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New homes in France for Haitian children

Agence France-Presse/Getty Images

A French woman leaves Charles de Gaulle airport, outside Paris, with her adopted Haitian child—one of 113 who arrived Wednesday. A total of 318 children are in a program taking them to France from Haiti, which suffered a devastating earthquake in January and a cholera epidemic. **Article on page 6**

Norilsk nears deal to end tycoons' fight

By Gregory L. White
And Alexander Kolyandr

MOSCOW—A bitter, multiyear struggle for control of OAO **Norilsk Nickel** may be nearing a resolution as the arctic metals giant closes in on a deal to buy out one of its warring billionaire shareholders, according to Vladimir Potanin, the second of the two combatants.

In an interview with The Wall Street Journal, Mr. Potanin, who owns just under 30% of Norilsk, indicated that the company could close a deal within three to four months to buy the 25% stake held by Russian tycoon Oleg Deripaska's UC **Rusal**.

Mr. Potanin has been battling a plan by Mr. Deripaska, chairman and controlling shareholder of Rusal, to merge Norilsk with the big aluminum company.

"Norilsk made a generous offer to Rusal," Mr. Potanin told the Journal Wednesday, referring to Norilsk's proposal last week to buy back Rusal's stake for $12 billion. "It creates the chance to resolve the shareholder conflict," he said.

Rusal has long said it has no plans to sell its stake in Norilsk. But it seemed to soften its position Wednesday, hiring Bank of America-Merrill Lynch to help value the stake and formally announcing that management was evaluating the offer. Rusal said it continues to view the holding as a strategic asset.

People close to Rusal said the company is inclined to sell, though at a price closer to $15 billion.

Mr. Deripaska wasn't available for comment.

At current market prices, 25% of Norilsk is worth $10.5 billion, but Norilsk's proposal shows it is willing to pay a premium to resolve the tensions between its two largest shareholders, which have all but paralyzed the management of the world's largest nickel and platinum producer.

Resolving the tensions between the two tycoons would free up Norilsk to be more active in buying up other mining assets in Russia and abroad.

Shares in both Norilsk and Rusal rose last week after the offer was announced.

Selling its stake would help Hong Kong-listed Rusal pay down its heavy debt load, but would also be something of an admission of defeat for Mr. Deripaska. Mr. Potanin, along with Norilsk's management, has opposed his push to merge Rusal and Norilsk. The battle turned into a kind of corporate trench warfare, fought with back-room maneuvering, public recriminations and lawsuits.

Tuesday, management seemed to strengthen its hand, announcing a deal to sell an 8% stake that the company held indirectly to com-

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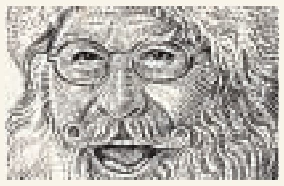
The Quirk



Yes, Virginia, there is a Santa, and these digital photos prove it. Page 29

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A comprehensive rundown of news from around the world. Pages 30-31

Editorial & Opinion

Britain abolishes the rule of law in tax collection. Page 14

Economic growth in U.S. shows signs of picking up

By Conor Dougherty

The U.S. economy grew slightly faster than the government previously estimated in the third quarter, and forecasters are raising growth projections for the fourth quarter and for 2011.

The nation's gross domestic product, a broad measure of goods and services produced by the economy, increased 2.6% in the third quarter, the Commerce Department said Wednesday.

In the government's previous report on how the economy performed, released a month ago, GDP was estimated to have risen 2.5% in the third quarter. This followed 1.7% growth in the second quarter.

Optimism for the U.S. recovery has grown sharply in the past month, fueled by a series of economic reports showing everything from consumers spending more freely to businesses curbing layoffs.

Wednesday's report showed exports strong and businesses spending more than previously thought on restocking shelves in the third quarter, a good sign since it can indicate they expect stronger sales ahead.

However, consumer spending was lower in the period than the government previously estimated.

The economy has shown signs of accelerating as it moved into the fourth quarter, and economists are predicting a strong holiday shopping season. The revival of consumer spending is also expected to continue next year, thanks in part to the large package of federal tax cuts signed into law earlier this month.

The sunnier outlook has led many economists to boost U.S. growth estimates for the fourth quarter and for 2011. Over recent weeks, eight banks and private economic research firms surveyed by The Wall Street Journal, including J.P. Morgan Chase & Co., Goldman Sachs Group

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PAGE TWO

EU badly needs Beijing bond backing

[Agenda]

By Patience Wheatcroft

The Diaoyutai State Guesthouse in Beijing was once the residence of Madame Mao. Now it provides China with an equivalent of Camp David, a high security compound for state visitors, and at the beginning of this week it was the site for the 3rd EU-China High Level Economic and Trade Dialogue.

Although the official communiques describe the talks in positive terms, there must have been moments when the EU delegation reflected ruefully on how the relative standing of the two blocs had changed since Chairman Mao's grim Cultural Revolution. A hint of what really went on inside the 800-year-old building came from the Chinese Commerce Minister, Chen Deming, who told the People's Daily: "We want to see if the EU is able to control sovereign debt risks and whether consensus can be translated into real action to enable Europe to emerge from the financial crisis soon and in a good shape."

As much of Europe continues to struggle with its mountainous debts, China has let it be known that it will be prepared to help out by buying bonds from stricken Greece and Portugal, but part of the price will be enduring lectures from the new paymasters.

Mr. Chen's qualms are, in any case, well justified. Another wave of protests against austerity measures erupted this week, with Greece brought to a halt by transport strikes and Italy beset by student demonstrators. In the U.K., Len McCluskey, the new head of the largest trade union, announced that he will convene a January meeting to discuss a "broad strike movement."

Governments which have, in some cases reluctantly, and only under pressure from their rescuers, adopted austerity measures will find it was easier to announce them than to put them into effect.

Reuters

Chinese Commerce Minister Chen Deming at the EU-China talks on Tuesday.

But as 2010 nears its end, there is in Europe a widespread acceptance of the fact that there are tough times ahead. A survey by Gallup International, conducted across 53 countries and reported on the BBC, found that people in 19 countries were generally optimistic about their well being for 2011 and people in 34 countries were not. Most European countries fell into the second group, while countries such as China and India were firmly in the first group.

Concerns over employment were one of the major factors influencing views in the West. With the public sector set to cut jobs in over-borrowed countries, the fear is that new jobs will be hard to find.

> The European Commission could retaliate with some comment on the evils of consumers under-spending.

That is one reason why the EU delegation made the trip to Beijing. China is Europe's fastest growing export market. EU exports to China reached €82 billion ($107 billion) last year, up 4% on the previous year, but this year has seen a much faster increase. In the eight months to the end of August, the increase over the same period in 2009 was almost 40%.

But, says the European Commission: "The absolute level of EU exports remains below the potential" that the designated "special relationship" between the two would justify. According to the Chinese, the country's trade surplus with the EU for the first 11 months of the year was a whopping $131 billion.

So even if it meant putting up with some lecturing on the errors of over-borrowing, Commission vice-president, Joaquin Almunia and his colleagues judged that the potential gains from the dialogue would make the visit worthwhile. They could, after all, retaliate with some comment on the evils of consumers under-spending.

But the communiques coming out of the meeting are short on detailed good news. There was an agreement to speed up a feasibility study for a bilateral investment treaty and some movement to enhance mutual trade in high-tech products. Yet while the EU team stressed the importance of access to raw materials, and in particular the rare earths which are essential components in many high technology and renewable technologies, it did not return from Beijing brandishing guarantees of supply. This is a crucial issue since China is now responsible for 97% of sales of these aptly named rare commodities.

Yet the EU is not in an enviable negotiating position. With the ratings agencies threatening another downgrade for both Portugal and Greece, the most pressing need is for China's support of the bond auctions which will be essential in the new year. The shifting balance of power which was a main theme in 2010 has a long way further to go and will be one of the major forces shaping the next decade.

Auditors in the dock

Ernst & Young insists that it will put up a vigorous defence to the charge that it helped Lehman Brothers stage a "massive accounting fraud." At this stage, the firm could hardly say anything else, even if there were some within the firm were already calculating what sum might buy a speedy settlement of what could be a highly damaging case.

The role of auditors in the banking crisis has occasioned remarkably little comment and less action. The fact remains, however, that the auditors' reports attached to banks which then came close to collapse gave no hint of their risky states.

Yet the Cuomo case against Ernst and Young goes further than failing to spot risks. The firm signed off on transactions which enabled Lehman to give a totally false picture of its financial state. Legal opinion, understandably sought, declared that if the transactions were sited in the U.K., then the practice was acceptable.

Ernst & Young says that: "There is no factual or legal basis for a claim to be brought against an auditor in this context where the accounting for the underlying transaction is in accordance with the Generally Accepted Accounting Principles."

Which might leave reasonable people to wonder whether the terms "accounting" and "principles" belong together.

What's News

- **Switzerland's government** signaled that it wants to quickly enact legislation aimed at ensuring that its biggest banks no longer are "too big to fail," putting a draft law out for comment. 19
- **European stocks extended** their winning streak to three sessions, while the Swiss franc hit a record against the euro as investors continued to seek safety from the euro zone's debt crisis. 23
- **Greece's public transport** workers walked off the job as demonstrators gathered in front of parliament to protest ahead of a vote on a 2011 austerity budget. 4
- **Sony started** a streaming music service in the U.K. and Ireland that it plans to roll out more broadly next year in an effort to catch up to rivals such as Apple. 19
- **DP World sold** 75% of its Australian port interests to an infrastructure fund managed by Citigroup. 19

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5. Odds Skew Against Investors in Bets on Strangers' Lives

The Source

blogs.wsj.com/source

'China's interest may delay the action that's sorely needed at the heart of Europe to make this project work.'

Continuing coverage

Browse defining images from the news in 2010 at **wsj.com/graphics**

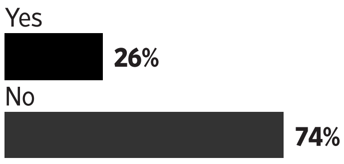
Question of the day

Vote and discuss: Do you plan to make a resolution for 2011? Tell us about it.

Vote online at **wsj.com/polls**

Previous results

Q: Should government impose 'net neutrality' on broadband providers?



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NEWS

BAA chief drops bonus amid Heathrow row

BY JONATHAN BUCK
AND KATHY GORDON

LONDON—The chief executive of U.K. airport operator BAA Ltd. said Wednesday that he will give up his annual bonus in the face of widespread criticism of his company's performance as a thaw in the U.K. enabled transport operators to increase services and shift part of the backlog of stranded passengers.

The respite may be brief, however: Temperatures hovering around zero degrees Celsius are forecast to dip below freezing again in coming days. Meanwhile, **British Airways** PLC, which operates more flights from London's Heathrow Airport than any other airline, is pulling out all the stops to get travelers to their destinations in time for Christmas.

BAA CEO Colin Matthews has been feeling the heat for his company's failure to restore promptly operations at Heathrow Airport after snow fell at the weekend.

Anger reached new heights Tuesday. Acknowledging that heavy snowfall had forced the world's busiest international airport to close, Prime Minister David Cameron said: "I'm frustrated on behalf of all those affected that it's taking so long for the situation to improve."

He added that he had offered military assistance to Heathrow's owner to help get the airport moving, but the offer had been declined.

BAA on Wednesday issued a tersely worded two-sentence statement containing remarks attributed to Mr. Matthews. "I have decided to give up my bonus for the current year," it said. "My focus is on getting people moving and rebuilding confidence in Heathrow."

The prospects of services getting back to normal improved Wednesday, but more disruption can't be ruled out. "More cold weather is forecast and there may be further delays and cancellations," BAA warned on its website.

Severe weather warnings were in place in central England in anticipation of heavy snow, but in the southeast, where London's Heathrow and Gatwick airports are located, conditions are forecast to remain snow-free until after Christmas.

BAA, a unit of **Ferrovial** SA of Spain, late Tuesday reopened Heathrow's second runway to increase capacity. The runway had been closed since the weekend snowfall.

BAA, which operates six U.K. airports, said it had removed 30,000 tons of snow from the runways and an additional 30,000 tons from the aircraft stands at Heathrow, the world's busiest international hub.

The BAA spokeswoman said Heathrow also had good stocks of deicer.

Eurostar, which provides a rail link between London and Paris and Brussels via the Channel Tunnel, on Wednesday was operating 90% of its scheduled service and had transported almost all its stranded passengers, a spokeswoman said.

In Frankfurt, conditions also were improving.

Associated Press

Riot police guard the Greek parliament building as protesters hold a banner that reads 'Stability pact? No thanks' during a rally in Athens, Wednesday.

Transit strike freezes Athens

By Alkman Granitsas

ATHENS—Greece's public transport workers walked off the job Wednesday in a 24-hour strike, as hundreds of demonstrators gathered in front of parliament to protest government reforms just hours ahead of a key vote on a 2011 austerity budget.

The demonstration was peaceful, with several hundred protesters holding banners that called for workers to resist reform measures. It was accompanied by a three-hour work stoppage in the greater Athens area that affected public services at government offices, local government operations, schools and other services. Greece's two major umbrella unions, the private sector GSEE and public sector ADEDY, organized the demonstration.

"Today's mobilization represents the continuing reaction of the workers, the pensioners and the unemployed against the unjust economic measures being implemented by the government," GSEE said in a statement.

The transport workers' strike halted all mass transit around the capital, Athens, and led to massive traffic jams, some stretching up to 10 kilometers in various parts of the city, as residents struggled to get to work. Since last week, Greece has been hit by a series of work stoppages and strikes over austerity measures and other reforms the government is implementing in exchange for the €110 billion ($144 billion) bailout from the European Union and International Monetary Fund that helped Greece avert defaulting in May.

The 2011 budget, which includes fresh austerity measures, such as further spending cuts and tax rises, aims to narrow the deficit to 7.4% of gross domestic product next year from a projected 9.4% gap in 2010. As part of the bailout agreement, Greece agreed to reduce its deficit to below 3% of GDP by 2014.

Last week, Greece's parliament approved separate legislation to cap salaries and slash bonuses at state-owned enterprises, particularly at loss-making public transport companies.

The measures have drawn criticism from both opposition political parties as well as from backbenchers among the ruling Socialists. Despite that, the Socialist government, which controls 156 seats in Greece's 300 member parliament, was expected to pass the budget.

Greek lawmakers were expected to vote on the budget at midnight local time.

Belarus opposition faces jail term

Associated Press

MINSK, Belarus—Seven presidential candidates who ran against the country's authoritarian leader could face as much as 15 years in prison, and one was beaten so badly in the election's aftermath he is unable to walk, his lawyer and a human-rights organization said.

Pavel Sapelko said Wednesday he suspects his client, Andrei Sannikov, has a broken leg, yet he was refused an X-ray.

"He feels very bad and looks very bad," Mr. Sapelko said.

Mr. Sannikov received the most votes among the opposition candidates—2.4%, compared with winner Alexander Lukashenko's 79.6%.

Mr. Sannikov is one of among seven candidates who could face as much as 15 years in prison in the wake of postelection violence and massive arrests, Belarusian human-rights organization Vesna said Wednesday.

Lawyer Tamara Sidorenko said her client Vladimir Neklyayev, another prominent challenger, was also beaten as he tried to lead a column of supporters to the protest in central Minsk on Sunday night.

He was taken to a hospital, and an aide said men in civilian clothing wrapped him in a blanket on his hospital bed and carried him away as his wife screamed. The lawyer said she hasn't been allowed to visit him since.

Agence France-Presse/Getty Images

People hold candles near a prison in Minsk in protest over mass arrests.

The former Soviet state's security service, which is still called the KGB, has filed charges against 20 top opposition figures, including the seven candidates, for organizing mass disturbances, said Ales Belyatsky of Vesna. KGB spokesman Alexander Antonovich declined to comment.

Overall, some 700 people were arrested after Sunday's election that returned Mr. Lukashenko to a fourth term in office. International monitors called the election fraudulent.

Two of the arrested candidates were later released, but both of them—Grigory Kostusyev and Dmitry Uss—were summoned to KGB offices for further questioning on Wednesday.

Mr. Lukashenko, often called Europe's last dictator, has been in power in Belarus for more than 16 years. The repression has been an embarrassment to the European Union, which had offered €3 billion ($3.9 billion) in aid if the elections were judged to be free and fair.

In a brief telephone interview, Mr. Kostusyev said "the regime has shown its true essence," adding, "We've been thrown 10 years into the past."

Others charged include Mr. Sannikov's wife, Irina Khalip, and the editor of an opposition website affiliated with Mr. Sannikov, Nataliya Radina, according to Vesna.

The other arrested candidates are Nikolai Statkevich, Vitaly Rymashevsky and Ales Mikhalevich.

At least 25 journalists were also detained during or after the Sunday's rally, and several of them were sentenced to as long as 15 days in prison for "participation in an illegal demonstration," a press freedom group said Wednesday.

Also Wednesday, the Belarusian parliament ratified an agreement to create a "unified economic space" with Russia and Kazakhstan in what some observers regard as Moscow's attempt to shore up influence among neighboring countries.

Preliminary agreement on the zone was reached 10 days before the election.

As part of that agreement, Russia said it would drop tariffs on oil exported to Belarus, a concession that significantly strengthened Mr. Lukashenko's hand.

Minister draws ire over Nobel ceremony

Associated Press

OSLO, Norway—Imprisoned Chinese dissident Liu Xiaobo's empty chair was a powerful symbol at the Nobel Peace Prize ceremony held in his honor.

Few noticed another absence at Oslo's City Hall: Norwegian Trade Minister Trond Giske, who is in charge of talks on a potentially groundbreaking trade pact with China.

Mr. Giske skipped the ceremony on Friday, Dec. 10—the highlight of the year in Norway—because he was sick, his spokeswoman, Anne Cecilie Lund, said this week.

Norway was represented by the royal family and top members of the center-left government, including Prime Minister Jens Stoltenberg and Foreign Minister Jonas Gahr Stoere.

Now some opposition politicians are questioning whether Mr. Giske's sudden illness—he returned to work the following Monday—was an attempt to appease the infuriated Chinese government and get trade talks back on track.

The minister has declined to discuss his illness, but opposition politicians are questioning the absence.

"If he had a cold he could just have said so. I think it is an attempt to get Norway back into trade negotiations with China," said Peter Gitmark, the opposition Conservative Party's spokesman on human rights.

Mr. Liu is serving an 11-year prison sentence for sedition after co-authoring a bold appeal for human rights and multiparty democracy known as Charter 08.

China reacted with outrage when the Norwegian Nobel Committee on Oct. 8 declared him the winner of the 2010 peace prize. Beijing said relations with Norway would suffer and pressured governments to boycott the ceremony.

The prize put Norway, a staunch defender of human rights around the world, in a tough spot. Oslo has long called for Mr. Liu's release as part of its human-rights dialogue with China. But it also aims to become the first European country to sign a bilateral free-trade agreement with China.

While expressing support for Mr. Liu, Norwegian officials lost no opportunity to remind China that the government has no influence on the decisions of the independent Nobel committee.

But some observers say that with Mr. Giske's absence, the government may have tried to send a signal that it doesn't want to jeopardize the trade ties. "If he had been there it could possibly cause him problems later in the trade negotiations," said Halvor Eifring, a China expert at the University of Oslo.

Mr. Giske's office declined requests for an interview with the minister. His spokeswoman confirmed Mr. Giske was in the office the day before the ceremony, which was on a Friday, and on the following Monday. She declined to give other details.

"There is no controversy about the fact that the minister was sick, and he should not have to elaborate on the details of his illness," Ms. Lund said in an email.

New tapes further roil U.K. coalition

By Alistair MacDonald

Press Association (left); Getty Images

Deputy Prime Minister Nick Clegg, pictured at left, center, said nobody should be surprised by reports of what Liberal Democrat ministers like Business Secretary Vince Cable, above, said reflecting disagreements with their Tory coalition partners.

The U.K.'s coalition government struggled to contain further fallout Wednesday as new tapes surfaced that illustrated tensions between the government's coalition partners.

The coalition between the Conservative and Liberal Democrat parties has been hit by anger from Liberal Democrat voters that their typically left-leaning party has backed the Tories' aggressive measures on deficit reduction.

The new tapes by the Daily Telegraph newspaper contained comments by three Liberal Democrat government ministers that revealed private concern over coalition policies such as on welfare reform and tuition fees.

The party's troubles deepened earlier this week when Vince Cable—one of the most influential members of the junior coalition partner—was stripped of key responsibilities after he was caught on an undercover reporter's tape saying he had "declared war" on Rupert Murdoch's **News Corp.**

Mr. Cable had been slated to make a key regulatory decision regarding News Corp.'s proposal to acquire the remainder of **British Sky Broadcasting Group** PLC that it doesn't already own.

News Corp. is the publisher of The Wall Street Journal. It also owns several U.K. newspapers, including the Sun, the country's best-selling paper, and the Times and Sunday Times.

Senior officials attempted to play down fractures in the seven-month-old government.

Both parties will likely seek to ride out the latest blow to their union, as both stand to lose more in a divorce than by sticking with their fractious marriage.

On Wednesday, Liberal Democrat leader Nick Clegg, the deputy prime minister, said nobody should be surprised by reports of what Liberal Democrat ministers said.

"There are differences of opinion in a coalition as indeed there are in all governments," he said.

The revelations severely undercut the picture of coalition cooperation painted by Mr. Clegg and Conservative Prime Minister David Cameron.

Both parties will likely seek to ride out the latest blow to their union, because both stand to lose more in a divorce than by sticking with their fractious marriage.

And the situation further weakens a Liberal Democrat party that found itself in an unlikely position of influence after a May election in which no party won a majority of Parliament.

"This will be taken as Liberal Democrats b— behind the scenes and not getting things done, and that will affect Nick Clegg's narrative that the party is achieving things in the government," said Steven Fielding, professor of political history at the University of Nottingham.

Mr. Cable's fall from grace also blunts the effectiveness of one of the party's most popular politicians and its second-most-powerful cabinet lawmaker.

The newspaper sting comes on top of a month's worth of woe for Britain's third party.

Earlier this month, the party was heavily criticized after almost half its lawmakers voted for an increase in higher-education tuition fees.

The party had pledged before May's election to vote down an increase.

Liberal Democrats have also come under fire for their general support for the Conservatives' wider spending cuts, which are the most aggressive of major economies.

In a recent poll for pollsters ComRes, only 11% of those asked said they would vote for the Liberal Democrats, down from a three-year average of 18%. The Conservatives have managed to mainly escape the public's wraith, polling around 37%.

Some Liberal Democrat Parliamentarians counter that the revelations could actually boost support, given they show that the party hasn't fully bought into the Tory agenda and is fighting behind the scenes. But most Liberal Democrats are looking nervously at a mid-January by-election in northern England that the party would once have been expected to win.

The opposition Labour Party cranked up its efforts to capitalize on the latest blunders, with business spokesman John Denham writing to Gus O'Donnell, the U.K.'s most senior civil servant, asking him to investigate whether Mr. Cable had breached the country's Ministerial Code, in which officials are asked to carry out their duties with objectivity and openness.

Mr. Denham also questioned the impartiality of Jeremy Hunt, the Tory lawmaker who has inherited Mr. Cable's power to rule on media-plurality grounds over News Corp.'s bid to buy the 60.9% of BSkyB it doesn't already own.

Mr. Denham questioned Mr. Hunt's impartiality, given that he has said publicly that the proposed merger doesn't amount to "a substantive change" amid other positive comments on Mr. Murdoch's business.

Mr. O'Donnell replied to Mr. Denham in a letter that Mr. Hunt's public "statements don't amount to a pre-judgment of the case in question."

BOE notes more inflationary risks

By Natasha Brereton And Nicholas Winning

LONDON—The Bank of England's Monetary Policy Committee saw an increase in inflationary risks in December, suggesting that its next move is more likely to be a rise in interest rates than a boost to stimulus.

Meanwhile, the U.K. economy expanded by a reduced estimate of 0.7% in the third quarter, although the savings rate rose slightly in the July-September period, the Office for National Statistics said Wednesday.

While economic growth was trimmed for the third quarter, the latest data still suggest the U.K. economy underwent solid growth through much of 2010. However, economists remain nervous about growth in the coming months.

Manufacturing and services-sector surveys have been strong recently but unemployment has ticked higher in recent months and house prices have fallen.

Minutes from the MPC's latest meeting showed that Adam Posen continued to favor a £50 billion ($77.31 billion) extension of the BOE's £200 billion program of buying U.K. government bonds, while Andrew Sentance once again called for a quarter-point rise in the key interest rate to 0.75%.

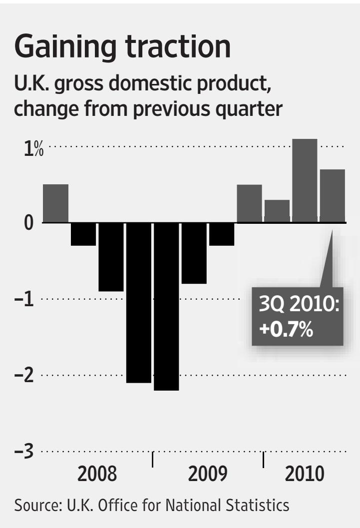
The majority, though, judged that conditions hadn't altered sufficiently to justify a change in policy, saying they saw "sizable" inflationary as well as disinflationary risks, and that they were ready to react to any material shift.

But "most of those members considered that the accumulation of news over recent months had probably shifted the balance of risks to inflation in the medium term upwards," the minutes stated.

The Dec. 8-9 policy meeting, at which the MPC majority agreed to keep the BOE's benchmark interest rate at its all-time low of 0.5% and to leave its quantitative-easing bond purchases at £200 billion, marked the third consecutive month that the vote has been split three ways.

The minutes underscore the delicate balance that BOE policy makers have to achieve, between fostering a sustainable economic recovery and preventing temporary inflationary shocks from becoming embedded in the public psyche.

On the one hand, euro-zone sovereign-debt concerns raise the risk



that private-sector demand won't be strong enough to compensate for aggressive fiscal austerity measures and to erode the large amount of economic spare capacity.

While the "persistent period of financial market distress" was unlikely to have a big direct impact on demand for U.K. exports, policy makers believed, it could have a negative influence on business and consumer confidence in the U.K. and beyond, and on the ability of U.K. banks to raise funding.

"The likelihood of these events occurring was hard to judge, but their impact could be large," the minutes said.

On the flipside, the MPC judged that the U.K. economy probably grew around or slightly above its trend rate in the second half of 2010. It also noted positive signs that activity was becoming less reliant on corporate restocking, and that a rebalancing of demand toward exports had begun.

Separately, the Office for National Statistics reported that U.K. output rose 0.7% in the third quarter compared with the second quarter, and by 2.7% annually. Third-quarter growth was previously reported at 0.8% and 2.8%.

The ONS also lowered its estimate for second-quarter growth, reducing the quarterly growth rate to 1.1% from 1.2%. However the ONS slightly cut the size of the economy's decline in 2009. As a result, the peak-to-trough output decline during the 2008-09 recession was revised to 6.4% from 6.5%.

—Laurence Norman and Ainsley Thomson contributed to this article.

Haitian kids arrive in France to start new lives

Associated Press

PARIS—More than 100 children from Haiti arrived in France on Wednesday to start new lives with their adoptive families—an event some parents described as an early Christmas present.

Many children were bundled up in bright new winter coats, and some were wrapped in reflective blankets to keep out the unaccustomed cold, as they arrived at Paris's Charles de Gaulle Airport from their Caribbean homeland.

The French government had chartered a plane to take adoptive families to Haiti to pick up 113 children from the country, which is still reeling from a January earthquake and now a deadly cholera epidemic.

Adoptive mother Isabelle Frapat, holding 15-month-old Mael in her arms, told reporters the experience was "pure happiness, and all that at Christmastime."

The flight Wednesday brought the first group of the more than 300 children who are expected to start a new life in France. Another flight is expected Friday.

EUROPE NEWS

European Pressphoto Agency

Prime Minister Viktor Orbán, left, met with President of the European Council Herman Van Rompuy in Budapest Tuesday.

Hungarian press law fuels EU concerns

By Veronika Gulyas
And Bernd Radowitz

BUDAPEST—A Hungarian media crackdown and an open policy clash between the government and its central bank have raised alarms just as the country prepares to take over the rotating European Union presidency.

The storm brewed up after Hungary's parliament Tuesday passed a controversial media law that will expand the government's power to monitor and penalize private media. The law allows a new media regulator appointed by Prime Minister Viktor Orbán's ruling center-right party to fine journalists if coverage is deemed politically "unbalanced."

The committee will be able to inspect media and force journalists to reveal sources in matters deemed to fall under national security.

The Organization for Security and Co-operation in Europe on Wednesday said the legislation violates OSCE standards for press freedoms and endangers editorial independence.

The law regulates all media content based on identical principles. It also gives unusually broad powers to the recently established media authority and media council, which are led exclusively by members supported by the governing party, said Dunja Mijatovic, the OSCE representative for press freedom.

"Such concentration of power in regulatory authorities is unprecedented in European democracies, and it harms media freedom," Ms. Mijatovic said.

Meanwhile, financial markets are worrying about the growing rift between Hungary's ruling Fidesz party and the country's central bank, which has been demanding the government use more fiscal restraint and has been increasing interest rates despite government objections. The tensions risk resurrecting memories of Hungary's financial crisis in 2008.

Mr. Orbán snubbed an offer of aid from the International Monetary Fund earlier this year, claiming that the country could regain fiscal stability on its own.

Capital Economics analyst Neil Shearing said Hungarian interest rates might now have peaked. "But tensions between the government and the National Bank are high and rising," he said. "Accordingly, Hungarian assets will continue to carry a hefty risk premium well into 2011."

After winning a landslide election victory in April with a populist message, Mr. Orbán has worked to jump-start economic growth by cutting personal income taxes, lowering taxes on smaller enterprises, and boosting some social welfare payments.

The governor of Hungary's central bank, András Simor, said the policies are risky and warned that eroding investor confidence is one of the biggest potential threats to the economy. Fidesz party lawmakers demanded that Mr. Simor resign and introduced a bill to change how the central bank's interest rate-setting committee is chosen.

Political Europe is more concerned about the new press law, and the image problem it could present for the 27-nation European Union.

Germany's government called on Hungary to take into account the OSCE's criticism, and a spokesman for the European Commission said the EU executive will follow the situation very closely and take action if European media law or legal principles were found to be infringed.

Spain draws fire over plan to cut solar-power aid

By Guy Chazan

A group of international investors has called on the Spanish government to reconsider plans to cut costly subsidies for solar power, saying they would cause a wave of defaults and more bad loans for Europe's banks.

Tom Murley, head of the renewable-energy team at U.K. private-equity firm HgCapital, said the changes represented a "breach of trust" that would increase regulatory uncertainty in the Spanish renewables industry.

"If they proceed on this path, they'll endanger not only our investment, but the whole sector," said Mr. Murley, who represents a group of 20 pension-fund managers and strategic investors in the Spanish solar-photovoltaic, or PV, industry.

The Spanish government is expected to adopt a proposal in the next few days that will cut solar-PV subsidies by as much as 30%—including for existing power plants, according to industry officials. A government spokesman couldn't be reached for comment.

Spain is one of a number of cash-strapped European countries that have been forced to review their generous system of subsidies for renewable energy, in order to lower electricity bills for consumers struggling under austerity measures and cuts in public spending.

Like Germany, Spain has long had feed-in tariffs, which guarantee the price for low-carbon electricity and so assure renewables companies a higher return than they could expect from the free market. They were seen as crucial if European countries were to meet tough targets for reducing their greenhouse-gas emissions.

In Spain, solar-PV plants that were connected to the grid by September 2008 receive a feed-in tariff of €450 ($589) per megawatt hour of electricity for 25 years—roughly 10 times the price utilities pay for power produced from conventional sources such as gas and coal.

Small-time investors poured in to take advantage of the incentives, building huge installations of photovoltaic panels across Spain. The country now has 3,200 megawatts of solar capacity, more than six times what the government expected to have by the end of 2010. Last year alone it handed out €2.6 billion in subsidies to solar power.

Since the financial crisis and ensuing recession hit in 2008, Spain has been seeking to reduce the cost of the handouts. In July it reached agreement with the renewables industry to cut the feed-in tariff for wind and solar-thermal projects—but only for new projects.

However, Spain took a different tack with solar photovoltaics. The cut it is planning for this sector will affect feed-in tariffs for existing power plants as well as new ones.

Investors say the cut is retroactive—a claim the government denies. Under the current regime, solar-power generators are entitled to be paid the feed-in tariff for all the electricity they produce. The government is proposing placing a cap on the number of subsidized hours of generation that solar plants can sell to the grid.

—Juan Montes contributed to this article.

European Pressphoto Agency

Valencia, Spain, hosted a photovoltaic solar-energy conference in September.

Swiss franc continues its surge against the euro

By Javier David
And Anita Greil

The Swiss franc is the new black. Unfortunately, that could push Switzerland's economy into the red.

Traders seeking shelter from financial instability in the euro zone have sent the franc rocketing to record highs against both Europe's common currency and the British pound. While a strong currency is normally a sign of investor confidence, the muscular franc poses a dilemma for Switzerland, whose relatively small and export-reliant economy may struggle under the surge in capital flows.

The Swiss franc rose broadly Wednesday, hitting another record high against the euro. The euro fell as far as 1.2440 francs, extending its declines this week. In afternoon New York trading, the euro was at 1.2472 francs. The franc also strengthened against the dollar to the highest levels since October.

Some market observers have taken to calling the Swiss franc "the new Deutsche mark," a reference to the German legacy currency that was once the darling of safe-haven investment flows. But Switzerland's gross domestic product is only $494 billion, less than half the size of the German economy.

"For a currency to be a safe harbor you need a big economy," said Arturo Bris, a finance professor at IMD Business School in Lausanne, Switzerland. "Switzerland cannot act as a shield from global shocks."

Underlying a large part of the Swiss franc's surge is an unfortunate truth. The global financial crisis has saddled most Group of Seven nations with sclerotic economies and budgets drowning in red ink.

"There is no acceptable reserve currency today," said Bruce Krasting, a former hedge-fund manager and Wall Street trader who now writes commentary about global markets. "The euro, dollar, sterling and yen all have issues."

Since March 2009, the SNB has periodically sold its currency in order to curb its strength. By printing Swiss francs and selling them against euros and dollars, the SNB effectively bloated its foreign-currency reserves, which rose to 212 billion Swiss francs ($221 billion) by November 2010, from less than 50 billion francs at the end of 2008.

Crack sentences still tough for many despite new law

By Gary Fields

The Fair Sentencing Act passed in the U.S. this summer knocked down the requirement of long prison sentences for possession of crack cocaine, but a quirk in how the law was written has resulted in some defendants being sentenced under the old rules—and the situation could continue for years.

Lawmakers who backed the change, with the support of the attorney general and federal sentencing officials, aren't pleased with the outcome. They said the new guidelines rectified an injustice born during the drug wars of the 1980s. Instead, the snafu has created a parallel universe where defendants face different rules for the same crimes—sometimes in front of the same judge—because their offenses were committed at different times.

The cause of the problem: Congress didn't say whether the legislation should apply to crimes committed before Aug. 3, when it was signed into law. Penalties for any repealed law remain in place for acts committed under that statute, unless lawmakers "expressly" establish otherwise, according to a federal statute.

And because prosecutors have a five-year statute of limitations to file charges for most federal crimes, people accused of committing crack-related offenses before the revision are subject to the old rules.

A Justice Department spokeswoman said prosecutors were required to seek the previous law's penalties for crimes committed before the changes were enacted.

But prosecutors and judges have always had some discretion in the crimes that are charged and sentences meted out. Congressional aides said the thinking of lawmakers who supported the law without a retroactive provision was that most prosecutors and judges would opt to follow the new, more lenient rules, even for acts committed before Aug. 3.

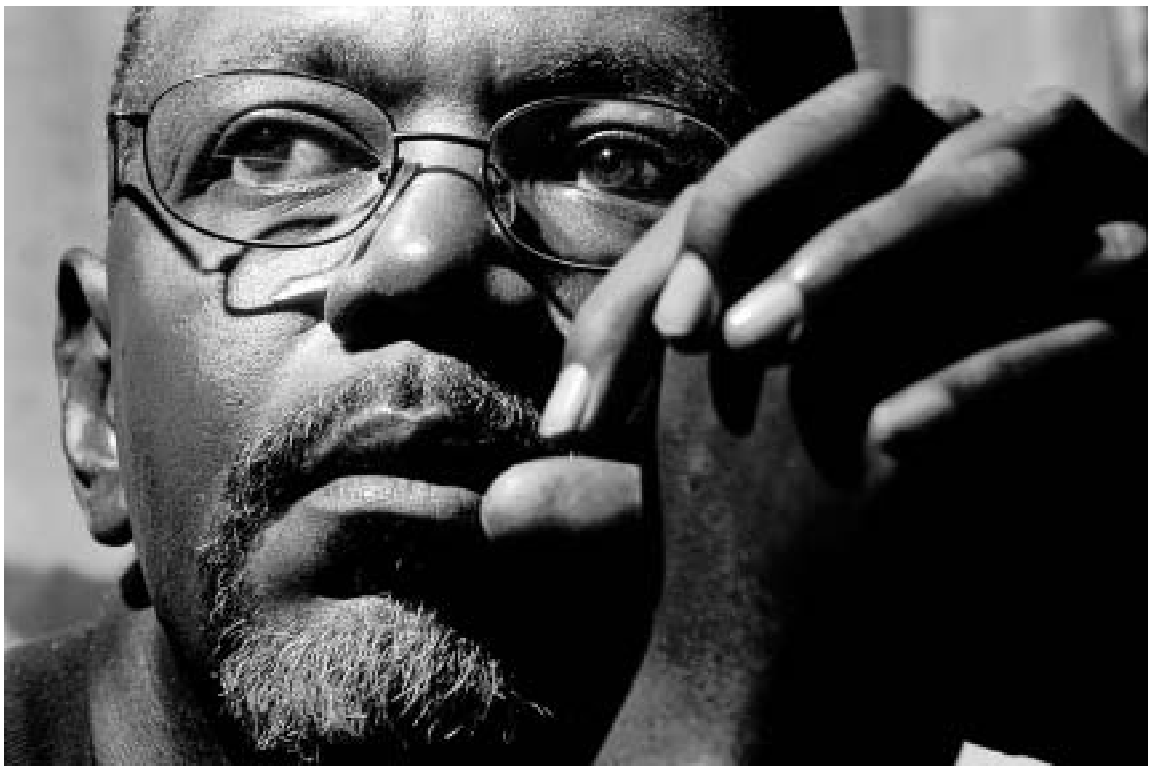
On Aug. 5—two days after the bill became law—Michael Donnell Sumerlin, 55 years old, was sentenced in a Birmingham, Ala., federal court to life in prison on a crack charge because he had two prior state marijuana-possession convictions. Under the new law, his sentence could have been closer to 12 to 15 years, said Scott Brower, the Birmingham attorney handling his appeal.

"I think this is something that's going to end up in front of the Supreme Court," Mr. Brower said.

Nearly 5,700 defendants each year are sentenced for crack-cocaine crimes, according to data from the U.S. Sentencing Commission, the agency that sets sentencing guidelines for judges.

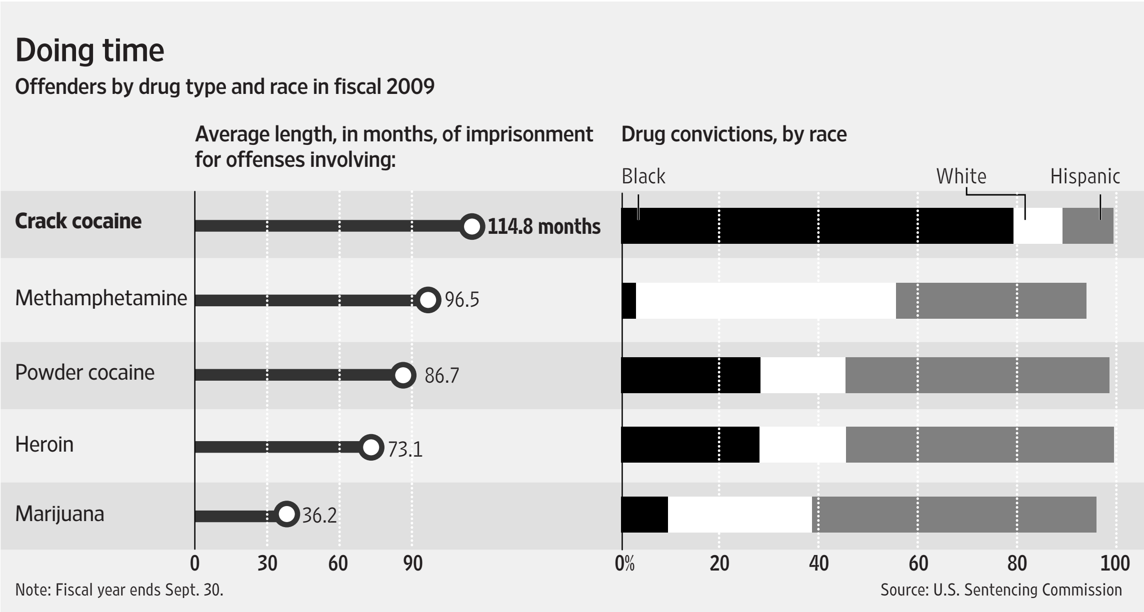
The new law was designed to ease a disparity in punishment for crack-cocaine versus powder-cocaine crimes. In the mid-1980s, lawmakers were worried about urban violence and generally held to the belief that crack cocaine was more addictive than powder cocaine. That theory has since been disproved.

The disparity also prompted charges of racism: Most people sentenced for crack are black, while those sentenced for powder cocaine are predominantly Hispanic, with whites and blacks to a lesser degree, according to the U.S. Sentencing Commission.



Associated Press

James V. Taylor was paroled after serving four years of a 15-year sentence for having a tiny amount of crack.



Previously, a defendant faced a minimum five-year term if convicted of possessing at least five grams of crack. Congress raised that minimum to 28 grams. The new law also raised the 10-year-sentence trigger for crack to 280 grams from 50 grams. Both moves bring the law closer to rules for powder cocaine.

In addition, under the old law, a life sentence was mandatory if a defendant had two prior felony drug convictions and then was found guilty of possessing at least 50 grams of crack. This was omitted from the new law.

Lawmakers didn't address whether the law should be retroactive out of concern that a battle over this issue would scuttle the tenuous deal that was reached to pass it, congressional aides said. Opponents of making the law retroactive argued that doing so would lead to a flood of appeals from people already sentenced.

A spokesman for Illinois Democratic Sen. Dick Durbin, one of the bill's proponents, said defendants should no longer be sentenced under a law that Congress has determined to be unfair. But Rep. Sheila Jackson Lee (D., Texas), who championed the measure in the House, said changing the law now to make it retroactive "is probably a steep climb." She instead intends to hold hearings to press prosecutors to exercise more latitude.

Rep. Bobby Scott (D., Va.) did introduce a bill Friday to make the law retroactive, but it is believed to have no chance of passing in the remaining days of Congress's lame-duck session.

Most judges are issuing sentences under the old crack-cocaine law for crimes committed before Aug. 3.

Earlier this month, Hartford, Conn., U.S. District Judge Christopher Droney sentenced a defendant to five years for possessing 14 grams of crack, after prosecutors argued that he had no alternative. Judge Droney said at the sentencing that he likely would have been more lenient if he had any leeway.

Early next year, in Bridgeport, Conn., Steven Singh, 32, and Marvin Conner, 32, will face the same five-year minimum sentence on the same day, before the same judge, for two drug crimes of different magnitude. Both pleaded guilty in October, Mr. Singh to possession with intent to distribute 15.8 grams of crack cocaine and Mr. Conner for intent to distribute 39 grams. Mr. Singh's offense occurred in Feb. 2009, putting him under the old law, which doubled his likely sentence. Mr. Connor's offense occurred at least partially after Aug. 3.

In Maine, U.S. District Judge D. Brock Hornby recently broke from the pattern, ruling in October that he would sentence William Douglas under the new law for an older crime. Mr. Douglas was convicted of possessing 113 grams of crack. Under the old rules he faced 10 years in prison.

In his ruling, Judge Hornby rejected the argument that the harsher law should be imposed, saying, "Congress stated its goal was to restore fairness to Federal cocaine sentencing. But what possible reason could there be to want judges to continue to impose sentences that are not fair over the next five years while the statute of limitations run?" Prosecutors filed notice they planned to appeal.

Arms pact with Russia is ratified by Senate

By Julian E. Barnes And Naftali Bendavid

WASHINGTON—The Senate voted Wednesday to ratify a new strategic arms treaty with Russia, a major foreign policy goal of the Obama administration, which views the pact as a key part of rebuilding relations with Moscow.

While ratification had appeared in jeopardy only days ago, the Senate voted 71-26 to approve the treaty, exceeding the two-thirds majority required. It was one of the final acts of the lame-duck Congress.

Senators spent much of this week working on side deals aimed at building support among wavering Republicans, including securing promises to continue missile-defense development and to modernize the nation's nuclear arsenal. In the end, 13 Republicans joined Democrats in voting for ratification of the bill.

Still, the Obama administration failed to secure support from some Republicans it had aggressively wooed.

Most prominently, Sen. John McCain of Arizona, a leader in the GOP on national security issues, voted against ratification.

Republican leaders were divided on the treaty, with Sen. Mitch McConnell of Kentucky and his top deputy opposed to the pact. Sen. Lamar Alexander, the No. 3 Republican senator, supported ratification.

The treaty cuts the deployed strategic force by about a third, to 1,500 warheads. It also restarts inspections of weapons facilities in the U.S. and Russia.

The treaty cuts the deployed strategic force by about a third, to 1,500 warheads. It also restarts inspections of weapons facilities in the U.S. and Russia.

Supporters say defeat would have weakened President Barack Obama, limiting his ability to negotiate future weapons pacts and his standing to lead efforts to reduce nuclear weapons around the world.

Still, critics remained firm, saying the treaty could eventually lead Russia to build a distinct strategic advantage, if it more aggressively pursued a new generation of nuclear weapons.

Opponents also said the treaty could constrain U.S. missile-defense efforts.

Vice President Joe Biden, a former member of the Senate Foreign Relations Committee, presided over the vote.

Secretary of State Hillary Clinton, also a former senator, came to the chamber for the occasion, hugging and chatting with former colleagues.

The ratification, coming with significant Republican support, was a major victory for Mr. Obama, capping a productive lame-duck session of Congress in which he showed he could cut deals with the GOP.

U.S. NEWS

'Don't ask' repeal is signed into law

By Jonathan Weisman

WASHINGTON—With gay veterans standing over his shoulder, President Barack Obama signed a law allowing homosexuals to serve openly in the military, hailing the hard-fought measure as a landmark in a struggle for equality and civil rights.

The emotional ceremony ended a battle that has been going on for decades, long before President Bill Clinton in 1993 signed what was supposed to be a compromise allowing gays into the military so long as they didn't reveal their sexual orientation. That "don't ask, don't tell" policy rested uneasily for nearly two decades.

The chairman of the Joint Chiefs of Staff, Adm. Mike Mullen, had opposed the policy, saying it encouraged U.S. servicemen to lie to their country and sacrifice their integrity.

The signing of the law doesn't end 'don't ask, don't tell' immediately, a point the president made as a warning to service members who might quickly come out.

Mr. Obama told a story of his recent, secret trip to Afghanistan, saying a young military woman pulled him into a hug and whispered: Get the repeal done.

"I said to her, 'I promise I will,' for we are not a nation that says 'don't ask, don't tell,' we are a nation that says 'out of many, we are one.' We are a nation that welcomes the service of every patriot. We are a nation that says all men are created equally," the president said.

He said the new law would "strengthen our national security and uphold the ideals our fighting men and women risk their lives to defend."

Opponents of the repeal, including prominent Republican veterans such as Sen. John McCain of Arizona, say they fear it will hurt military cohesion when the U.S. is fighting two wars. Marine Corps Commandant James Amos has said the repeal could affect combat effectiveness.

At the signing ceremony, Mr. Mullen, the joint chiefs chairman, stood on stage with Mr. Obama, along with Marine Staff Sgt. Eric Alva, the first American wounded in Iraq. With them was Commander Zoe Dunning, a U.S. Naval Academy graduate who came out as a lesbian at a rally during the 1993 effort to end the ban on gays in the military.

Mr. Alva was awarded the Purple Heart after a landmine blew off a leg and broke his right arm. After his medical discharge, he went to work for the gay-rights group Human Rights Campaign to lobby for the "don't ask, don't tell" repeal.

Ms. Dunning won a 2½-year legal fight to remain in the Navy Reserves, retiring in 2007 as one of the few veterans to serve as an openly gay officer for 13 years.

The signing doesn't end "don't ask, don't tell" immediately, a point Mr. Obama made as a warning to service members who might quickly announce themselves as gay. The military leadership and the president must first certify the change won't hurt troop readiness. But Mr. Obama promised to implement the repeal "swiftly and efficiently."

The signing came on what is likely the final day of the 111th Congress. A swarm of Democrats cheered as Mr. Obama acknowledged House Speaker Nancy Pelosi (D., Calif.), Senate Majority Leader Harry Reid (D., Nev.), and especially Rep. Patrick Murphy (D., Pa.), an Iraq War veteran.

Bloomberg News

President Barack Obama signs a repeal of 'don't ask, don't tell,' the legislation barring gays from serving openly in the military, in Washington on Wednesday. The ceremony ended a battle that has been going on for decades.

Mr. Murphy, once considered a rising Democratic star, spent much of this year campaigning for repeal of "don't ask, don't tell" instead of for re-election, a decision that infuriated many Democratic leaders. He lost his seat in last month's Republican House landslide.

The president used the signing ceremony in part as a victory lap marking the end of complete Democratic control of Congress, a period in which he signed into law sweeping health-care legislation, a record economic stimulus bill, a re-regulation of Wall Street, an overhaul of higher-education assistance, an extension of tax law and unemployment benefits and now a measure to allow gay service members to serve openly. In addition, the Senate on Wednesday ratified an arms-control treaty with Russia.

Historians say it has been the most productive legislative era since Lyndon Johnson's Great Society Congress in the 1960s, but it has been marked by acrimony and division. Only in the lame-duck session, after Democratic losses in the mid-term elections, has a hint of bipartisanship entered, said presidential scholar Robert Dallek. That change may prompt Americans to see this Congress as productive, he said.

"They've gotten a lot done during these two years, but somehow it hasn't registered until this lame-duck session," said Mr. Dallek, a Johnson biographer. "It's not the Great Society and New Deal, but this is the most productive session since Great Society."

—Jared A. Favole contributed to this article.

Economic growth shows signs of picking up speed in the U.S.

Continued from first page

Inc. and Macroeconomic Advisers, have raised their growth estimates for the last three months of the year to an average of 3.5% from 2.6% earlier in the month.

"Bottom line: People are less scared about a double dip," said Nariman Behravesh, chief economist at forecasting firm IHS Global Insight. Mr. Behravesh's firm recently increased its fourth-quarter forecast to 3.5% from 3.0% earlier in December.

Separately, the National Association of Realtors on Wednesday reported that U.S. sales of existing homes rose 5.6% in November from a month earlier, to a seasonally adjusted annual rate of 4.68 million units. Sales of used homes represent more than 90% of house sales in the U.S. The average price for an existing home was up for the first time since August, to $170,600 in November. That was an increase of 0.4% from a year ago.

The housing market is still extremely weak, despite the steadily improving outlook elsewhere in the economy. There is a huge stock of unsold homes, and roughly a third of existing homes sold were under some sort of financial stress, either in the form of foreclosure or homes sold for less than the owner owed the bank.

The inventory of previously owned homes listed for sale fell 4.0% at the end of November to 3.71 million units. That's a 9.5-month supply at the current sales pace, compared with a 10.5-month supply in October.

Associated Press

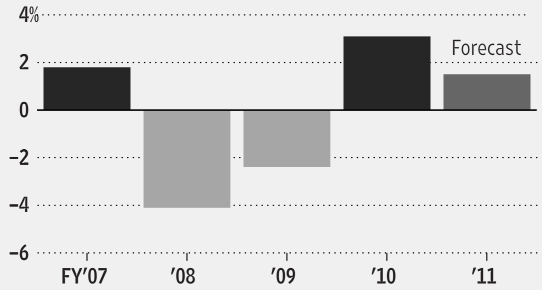
People shop on New York's 34th Street earlier this week.

WORLD NEWS

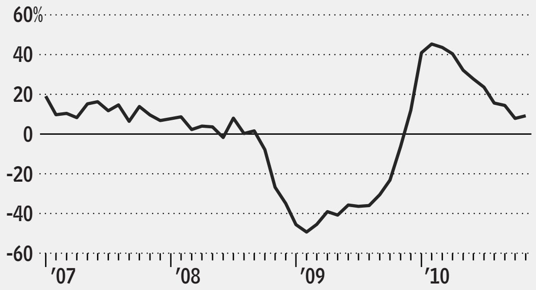
Exports driven | Japan's economic outlook

Newly produced cars and a container ship are seen at an industrial port in Yokohama, south of Tokyo.

Annual GDP growth rate



Exports, change from previous year



Note: Fiscal years starting April 1

Sources: Japanese government (GDP); Ministry of Finance (exports); Reuters (photo)

Japan expects an end to downturn next year

By Toko Sekiguchi
And Takashi Mochizuki

TOKYO—Japan's government Wednesday offered a relatively upbeat forecast of 1.5% growth next year, its optimism reinforced by positive November trade data.

The forecast for the year starting next April compares with revised expectations for 3.1% economic growth for the current fiscal year, the first annualized expansion in three years. But recent indicators have pointed to a slowdown over the past few months due to the end of consumer subsidies for energy-efficient autos and appliances as well as the impact of the strong yen.

"We expect to be out of an economic standstill from next year," said Hiroyuki Inoue, a deputy director in the cabinet's economic office. "Policywise, this is a realistic goal."

Unemployment is expected to continue to fall slowly, with the jobless rate forecast to decline to 4.7% from 5%.

The government also expects deflationary pressures to lessen, but not disappear. It forecasts the consumer-price index to be flat next year, compared with a 0.6% decline for this year.

When he took office in June, Prime Minister Naoto Kan set a goal of ending deflation by fiscal 2011, but officials say the flat forecast for consumer prices doesn't mean the government expects to declare an end to deflation next year.

The Ministry of Finance said Wednesday that Japanese exports rose 9.1% in November due to solid demand from China, with the pace of growth accelerating for the first time since February, in a positive sign for the country's export-dependent economy.

"Export growth seems to be accelerating, and it's possible it will continue to pick up down the road," said Seiji Shiraishi, chief economist at HSBC Securities. But he added that, given other economic problems, the government's growth forecast may still be too ambitious.

"I think the government's outlook is slightly optimistic probably because they anticipate a stronger tailwind from the latest stimulus package," said Mr. Shiraishi, who expects 1.2% gross domestic product growth in the next fiscal year.

Other reports released Wednesday showed that new sources of demand will be needed to avoid two quarters of contraction and a renewed recession. Both the government and the Bank of Japan issued their December scorecards on the economy, and both left their guarded assessments unchanged.

"Japan's economy is likely to grow at a slower pace for some time, but is expected to return to a moderate recovery path thereafter," the central bank said in its report, while the government said that the economy "has been in a lull recently and faces severe conditions such as a high unemployment rate."

Economy Minister Banri Kaieda also voiced caution, quoting Mr. Kan as saying he was "very concerned" about the current state of the economy, and saying a new working group to study the economy would be established.

Both the BOJ and the government have taken steps recently to stimulate the economy.

The central bank announced "comprehensive monetary easing" measures in October, including lowering its benchmark overnight lending rate to a range of zero to 0.1%. It also launched a five trillion yen ($59.71 billion) asset-purchase program to buy government bonds and private-sector assets such as real-estate investment trusts and exchange-traded funds.

Mr. Kan's government, meanwhile, is pinning its hopes on a plan to cut corporate taxes by five percentage points from the current 40% rate, which would still leave the rates well above Asian rivals' levels. However, given Japan's bloated government debt, which stands at nearly 200% of GDP, it will need to find the lost revenue elsewhere.

The government will unveil its budget for the coming fiscal year this week, and people familiar with the matter said the blueprint will retain the current pledge to keep new borrowing at less than 44.3 trillion yen. Even so, total borrowing is set to rise to a record 170 trillion yen. Mr. Kan is also hampered in his efforts by a political fight with an increasingly strong opposition that has made clear that its main goal is to bring down his government. The cabinet's support rate is now at just 25%, according to local media polls, further limiting his room for maneuver.

—Megumi Fujikawa contributed to this article.

Tokyo shows how hard it is to escape post-bubble funk

[Capital]

By David Wessel

Federal Reserve Chairman Ben Bernanke is under attack for doing too much to reduce unemployment and lift inflation.

His Japanese counterpart, Masaaki Shirakawa of the Bank of Japan, is under attack for doing too little.

Japan is a puzzle—and not only to foreign visitors who wonder how a stagnant economy can feel so prosperous. Academics wonder how Japan avoided the deflationary spiral their theories predicted and, instead, suffered only a decade of low-grade deflation. Foreign central bankers and market analysts wonder why the Bank of Japan won't do more. Japanese politicians wonder if they can force the central bank to be more aggressive. The ruling party has an Anti-Deflation League, and a band of parliamentarians want to give the BoJ a target for inflation to press it to create some.

Since 1997, the price level in Japan has fallen more than 3%. Had the BoJ achieved 1% inflation each year, prices would have risen 14%. After accounting for price changes, the Japanese economy has grown at a rate of only 0.9% over the past two decades. And, as the Bank of Japan said this week, "The recovery seems to be pausing." Still, it predicted hopefully that Japan will "return to a moderate recovery path" as emerging economies and commodity producers propel global growth.

In Japan, a little inflation would be welcome. It would make inflation-adjusted interest rates lower. (If interest rates are 1%, and deflation 2%, then real, or inflation-adjusted, interest rates are 3%. But if inflation is at 2%, then real interest rates are minus 1%, which makes borrowing much more attractive.) It would make paying Japan's huge debts easier. It would tend to cheapen the yen, aiding exports.

American pundits, policy makers and economists ought to be a bit humble about judging Japanese policy. When the U.S. was booming, it was easy for American experts to assert that if only Japan took their advice, everything would be fine. These days, the U.S. is learning how hard it is to climb out of a post-bubble funk.

U.S. economist Adam Posen, now at the Bank of England and once a stiff critic of the Japanese, said earlier this year that one lesson he learned from Japan is "to have much more humility about what we are capable of doing with monetary policy."

Although it's hard to swallow the notion that a central bank cannot thwart deflation, look at all this through the BoJ's eyes.

One, they say, we have done a lot of monetary easing already, long before we were hit by the "Lehman shock," as it's known in Tokyo, and the resulting plunge in our exports. Our 2003-07 battle against deflation succeeded for a time. Measured against the size of our economy, our portfolio of bonds has increased more and is larger than that of the U.S. or Europe. (OK, says the critic, but so what? It's not what you did in the past that matters. It's what you're accomplishing now.)

Two, we're doing a little more asset buying, even dabbling in corporate bond, real-estate trusts and business bank loans to direct credit where it's needed. But 10-year Japanese government bonds are yielding less than 1.2%, already pretty low. We're not sure massive Bernanke-style quantitative easing would do much good. (Neither is Mr. Bernanke, says the critic, but he figures doing something beats doing nothing.)

Three, much of Japan's deflation is beyond our control, they say. An already low inflation rate was pushed down by competition from China and other emerging markets. (Perhaps, says the critic, but if we hold central bankers accountable for *inflation*, shouldn't they be held accountable for *deflation*, too?)

Four, we don't think deflation is Japan's big economic problem. Japan suffers from a shrinking population, crippling regulation and disappointing productivity growth. Political gridlock is an obstacle to fixing anything. BoJ medicine can't cure those ills. (Deflation may not be Japan's big problem, says the critic, but isn't it the one problem a central bank should be able to solve?)

The Bank of Japan, with the benefit of hindsight, made some mistakes. It kept rates too low too long, helping to fuel a bubble. It failed to act before deflation infected its economy, showing that it's a lot easier to avoid deflation than to get out of it. And it moved prematurely to tighten before the economy was ready. The Fed learned from all that.

Now the BoJ is being tested again. The betting is that it'll eventually follow the Fed and buy a lot more bonds of some sort. It's hard for an outsider to tell if it believes it lacks the ability to eradicate deflation or if it lacks the will. But it'll be tough for Japan's economy to get much traction if it can't whip deflation now.

Parallel tracks?

Year-to-year change in consumer prices excluding food and energy, Japan 1991-2010, U.S. 2007-2010.

Sources: Statistics Bureau (Japan), Bureau of Labor Statistics (U.S.)