2009. The initial reading, showing growth of just 0.1%, led Conservative Treasury spokesman George Osborne to charge that, under Labour, the country was "badly prepared for this recession and now we're badly prepared for the recovery."

However, the estimate was later revised up to 0.3% and eventually to 0.4%, suggesting the economy did exit the recession with some momentum.

German economic outlook picks up

BY NINA KOEPPEN
AND BRIAN BLACKSTONE

German economic expectations improved considerably in April, indicating the recovery is gaining steam. Separately, the combined current-account deficit of the 16 countries that use the euro widened in February, despite signs of increasing strength in exports.

The ZEW think tank said Tuesday its economic expectations index jumped 8.5 points to 53.0 in April. The outcome was well above economists' forecasts of 46.0 points, and above the indicator's historical average of 27.3 points.

"Impulses from exports are invigorating German business activity," ZEW President Wolfgang Franz

said. Michael Schröder, head of international financial markets at ZEW, said: "Almost all sectors are extremely strong, especially sectors with a strong orientation toward exports."

Current economic conditions in Germany also improved, with the corresponding indicator up 12.7 points at -39.2 points, the ZEW survey of 294 analysts and institutional investors showed.

Though Germany's economy is likely to have posted minimal growth in the first quarter, "the second quarter should have positive surprises in the offing," said ING Bank economist Carsten Brzeski.

The German economy is forecast to grow around 1.5% this year, after contracting 4.9% in 2009—the

sharpest fall in some 60 years.

Meanwhile, the current-account deficit widened to €3.9 billion (\$5.26 billion) in February compared with a deficit of €1.7 billion in January, the European Central Bank said.

The ECB said exports rose 1.5% from a month earlier to €118.9 billion, their highest level since November 2008. Imports fell slightly to €113.4 billion, giving a merchandise trade surplus of €5.5 billion, up from €2.4 billion in January.

The ECB said gross foreign debt of the euro zone totaled €10.5 trillion at the end of 2009, equivalent to 117% of gross domestic product. It said this was "virtually the same" as at the end of the previous quarter.

—Geoffrey T. Smith
contributed to this article.

Back on track

Germany's ZEW indicator of economic sentiment



Source: ZEW

Volcano adds complication to U.K. plans for May 6 vote

BY ALISTAIR MACDONALD
AND JEANNE WHALEN

The Icelandic volcano ash cloud is toying with the efforts of some British voters hoping to cast a ballot in the May 6 general election.

Tuesday was the deadline to register to vote and to apply to vote by mail. That means some travelers stranded overseas lost their opportunity to register.

The situation brightened Tuesday, after Britain's government said U.K. airports would reopen Tuesday, according to news reports.

If the disruption continues, some may not receive their absentee ballots in time or won't be able to return them. People who applied for absentee ballots, or "postal votes," before the volcano erupted likely have already had their ballots sent to them, and could have already returned them. Those who waited—either to apply or return their ballots—now have to keep their fingers crossed.

If the disruption continues, some may not receive absentee ballots in time.

Royal Mail spokeswoman Sarah Womack said it is the responsibility of other countries to get absentee ballots for next month's election delivered to U.K. borders. Once they arrive in the U.K., the Royal Mail will consider it a "priority task" to deliver them on time, she said. Ms. Womack said she wasn't certain what steps other countries might be taking to deliver the ballots.

Seeing possible problems developing, the Electoral Commission, Britain's independent election watchdog, reminded registered voters that they still have time to apply to vote by proxy—appointing someone to vote on their behalf—if they think they may not be able to do so in person.

"Some registered voters caught overseas by the disruption to air travel may decide there's a risk they can't get to the polling station on May 6 and while it's too late to apply for a postal vote after 5 p.m. [Tuesday], they still have time to apply for a proxy vote," said Andrew Scallan, the commission's director of electoral administration. The deadline to apply is April 27.

Some voters are already kicking themselves at the disruption. Sophia Meredith expressed her frustration on a Facebook page devoted to the election's man of the moment, Nick Clegg, leader of the perennial third-place Liberal Democrat Party that has seen its ratings surge in polls. Fresh polls late Tuesday showed continued strong support for the Liberal Democrats, with one survey putting them in the lead and another showing them running a narrow second to the Conservatives.

"Stranded on the other side of the world, therefore will miss the deadline registering to vote. But if I did vote, I'd vote Lib Dem," Ms. Meredith wrote.

U.S. NEWS

Lawmakers aim at Lehman leaders

House panel investigating collapse also criticizes regulators; Fuld says SEC and Fed were 'privy to everything'

By MICHAEL R. CRITTENDEN

WASHINGTON—Lawmakers took aim at Lehman Brothers Holdings Inc. and federal regulators for the investment bank's collapse at the height of the financial crisis, accusing one of manipulation and the other of negligence.

"Wall Street executives continue to embellish the truth, tell half-truths and hide behind their power in the marketplace," Rep. Paul Kanjorski (D., Pa.) said at a House Financial Services Committee hearing.

Rep. Spencer Bachus of Alabama, the ranking Republican member of the panel, singled out the Federal Reserve as being either "incompetent or they concealed the facts."

"At best, regulators failed to catch the accounting manipulation that permitted Lehman to give a misleading picture of its financial health," Rep. Bachus said.

SEC Chairman Mary Schapiro acknowledged that her agency, which she didn't head at the time, could have pushed Lehman harder to improve its financial position and that there were federal missteps. "I don't think any of us would claim the oversight of Lehman was a success," Ms. Schapiro said.

The hearing comes as Washington has stepped up its focus on Wall Street. The Securities and Exchange Commission on Friday rocked markets by filing civil charges against Goldman Sachs Group Inc., and later this week the Senate could begin debate on wide-ranging legislation to overhaul regulation of U.S. financial markets.

President Barack Obama will step into the fray Thursday in a speech in



Treasury Secretary Timothy Geithner, Fed Chairman Ben Bernanke and SEC Chairman Mary Schapiro, left to right, testify Tuesday about Lehman's collapse. Mr. Bernanke said the government had no choice but to let Lehman file for bankruptcy.

New York on proposed changes to derivatives oversight and regulation of the largest financial institutions.

Though ostensibly about Lehman, the hearing was used by lawmakers as a proxy for the broader debate on financial-overhaul efforts.

Republicans said the missteps by the government in the Lehman episode argue against giving federal regulators more authority because they haven't shown a willingness to use their existing powers. "Given

their track record, giving these regulators more power will provide the markets with a false sense of security, while hampering the free market," Rep. Scott Garrett (R., N.J.) said.

Tuesday's hearing gives lawmakers a chance to examine a key moment of the financial crisis: the September 2008 collapse of Lehman. Members of the panel seized on a detailed report from bankruptcy examiner Anton Valukas that sug-

gested Lehman's executives engaged in "balance-sheet manipulation" and masked huge losses from investors.

Rep. Jackie Speier, a Democrat from California, was critical of the so-called Repo 105 transactions Lehman used to make the leverage on its balance sheet look smaller than it was. "Repo 105 is more like criminal procedure 101," Rep. Speier said.

Mr. Valukas said regulators missed chances to learn about the repurchase agreements.

He said it isn't clear that even "the most engaged regulator" could have prevented the firm from faltering. "What is clear is that the regulators were not fully engaged and did not direct Lehman to alter the conduct we know in retrospect led Lehman to ruin," he told the panel.

Former Lehman Chairman and CEO Richard Fuld Jr., who was scheduled to appear before the panel, sought to defer some of the attention to missteps by regulators. The SEC and Fed "were privy to everything as it was happening," he said in prepared remarks.

"I am not aware that any data was ever withheld from them, or that either of them ever asked for any information that was not promptly provided," Mr. Fuld said.

Top administration officials, including Treasury Secretary Timothy Geithner and Fed Chairman Ben Bernanke, suggested they weren't informed of some of the more controversial decisions Lehman executives were making. They also suggested they didn't have the authority to prevent the bank's failure.

"Tragically, when we saw when firms mismanage themselves to the edge of failure, the government had limited ability to step in and protect the rest of the financial system," Mr. Geithner said.

Mr. Bernanke said the Fed didn't have a good "stick" to deal with Lehman Brothers, leaving it only with the "nuclear option" to let it fail. In his prepared remarks, Mr. Bernanke said the government had no choice but to let Lehman file for bankruptcy after the firm and federal officials were unable to arrange financing or an acquisition.

Incentives drive smaller turbines

By CHRISTINE BURMA

Towering wind turbines are becoming a common sight in rural fields and other remote areas across the U.S. But spinning rotor blades are increasingly cropping up in unlikely places, including suburban yards and urban parks, as the small-scale wind-turbine industry expands.

Wind turbines for residential and commercial use are essentially smaller versions of their industrial-scale counterparts.

Small turbines are generally 12 meters to 30 meters high, while industrial turbines are typically about 150 meters high.

As concerns about carbon-dioxide emissions from power plants have driven growth in the industrial wind-energy sector, the small-scale wind industry has also gained momentum.

The American Wind Energy Association, a Washington, D.C., industry group, reports that, despite the economic downturn, the U.S. market for small wind turbines grew by 15% in 2009. The outlook for the small wind-turbine industry is bright as rising consumer demand for carbon-free energy and new policy initiatives drive investment in the renewables sector. The 2009 American Recovery and Reinvestment Act, for example, grants consumers 30% of the total cost of a small wind system as a tax credit.

"There are a number of state incentives for turbines, combined with the new federal incentive," said Trudy Forsyth, leader of distributed wind projects for the National Renewable Energy Laboratory, a government-sponsored research laboratory in Golden, Colo.

The small wind-turbine market continues to expand, particularly as the economy stabilizes.

"It's also a demographic thing. You have baby boomers who have had environmental values throughout their lives, and now they're retiring with some pretty good pots of money that they're putting into small wind energy."

Small wind turbines, which have shorter blades than their industrial-scale brethren, look like very tall, white pinwheels.

Typical buyers of small wind turbines include residents of rural or semirural areas who own a few acres of land and who want to install a single turbine on their property. The turbines are installed by

contractors and can be connected to the electric grid through an underground line to the customer's house. Although small wind turbines are designed to operate in very low wind, they work best in open areas with few trees.

In the U.S., the small-turbine market is dominated by a handful of closely held manufacturers, including Southwest Windpower in Arizona and Northern Power Systems in Vermont.

Southwest Windpower's residential-turbine system costs about \$15,000 before tax incentives and produces about 300 kilowatt-hours a month, on average, reducing the typical electricity bill by about 30%.

With tax incentives, the cost of the system can drop to as low as \$5,000. Larger residential wind systems can cost as much as \$40,000 and cut electricity bills by 80% to 90%.

In addition to the federal tax incentive, state rebates are also available for small wind-turbine systems.

The California Energy Commission, for example, offers partial rebates on small wind turbines to customers of utilities, including Edison International subsidiary Southern California Edison, PG&E Corp.'s Pacific Gas and Electric and Sempra Energy's San Diego Gas & Electric Co.

Still, the small wind-turbine market remains tiny compared with the U.S. renewable energy market as

a whole.

Total installed U.S. small wind-turbine capacity is about 100 megawatts, or enough to power roughly 80,000 homes, versus just over one gigawatt of solar photovoltaic capacity at the end of 2008.

Zoning and permitting can present major hurdles for consumers looking to install small wind-turbine systems, particularly in higher-density suburban areas.

Many municipalities prohibit buildings and structures taller than 30 feet high in residential subdivisions.

For that reason, Southwest Windpower has focused its marketing efforts on homeowners and business owners in rural areas.

"Our target market is areas where property owners have a half-acre of land or more," said Andy Kruse, the company's co-founder and vice president of business development.

But the small wind-turbine market continues to expand, particularly as the economy stabilizes, said Ron Stimmel, manager of small wind systems for the American Wind Energy Association.

"The economic recession hit everybody, and small wind was no exception," Mr. Stimmel said. "But the interest is still there."

As the economy recovers, I think we'll see a surge in sales from people who had temporarily put off the decision."

Senate clears Lael Brainard for Treasury

By COREY BOLES

WASHINGTON—Lael Brainard on Tuesday won Senate approval to take over the Treasury Department's top post for international affairs after a months-long delay, filling a key position at the agency more than a year after President Barack Obama arrived at the White House.

Ms. Brainard, 47 years old, and a former deputy director of the National Economic Council in the Clinton administration, is expected to play a major role on issues such as the U.S.'s delicate negotiations with China over the value of its currency and Washington's push to secure international cooperation on the restructuring of the global financial sector's regulatory framework.

Ms. Brainard's nomination for the job of undersecretary for international affairs had been delayed for months by Republican senators who expressed concerns over allegations she had failed to pay property taxes on time, and her perceived reluctance to come clean on the issue.

On Tuesday, the Senate voted 78-19 to approve Ms. Brainard's candidacy, with 19 Republicans joining the majority Democrats.

Democratic lawmakers have argued that Republicans are delaying a historically large number of administration officials.

WORLD NEWS

IMF in warning over new phase for debt crisis

BY TOM BARKLEY
AND BOB DAVIS

WASHINGTON—Greece's upheaval could mark the starting point of a "new phase" in the global financial crisis, one marked by escalating concerns about sovereign debt, the International Monetary Fund warned Tuesday.

"Higher debt levels have the potential for spillovers across financial systems, and to impact financial stability," the IMF said, noting that debt levels among advanced countries have already risen to levels not seen since the end of World War II.

Mounting risks of sovereign default can reverberate through the global economy, the IMF said, including by pushing up interest rates on government debt, which in turn causes interest rates on commercial debt to rise as well. A diminished faith in the value of government guarantees can also push up bor-

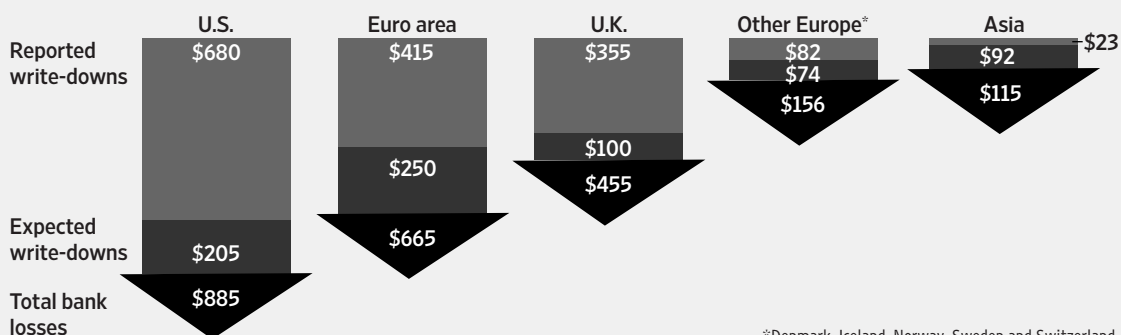
rowing costs across nations as the market demands higher interest rates for commercial debt.

Tuesday's warnings come at a time when the global concern over bank losses appears to have ebbed. In its semiannual Global Financial Stability Report, the IMF projected that global banks would book losses of \$2.3 trillion for the 2007-2010 period, down from its October 2009 projection of \$2.8 trillion in losses. About \$1.6 trillion has already been written off, it said, with another \$700 billion in losses still to be recognized. The report estimated that banks could cover those losses through their anticipated earnings.

"Banks have been raising significant amounts of capital so that now they can cope with the losses that are coming in a way that puts them in a rather comfortable position," Jose Vinals, director of the IMF's monetary and capital markets department, told reporters.

Bank losses

The International Monetary Fund reduced its global estimates of bank write-downs between 2007 and 2010 to \$2.3 trillion from its Oct. 2009 estimate of \$2.8 trillion. Estimated losses, in billions of dollars, by region.



Two former senior IMF economists, Kenneth Rogoff, now at Harvard, and Carmen Reinhart, now at the University of Maryland, have been warning that banking crises frequently lead to sovereign debt crises several years later, in part because governments spend so heavily to restore their banking systems to health. Essentially, the IMF report was adding detail to the work of Mr. Rogoff and Ms. Reinhart.

"Careful management of sovereign risks is essential: governments need to design credible medium-term fiscal consolidation plans in order to curb rising debt burdens and avoid taking the credit crisis into a new phase," the IMF said in its report. Greece's struggles to get

out from under a mountain of debt should serve as a "wake-up" call to governments, Mr. Vinals said.

Still, Mr. Vinals was quick to describe Greece as a special case that shouldn't be lumped together with other countries whose deficits have come under the market's glare: Spain, Portugal and Ireland started out with better fiscal situations and institutions than Greece, he said, and have already taken measures to address budget concerns.

Speculation in sovereign credit-default swaps, which Greek Prime Minister George Papandreou has blamed for helping push the country deeper into crisis, may sometimes can exaggerate public debt strains, said Mr. Vinals. Proposals to ban na-

cred CDSs—betting on the default of a credit without having an underlying interest in the bonds—would be counterproductive given the difficulty of defining illegitimate activities, he said.

The IMF report noted that money is flooding into Asia and other emerging markets, particularly because interest rates are so low in the U.S. and Europe. Some markets show evidence of overheating, and not only in developing countries, the IMF said. These include residential real estate in Australia, China, Hong Kong and France, and sovereign debt in Japan. "But we find little evidence that bubbles have formed in these segments in the near term," the IMF said.

India raises rates to curb inflation

BY ANANT VIJAY KALA
AND SUBHADIP SIRCAR

MUMBAI—India's central bank raised interest rates for a second time in as many months and tightened monetary policy Tuesday, withdrawing some stimulus that spurred an economic recovery but is now fanning inflation.

The Reserve Bank of India raised the rate at which it lends overnight money to banks—known as the repurchase rate—by a quarter-percentage point to 5.25% and its main borrowing rate, the reverse repurchase rate, by a similar quarter point to 3.75%, effective immediately. It also drained 125 billion rupees (\$2.79 billion) of liquidity from the banking system by raising the cash reserve ratio, or the part of deposits that banks must set aside with the Reserve Bank of India, by a quarter point to 6%.

The tightening showed India's central bank is trying to balance the need to fight the surge in inflation while ensuring it doesn't derail the economy's rebound.

India is among a few Asia-Pacific countries that have begun normalizing loose monetary policy, while many Western nations, unaffected by inflation, continue to maintain an easy stance to spur growth.

Asia has led the recovery in the global economy, but very easy monetary policies of regional central banks have stoked consumer-price pressures and ignited inflation in real estate and other asset prices. Australia, Malaysia and Vietnam have increased interest rates.

Others, including China and the Philippines, have stepped up efforts to soak up liquidity. Singapore last week conducted its most aggressive monetary tightening ever to keep a lid on prices.

India's central bank gave an upbeat outlook for growth and predicted inflation would gradually decline from its near double-digit level

now. But bank policy makers indicated—in sentiments echoed by Finance Minister Pranab Mukherjee—that further monetary tightening is on the horizon, as it rolls back the extraordinary stimulus that helped India ride out the global financial crisis with only a relatively mild slowdown in growth.

In an interview, RBI governor Duvvuri Subbarao warned that structural pressure on inflation may remain for some time.

"As income levels go up, people eat better, supply pressures build and responses take time to meet those pressures," he said.

A large part of inflation remains outside the scope of the central bank's policy influence, Mr. Subbarao added, noting, "Food has a weight of 46%-70% in inflation indexes. In that context, a large percentage of commodities in the inflation basket is beyond the scope of demand-side management. It will be challenging and probably inappropriate for RBI to be an inflation-targeting bank."

The central bank said in its annual monetary policy review that "in the emerging scenario, lower policy rates can complicate the inflation outlook and impair inflationary expectations, particularly given the recent escalation in the prices of non-food manufactured items."

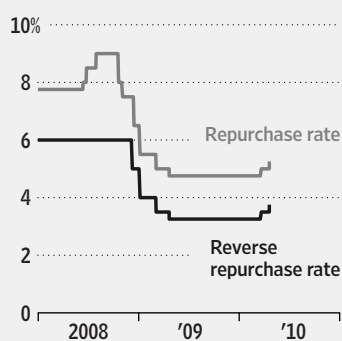
The tightening builds on a surprise intermeeting rate increase in March, but the RBI still has a long way to go to reverse the deep rate cuts it made from October 2008 to April 2009.

With inflation at 9.9% in March and spreading from food prices to manufactured goods, some analysts say the central bank has fallen behind the curve.

Economists said the RBI may make its next move before its next scheduled meeting in July, predicting it may raise its key policy rates and cash reserve ratio by another quarter point each. HSBC expects

Another rise

India's key interest rates



the RBI to raise its key interest rates by 1.5 points by mid-2011. It has also penciled in a quarter-point increase in the cash reserve ratio this year.

Mr. Mukherjee, the finance minister, said the RBI's move will likely have a mild effect in tightening monetary conditions and damp further inflationary pressures, but indicated the central bank's move to tighten more should be calibrated.

"I believe that it is time to move back toward neutral policy rates, that is, rates that should prevail when an economy is stable and on track. I view these changes as moves toward normal times," he said. "It has to be recalled that these policy rates were lowered in the last two years in order to combat the fallout of the global recession on the Indian economy. India has now bounced back, with growth seemingly back on track and inflation, though high, on a clear downward trend."

Mr. Subbarao said the central bank will take "several baby steps" to increase interest rates.

"We are also sensitive to the fact that growth is coming from sectors which are interest-rate sensitive. So I believe that what we have done to-

day is a long road map for normalizing policy rates," Mr. Subbarao said.

He didn't rule out the possibility of any action before the next scheduled policy meeting on July 27.

Bankers said the RBI's decision will create an upward bias on interest rates, but may not lead to an immediate increase in the cost of borrowing.

"Clearly during the year I see interest rates going up and there is clearly an upward bias. However I don't see an immediate impact on interest rates as of now," said Chanda Kochhar, managing director and chief executive at ICICI Bank.

The RBI forecast inflation will ease to 5.5% by the end of March 2011. Mr. Mukherjee is optimistic that inflation will come down further, forecasting it will fall to near 4%, with an upward bias, over the same time frame.

Prices in India surged after farm output was hit by the worst drought in 37 years last year and as supply bottlenecks compounded the problem.

The government expects inflation to remain high until around June, when the start of the monsoon season may help to cool down food prices.

An increasingly sturdy recovery in the economy gives the central bank room to pull back its monetary stimulus.

The central bank forecast the economy will grow 8.0% in the fiscal year that began April 1, slower than a 8.5% expansion projected by the government, but a faster rate than for the past fiscal year.

The central bank said it expects growth in the past fiscal year was between 7.2% and 7.5%.

The Bombay Stock Exchange benchmark Sensex was also up 0.8% after the rate decision and ended 0.3% higher at 17460.58.

—Nupur Acharya, Harsh Joshi, Prasanta Sahu and Khushita Vasant contributed to this article.

G-20 advised it should tax financial firms

BY BOB DAVIS

WASHINGTON—The International Monetary Fund advised the Group of 20 industrialized and developing nations to enact taxes on the balance sheets, profits and compensation of financial institutions to pay for the cost of shutting troubled financial firms in the event of another financial crisis.

"Expecting taxpayers to support the (financial) sector during bad times while allowing owners, managers and/or creditors of financial institutions to enjoy the gains of good times misallocates resources and undermines long-term growth," the IMF wrote in a briefing paper for the G-20 members.

Specifically, to pay for the costs of shutting troubled financial institutions, the IMF proposed what it called a "financial stability contribution"—a tax on balance sheets, including "possibly" off-balance-sheet items, but excluding capital and insured liabilities.

That tax would initially be a flat fee paid by all financial institutions, but over time could be adjusted to reflect the "riskiness" of an institution and its "contribution to systemic risk," the IMF said—the chance that a bank's failure could threaten to undermine a nation's economic system.

On top of that, the IMF urged nations to adopt what it called a Financial Activities Tax, levied on profits and compensation at financial institutions. That would be paid to a nation's treasury to help finance the costs of a financial crisis.

But the FAT would also reduce the size of the financial sector so it is more manageable and its failures would be less likely to batter economic growth. The proposal was initially disclosed in a report by the British Broadcasting Corp.