In a tight spot: Why luge course for Olympians became too fast

THE BIG READ 14-15

European stocks on rise but euro slides again

BUSINESS & FINANCE 17

THE WALL STREET JOURNAL.

VOL. XXVIII NO. 14 | * | EUROPE | Thursday, February 18, 2010

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Providing comfort—and €230 million—to quake victims

Associated Press

French President Nicolas Sarkozy comforts a baby during a visit at a French field hospital in Port au Prince. Article on page 10.

U.K. data highlight frail upturn

By Ilona Billington
And Natasha Brereton

LONDON—British unemployment rose sharply in January after two months of declines, highlighting the fragility of the economic recovery, while average earnings rose at a record-low pace for a third straight month, data showed Wednesday.

Minutes from the Bank of England's February Monetary Policy Committee meeting also showed policy makers unanimously approved suspending the bond-buying program in February, but that for some members it was a close call. The releases keep the possibility of further BOE easing alive, and signal that the central bank will maintain loose policy for some time.

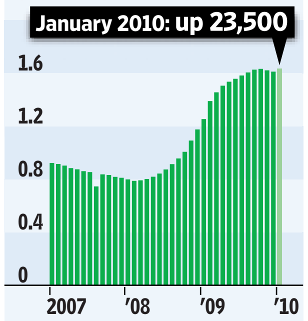
The Office for National Statistics said the widely watched claimant count measure of unemployment increased by 23,500, the biggest rise since July 2009. The jobless rate remained at 5%. The increase, which, which compared with a revised fall of 9,600 in December, surprised economists who had forecast a fall of 13,500.

The U.K. government warned last month that it expected to see unemployment rise again in the coming months as the economic recovery remains fragile.

"Unemployment is lower than everybody expected last year, but we still need to do more to support the recovery, secure the recovery and help get more people back into work," said Yvette Cooper, secretary of state for work and pensions.

Looking for work

U.K. claimant count, in millions



Source: U.K. Office for National Statistics

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The hardest part of being a successful rock band is finding a name. Page 29

World Watch

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

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IA European bailout for Greece would be unlawful and imprudent. Page 12

Akio Toyoda shuns U.S. panel

By Mariko Sanchanta
And Yoshio Takahashi

Toyota Motor Corp. President Akio Toyoda said he won't testify before the U.S. Congress at hearings next week and left vague his plans to visit the country, the company's single largest market.

Mr. Toyoda, the grandson of the company's founder, said he would send Yoshimi Inaba, his trusted lieutenant and the head of its North American sales operation, to next week's congressional sessions.

"We will give full support to him at the hearing," said Mr. Toyoda. "I am not saying that I am never going to the U.S. I am looking at my schedule and preparing."

His comments came as the Japanese car maker said it was looking into possible steering problems with the popular Corolla compact.

Speaking to reporters, Mr. Toyoda also said the company plans to equip all new cars with a braking system that should be able to stop vehicles even if their accelerator gets stuck or pinned down.

European Pressphoto Agency

Akio Toyoda

The move is an expansion of Toyota's previous plan to put the braking technology into only certain models, and it represents the car maker's latest effort to rebuild confidence after recalling millions of vehicles and acknowledging serious quality issues.

But Mr. Toyoda offered few details about a new internal panel intended to revamp Toyota's quality-control systems, which he said won't meet for six more weeks.

U.S. officials this week intensified their probe into Toyota.

Regulators, who are facing increasing pressure from U.S. lawmakers, are looking into whether the company made its string of recalls in a timely manner.

■ Toyota to roll out braking system for new cars 17

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AFME must make the case for banks

[Agenda]

By Patience Wheatcroft

For those who have been in Barcelona this week at the world Mobile Congress, AFME is the acronym for Ad-Funded Mobile Entertainment, a source, many delegates hope, of significant income growth to come.

In France, AFME denotes the *Association Francaises des Medecins Estheticiens*. In a third incarnation, the initials have a meaning that should certainly not be confused with the merely cosmetic: the Association for Financial Markets in Europe.

Now, considering how much Europe's financial markets have been in the news of late, and in the firing line, it seems remarkable that this version of AFME hasn't become better known. Since the organization is the product of a merger between the London Investment Banking Association and the European operations of SIFMA, the U.S. based Securities Industry and Financial Markets Association, one might have expected AFME to be popping up all over the place to defend its members against various proposals to take apart their businesses and decimate their compensation, as well as all round vilification. Instead, AFME has been what can only be described as muted, verging on the invisible in its response.

Despite a board of directors that boasts representatives of nearly all the major investment banks, its public reaction to the furor has been limited to low-key statements in response to working parties or reviews.

Yet never has an industry been more in need of a trade organization to make its case, both with governments and the public. Angela Knight, the director-general of the British Bankers Association, does valiant work on behalf of her members, doing the rounds of broadcasting studios to put the positive case for bankers. However, the moves against the current shape of the banking industry come from round the globe and surely merit a response that goes beyond national boundaries.

Associated Press

Barclays President Bob Diamond recently defended the industry at Davos

Some individual bankers have been prepared to speak out. Barclays President Bob Diamond gave a spirited performance in Davos and earlier this week Barclays Chief Executive John Varley made a strong case for the universal-banking model that so many (most vocally Paul Volcker, the former chairman of the U.S. Federal Reserve) would dismantle.

> **Organizations such as AFME should be hammering out their own proposals for restructuring**

The pair have sacrificed their bonuses for the year in an impressive move that deserves to be emulated by other industry leaders. It is a gesture that might be interpreted as making them an acceptable face of banking with which those on the other side of the arguments might be prepared to negotiate.

But such is the demand for wholesale change in banking that it is debatable whether representatives of individual banks will be seen as well placed to negotiate with the authorities. Would their competitors fall in behind them? Would they be viewed as seeking only what was in the best interests of their organization?

That is where a powerful trade association can come into its own. Wherever the efforts to reshape banks are being discussed, whether at Europe's Financial Stability Board, the G-20 or the City of London's regulators, then the industry needs to have a strong voice to make its case.

One problem for AFME is that last November, it lost the man who had been its voice since 2005. Jonathan Taylor, a former UBS managing director, has been lured back to his earlier employer, the U.K. Treasury. Next month he starts his new role as its managing director of financial services. In that position, the experience he gained with AFME and its predecessor should mean that he doesn't adopt the adversarial role assumed by some bureaucrats and politicians in their dealings with banks, and he can be more constructive.

The banks, however, need to begin being a little more constructive themselves. Organizations such as AFME should be hammering out their own proposals for restructuring an industry that, undeniably, cannot be allowed to repeat the mistakes that have created such chaos. Even those that haven't needed to plug into governmental life-support machines must realize that governments are serious in their determination to bring about change.

Baroness Thatcher in her time as prime minister once remarked of one of her favorite ministers, Lord Young of Graffham: "Other ministers bring me problems, David brings me solutions." If they are to avoid the worst of changes that might be proposed, the banks might try coming up with some reasoned solutions. An industry-wide response might just be given some credibility.

Britain isn't working

The concept of a jobless recovery is very hard to comprehend. Hence the dismal jobs figures from the U.K. yesterday will have renewed fears of a double-dip recession being a real possibility. Those claiming benefits rose significantly while the forecasts had been for a fall. More ominously, the number of people out of work for more than a year during the final quarter of 2009 was the highest it had been in 13 years. That was the point at which a general election removed the Conservative government and installed Labour.

"Labour isn't working" had been the slogan plastered on election-winning posters that removed the previous Labour administration. Now there must be people inside the No. 10 worrying whether that effect might be repeated.

Despite the U.K., and much of Europe, having been in recession, the effects have been cushioned since those in work and with mortgages have enjoyed the benefits of rock-bottom interest rates. But being out of a job and in debt, even when interest rates are low, changes the picture dramatically. Job creation is the answer, and there is little sign of that at the moment.

More bank lending would help: a point that AFME would do well to stress.

What's News

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ONLINE TODAY

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5. Barclays Answers Its Critics

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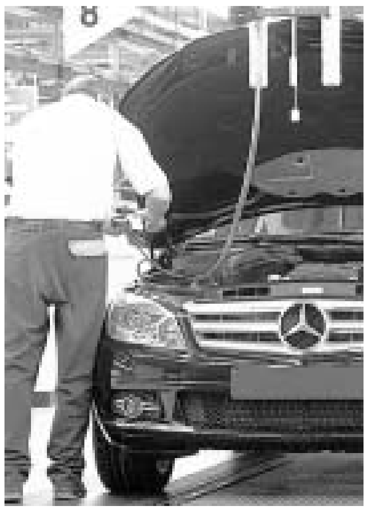
"The vision of a connected society is exciting, but the road toward it is likely to be long and bumpy."

Gustav Sandstorm on complications with advanced cellphone technologies

Continuing coverage



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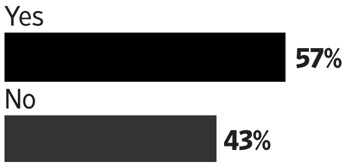

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NEWS

From the catwalk to buyers' closets

Moving to cut the sales time for new designs

By Vanessa O'Connell

Christian Hansen for The Wall Street Journal (left); Getty Images (right)

After Cynthia Rowley unveiled her line on Monday, right, versions were sold at a New York City gallery, left.

Some designers are chipping away at one of the industry's most stubborn schedules: the six-month lag it takes for runway looks to appear in stores, if they appear at all.

In the past, stirring demand for a designer's collection was the role of monthly magazines with long lead times, such as Vogue and Elle. Editors attended shows and would feature designers' samples in spreads published months later. Retail buyers, meanwhile, placed bets on styles with the greatest commercial potential, and the designers put those styles into production.

The typical six-month gap has been blamed as contributing to last year's 11% decline in global sales of designer clothing. Part of the problem, designers say, is that copycats and chains like H&M and Zara, called fast-fashion retailers, are able to quickly replicate styles and sell them at lower prices. For instance, the sports bra, biker shorts and the so-called "football" clutch purse all moved quickly from the Alexander Wang runway to mass-market retailers last year, as did Stella McCartney's oversized silk blouses.

Fashion has "an industry problem", designer Donna Karan said of the delay. The solution is "redesigning the whole system", though the difficulties are huge. Neither her Donna Karan collection nor her DKNY lines sold directly from the runway this season, and she said she has no imminent plans to do so.

Designer Norma Kamali began putting her collections up for sale on her Web site after her presentation in New York on Monday. Cynthia Rowley offered the public three of her 34 runway samples after her Friday show, including a tassel shell with a hand-cut lace skirt, a tassel dress and a lace dress, each priced at $4,800 as head-to-toe outfits. By late Tuesday, none of her originals had sold, but some copies had.

"You can't go into it expecting it to be big numbers," said New York-based designer Derek Lam, who will test fresh-off-the-runway sales this year. "It's a way to get in touch with the people who are watching" the show, particularly on the Internet.

Beyond production challenges, designers also risk angering retailers by cannibalizing demand for the line when it hits stores later. "Fashion shows are for the retail buyers," said designer Diane von Furstenberg, who isn't interested in direct-from-the-runway sales right now.

In the past, brands trying a buy-now strategy relied on third-party retailers, such as fashion Web sites. Bonnie Takhar, Halston's chief executive, two years ago, made available two fall styles for sale via online retailer Net-a-porter the day after Halston's runway show. This was an attempt to feed a desire for instant gratification and, more important, to hurt knock-off artists.

French designer Roland Mouret is taking it a step further: pre-selling his RM line to retailers before showing it on the runway, so his styles will hit stores just a month after his show. "The new reality of fashion will be to have the clothes right after the show," he said. Shoppers "don't want to wait six months and don't want to see copies".

—Rachel Dodes contributed to this article.

Heard on the runway

See updates from New York fashion week at **blogs.wsj.com/runway**

Spain has a hard sell

The government says its deficit is more manageable than Greece's

By Jonathan House

MADRID—When Spanish Deputy Finance Minister José Manuel Campa goes to the U.S. Thursday on a fund-raising tour, he will come face to face with investors alarmed by a country with a double-digit budget deficit and an unemployment rate of nearly 19%.

But in a key test of sentiment, the Spanish treasury completed the sale of €5 billion ($6.9 billion) of 15-year bonds. The treasury offered a hefty premium on the deal, but received offers to buy more than €13 billion of the new bonds.

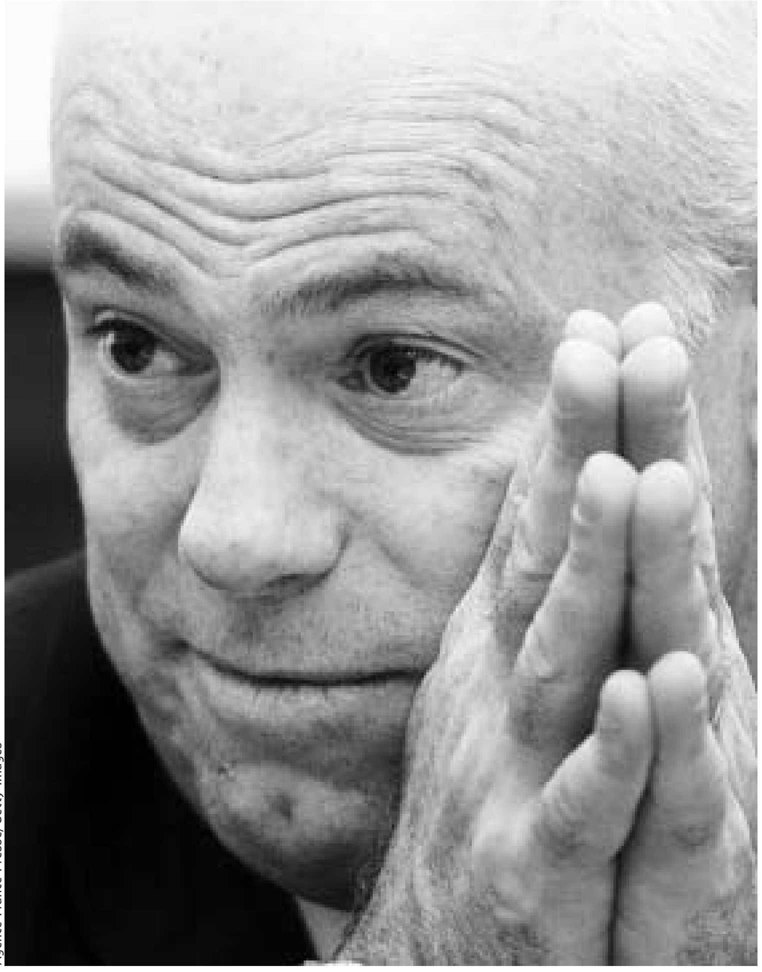
Spanish officials are quick to reject comparisons with Greece, where deep fiscal problems are compounded by a history of dubious budget accounting. The key for Spain, Mr. Campa said, is to sweep aside what he called "subjective" market judgments with a torrent of facts on what the government has planned.

"As markets see that our diagnosis of the situation is correct and that the measures we are taking are adequate, this offers reassurance," Mr. Campa said.

It won't be easy. The Standard & Poor's Corp. ratings agency in December lowered its ratings outlook on Spain to negative, saying the country will probably see "significantly lower" gross domestic product growth and "persistently high fiscal deficits relative to peers over the medium term." S&P cut Spain's rating to AA+ from the AAA maximum in January 2009. Moody's Investors Service Inc. and Fitch Ratings Inc. maintain AAA ratings for Spain.

Though like Greece, Spain also had a double-digit budget deficit in 2009—11.4% of GDP, compared with 12.7% in Greece—Spain's ratio of debt to GDP remains below the euro-zone average.

And Spain has a good record of fiscal management: In 2007, the government had a budget surplus of more than 2% of GDP.



Agence France-Presse/Getty Images

José Manuel Campa says 'markets see that our diagnosis' is correct.

In recent days, yield spreads between Spanish 10-year bonds over comparable German government bonds—a key risk gauge—have been hovering at around 0.8 percentage point. Though a reflection of investor distaste, the Spanish spread looks rock solid compared with the more than three percentage points for the equivalent Greek bonds.

The Spanish government has taken new steps to bring the deficit down to 3% of gross domestic product by 2013, as required by European Union rules.

While still lingering in a shallow recession in the fourth quarter, the government is forecasting that economic recovery will soon take hold to ease the fiscal crunch. Consumer spending—a key component of the Spanish economy—rose for the first time in nearly two years in the fourth quarter.

—Emese Bartha in Frankfurt contributed to this article.

Italy sees lasting derivative pain

By Christopher Emsden

ROME—Derivative contracts taken out by Italian municipalities could jeopardize local public finances for decades, even though the global financial crisis has softened the blow in the short term, Italy's Audit Court said.

"Certain debt and imbalances are magnified over time, and may wring sacrifices from future generations for 20 or even 30 years," Mario Ristuccia, the chief prosecutor of the administrative court, said in a speech here Wednesday.

The Greek government's use of derivatives has stoked claims of deception and fraud as Athens used the sophisticated over-the-counter contracts to prod its fiscal accounts into apparent compliance with European Union rules.

Italy itself used a currency swap to help its application to join Europe's monetary union at its inception more than a decade ago.

National governments aren't alone. After a 2002 Italian budget law allowed local administrations to engage in sophisticated finance, local governments entered into about €35 billion ($48 billion) of derivative contracts. That is equivalent to almost a third of all debt held by Italy's regions, provinces and municipalities. More than 500 municipalities signed derivatives deals.

The contracts were often designed to protect public bond issuers against adverse interest-rate movements, until the central government banned the practice in 2008. But while the derivatives were supposed to hedge balance-sheet risks, they also were used to rake in upfront cash for current spending, at times with pure "speculative intent," Mr. Ristuccia said.

Many small Italian municipalities, lacking the expertise to judge the deals offered to them by investment banks, made "distorted use" of derivatives, he said.

Last year, the government ruled that any upfront proceeds from such deals had to be classified as debt, and made the use of them to fund current spending a crime.

Despite the freeze, Italian cities face potentially large losses from derivatives. Such losses were likely to be almost €2 billion at the end of 2008, according to Italy's central bank. That prospective loss had doubled from the year before. However, many of the derivatives were linked to interest rates, which in the euro area rose to 4.25% in the middle of 2008 but have since been cut to 1.0%. While market rates can vary, they are broadly down, which probably has reduced those losses.

'The relatively contained magnitude of the crisis has to be ascribed ... paradoxically to the crisis in financial markets' and the consequent drastic reduction of interest rates.'

"The relatively contained magnitude of the crisis has to be ascribed not to the due diligence and competence of public officials, but paradoxically to the crisis in financial markets and the consequent drastic reduction of interest rates," Mr. Ristuccia said.

He estimated that the lower interest rates had cut more than 50% of the overall mark-to-market value of derivative contracts held by Italian municipalities.

Italian courts have seized assets from four banks, including **J.P. Morgan Chase** & Co., **Deutsche Bank** AG and **UBS** AG, pending an investigation into claims that bankers misled public officials in derivatives transactions. The probes continue.

Greece denied in '08 it used swaps

By Adam Cohen

BRUSSELS—Greece denied using complex currency transactions to mask its budget deficit in a 2008 meeting with European Union officials, according to the European Commission.

Officials from Eurostat, the bloc's statistics agency, met Greek government officials in Athens in September 2008 to discuss whether the country was using currency or interest-rate swaps to reduce its budget deficit artificially.

"There was a visit in September 2008, and the Greek government told Eurostat that they don't use any of these complex products," said the commission's spokesman for economic issues, Amadeu Altafaj.

Eurostat issued a report in March 2008 telling countries how they should account for lump-sum payments related to these products, suggesting a wider concern involving more than one EU country.

According to a report in German weekly magazine Der Spiegel, Goldman Sachs helped Greece raise about $1 billion through 2002 currency swaps that weren't recorded in the country's budget data. The report alleged that the deal, which was linked to dollar- and yen-denominated Greek debt, used a "fictional" exchange rate to boost the country's income.

Eurostat has issued several reports in recent years outlining how governments should record some of these transactions. "In the case of currency swaps Eurostat has decided to value any outstanding foreign currency debt according to the market exchange rate and not at the exchange rate agreed in the swap contract," Eurostat informed EU governments in 1997, suggesting a fictional rate in the Greek swaps might have violated EU rules.

Eurostat didn't respond to calls and an email seeking comment. The commission has asked Greece to provide details about these transactions by Friday. It also is asking other countries whether they used similar transactions, though Greece currently is the only country facing a specific investigation.

A one-time windfall of $1 billion was unlikely to obscure Greece's finances fully—for the sake of scale, the country's budget shortfall in 2009 was about €30 billion. But this transaction illustrates a broader problem the EU has struggled with since the creation of the euro just over a decade ago: how to ensure governments don't use creative accounting to get around budget rules.

Several EU countries, including Greece, Italy, Austria and Finland, used off-balance-sheet securitizations until 2002 to record one-time profits. Greece, for example, securitized future income from its national lottery and airports.

Following the December 2001 collapse of Enron, which also used off-balance-sheet transactions, these government deals faced sudden scrutiny in the EU. Eurostat in July 2002 ruled that governments had to treat this type of securitization as government borrowing.

Two years later, Eurostat ruled that EU governments could no longer use public-private partnerships to hide state spending or conceal government liabilities. Such practices were widespread across the EU until that decision, including a 2002 deal in which then-U.K. Chancellor of the Exchequer Gordon Brown guaranteed £9 billion ($14.21 billion today) in financing for the country's rail network but didn't record it in the national budget.

Euro-zone trade surplus increases

By Nicholas Winning

LONDON — The euro zone's trade surplus grew to its strongest level for more than five years in December as exports hit a one-year high, in a sign that demand from abroad is helping the currency area recover from its severe recession.

Seasonally adjusted figures released by the European Union's Eurostat statistics agency showed the 16 countries that use the euro posted a combined trade surplus of €7.0 billion in December, the highest surplus since May 2004 and up from €5.3 billion in November.

"The recovery is there, but exports remain way below the pre-crisis level," said Dominique Barbet, senior economist at BNP Paribas SA. "The bottom line is that the euro zone benefits from external economic dynamism, but it has very little domestic momentum."

Euro-zone exports rose 3.1% from the previous month to €114.4 billion in December, the strongest level for a year, while imports increased 1.7% to an 11-month high of €105.6 billion. However, the overall level of trade remains low when compared to December 2007, when exports totaled €125.4 billion and imports stood at €128.1 billion.

The euro-zone economy grew 0.1% in the fourth quarter of last year following a 0.4% quarterly expansion in the three months to the end of September, fueling fears that the recovery is faltering after a temporary boost from companies rebuilding supplies. Fourth-quarter gross domestic product was 2.1% weaker than in 2008. But economists said export growth in December raised hopes that firmer demand in overseas markets could help support recovery.

"Euro-zone exporters will benefit from the marked retreat in the euro, from a 15-month high of $1.5145 in late November to its current level around $1.37," said Howard Archer, chief European and U.K. economist at IHS Global Insight.

U.K. tax ruling resounds

Court denies nonresident status for millionaire, fueling uncertainty

By Cassell Bryan-Low

LONDON—A U.K. court ruling against a wealthy tax exile creates uncertainty for high-net worth individuals seeking to reduce taxes by living overseas and underscores broader efforts by authorities here and in other countries to clamp down on tax breaks for the rich.

The U.K. Court of Appeal on Tuesday rejected a case by British-born millionaire Robert Gaines-Cooper, who claimed non-U.K. resident tax status. Mr. Gaines-Cooper, who owns an estate in the Seychelles and is a British citizen, argued that because he had spent less than 91 days a year on average in the U.K., he met the criteria for obtaining nonresident tax breaks.

The U.K. isn't alone in trying to shut loopholes used by the wealthy, whether at home or abroad. U.S. President Barack Obama has called for tax increases on families with income above $250,000. Meanwhile, Berlin is pursuing wealthy Germans who hold Swiss bank accounts that shield hundreds of billions of euros, by some estimates.

The Court of Appeal said the government was justified in denying Mr. Gaines-Cooper the tax breaks because he retained significant personal ties to the U.K. According to legal filings and Mr. Gaines-Cooper's Web site, the 72-year-old entrepreneur kept a residence in Henley-on-Thames, Oxfordshire, and returned frequently to the U.K. for business and social functions. His son was also born in the U.K. and attended an English boarding school.

A nonresident must "demonstrate a distinct break from former social and family ties within the U.K.," the judges said in their ruling.

Peter Vaines, a London-based lawyer for Mr. Gaines-Cooper at Squire, Sanders & Dempsey said his client was disappointed with the ruling and is seeking an appeal. Mr. Gaines-Cooper "feels he's been unfairly treated," Mr. Vaines said.

The test for residency in the U.K.—which effectively means one can't spend more than three months in the U.K. without forfeiting nonresident tax breaks—is tougher than some other jurisdictions. The threshold in the U.S., for instance, is about four months on average, while in some other European countries it is about six months.

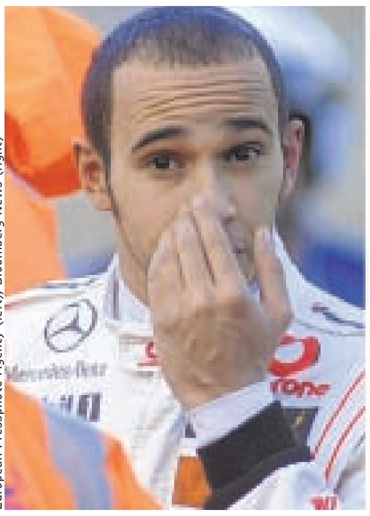
"It's had the effect, together with revised guidance, of moving the goal posts and making it much more difficult for someone who is currently a U.K. resident to become a non-U.K. resident for tax purposes," said Andrew Tailby-Faulkes, a senior private-client partner at Ernst & Young LLP in the U.K.

Those wanting to claim nonresidence may well have to sell properties here and leave the U.K. social scene, added Mr. Tailby-Faulkes. People "will really have to think carefully about whether they can endure the disconnect with the U.K.," he said.

Mr. Gaines-Cooper's Web site said he had distributed jukeboxes in the U.K. before forming various businesses abroad, including a medical-equipment company in the Seychelles. He says that after he left the U.K. about 30 years ago, he bought an estate in the Seychelles, where he met his current wife.

The case also illustrates a broader shift by the government to toughen its tax stance toward wealthy individuals. In April, the government will increase the income-tax rate to 50% from the current 40% for individuals who earn more than £150,000 ($235,740) annually. That comes on top of stricter rules on tax breaks for foreigners who reside in the U.K. but claim their tax domicile elsewhere. And, last year, the government set up a new unit to scrutinize the tax affairs of the country's top 5,000 earners—which broadly speaking captures those with a net worth of about £30 million or more.

Robert Mirsky, a managing director at Laven Partners Ltd., a London-based hedge-fund consultancy, says he has clients who are planning to or considering moving out of the U.K., because of the increase in income-tax rates, among other reasons. However, some clients are concerned about whether they will qualify for nonresident status if they retain ties to the U.K. People who are planning to leave are left in "limbo," said Mr. Mirsky.




European Pressphoto Agency (left); Bloomberg News (right)

Racing driver Lewis Hamilton (left) lives in Switzerland, and Terra Firma founder Guy Hands said he moved from the U.K. to Guernsey for tax reasons.

Chills and fevers | Shifting momentum in the climate debate

April 17, 2009
The administrator of the Environmental Protection Agency declares that emissions of carbon dioxide and other greenhouse gases threaten public health and welfare, the legal prerequisite for regulating such emissions under the Clean Air Act.

May 19, 2009
Flanked by representatives of the auto industry and environmental groups, President Obama announces that the EPA and the Department of Transportation will craft rules aimed at boosting the fuel economy of U.S. automobiles and reducing their emissions of greenhouse gases.

June 26, 2009
The U.S. House of Representatives passes legislation by a 219-212 vote that calls for cutting U.S. industrial emissions of greenhouse gases by 17% from 2005 levels by 2020, including by requiring companies to buy permits for emissions.

Nov. 26, 2009
China announces it will aim to cut its 'carbon intensity'—or the amount of greenhouse gas it emits per unit of gross domestic product—by 40% to 45% below 2005 levels by 2020.

Getty Images

Associated Press

Nov. 17, 2009
Senate Democratic leaders announce they will put off debate on a big climate-change bill until spring, citing a desire to first address legislation on health care and financial regulation.

Nov. 19, 2009
Emails and documents hacked from the Climate Research Unit at East Anglia University in the U.K. are cited by global-warming skeptics who say they call into question the validity of U.N.-sponsored reports contending that the Earth is heating up and that it's largely because of human activity.

Dec. 19, 2009
A summit on climate change in Copenhagen, Denmark, ends with a final statement that calls on countries to "enhance our long-term cooperative action to combat climate change," but doesn't legally obligate any country to meet a specific target for reducing emissions.

Jan. 18, 2010
U.N. body on climate change says it is studying how its landmark 2007 report came to include a statement that Himalayan glaciers would disappear by 2035.

Feb. 5, 2010
As a huge snowstorm bears down, the Virginia Republican Party releases an ad that mocks Democrats for supporting legislation to fight global warming.

Controversies open way for critics

Disputes between scientists over global warming give opponents fresh opportunities to emphasize their case

By Gautam Naik
And Keith Johnson

The spate of recent controversies about climate research has given fresh voice to a group of scientists who question the mainstream view that human activity is warming the planet to dangerous levels.

Few scientists disagree that the earth's climate has warmed since 1850. But some have long argued that there are too many uncertainties about man's role, and that other factors, such as solar activity and the greenhouse effect of clouds, could account for a large part of the warming trend. Among this group are researchers who criticize the limitations of past temperature records and mathematical models used to forecast future effects.

Such views have had a fresh airing after recent controversies dogging climate researchers. A United Nations group, the Intergovernmental Panel on Climate Change, or IPCC, has been criticized for publishing an unsubstantiated claim that Himalayan glaciers would entirely melt by 2035. A recent report also included several other claims later found to lack a scientific basis, including predictions of the impact of climate change on agriculture in Africa and the retreat of Amazonian rain forests, among others.

News of those discrepancies followed a scandal in Britain where the publication of hacked emails of climate scientists suggested they had declined to share their data with fellow researchers and tried to squelch dissenting views.

It's too soon to tell whether the critics' views will make the scientific community revisit the prevailing view of man-made climate change. Many of their colleagues are resolute in their stance that warming is caused mainly by humankind. The IPCC has said its errors, while serious enough for a re-examination of its procedures, do not change the central point of its influential 2007 report, which concluded that evidence for the human role in global warming is "unequivocal".

"It's important to say that the scandals we've had don't change the fundamental point that global warming is man-made and we need to tackle it," says Bjorn Lomborg, a Danish academic and environmental writer. In his view, "the standard message—that we need to cut a lot of emissions right now or doom is upon us—is not correct." He advocates investments in green technology instead of cutting emissions.

The political fallout from the IPCC's mistakes was evident Tuesday when Texas said it was taking legal action against the U.S. Environmental Protection Agency's efforts to curb greenhouse gases under the Clean Air Act. In its filing, the state argued that the information the EPA used to make its decision is based on data from the IPCC. Alfredo "Al" Armendariz, EPA regional administrator for Texas and nearby states, said he expects the agency's efforts to withstand a court challenge. Virginia Attorney General Kenneth T. Cuccinelli II asked the EPA to delay final consideration of that finding so "newly available information" can be reviewed, the Associated Press reported.

Among the most vocal of the scientists who have questioned recent IPCC work is John R. Christy, director of the Earth System Science Center at the University of Alabama-Huntsville who contributed to a big 2001 IPCC report. He, like several other of the critics, was repeatedly criticized in the hacked emails.

Dr. Christy spent years comparing temperature data from satellites with ground stations. He concluded that the reliance on a few well-known ground-based measuring stations may vastly overstate how much temperatures have risen. He suggests that surface temperatures are actually measuring an increase in human development—more and bigger cities, more asphalt, more air-conditioning—and not rising temperatures in the atmosphere. Most climate scientists, by contrast, ascribe rising temperatures largely to man's introduction of greenhouse gases into the atmosphere.

Some dissenters have focused on the complex effect of clouds. Richard Lindzen, a professor of meteorology at the Massachusetts Institute of Technology and a past contributor to an IPCC report, says clouds and water vapor—the main greenhouse agents in the atmosphere—are among the least understood factors in climate science. It's a limitation the IPCC acknowledges.

Associated Press

An IPCC claim that Himalayan glaciers would disappear as early as 2035 turned out to be off by hundreds of years.

Prof. Lindzen says the key issue is "climate sensitivity"—how much will temperatures rise when carbon-dioxide levels double. He asserts that climate models include a "positive feedback" effect whereby clouds and water vapor act to amplify CO²'s greenhouse effect. In response to a doubling of carbon-dioxide levels, the IPCC has found climate sensitivity to be between 1.5 degrees and five degrees Fahrenheit. Prof. Lindzen says those figures, derived from models, overstate the case.

He recently published a study based on radiation measurements taken from satellites—not models—and concluded that climate sensitivity as a result of clouds and vapor was more likely in the 0.3 degrees to 1.2 degrees range, much lower than the figure accepted by most researchers.

Dr. Willie Soon, a professor at Harvard University, believes that changing levels of solar radiation are driving huge, slow changes in the earth's climate—much as they did in past centuries. The theory rests on the fact that the sun emits different amounts of energy at different times.

U.S. NEWS

New push expected on yuan valuation

By Kathy Chen
And Jason Dean

The mounting political tension between U.S. and China is poised to take on a more pronounced economic component—with Washington, in coming months, expected to press China over what officials see as an undervalued yuan.

This week, China is facing off with the U.S. over President Barack Obama's planned meeting Thursday with the Dalai Lama, whom Beijing alleges has pushed for Tibetan independence from China. On Wednesday, the U.S. State Department said Secretary of State Hillary Clinton would also meet Thursday with the exiled Tibetan spiritual leader.

Those tensions come on top of January's announcement that the U.S. would sell $6.4 billion worth of arms to Taiwan, which Beijing claims as part of its territory, and sparring over a cyberattack on Google Inc. widely seen as originating in China.

But for U.S. officials, China's exchange rate is becoming a top concern. Mr. Obama and other officials argue that the Chinese currency is undervalued. That makes Chinese exports artificially cheap in terms of other currencies, contributing to the U.S.'s large trade deficit with China and depriving Americans of jobs.

Also on the economic front, U.S. officials have taken notice of increasing, vocal concerns among U.S. multinationals over what these companies view as growing protectionist trends in China. For years, these companies have acted as a ballast for stable bilateral ties.

"We expect to see actions by China" to help rebalance global trade flows, a White House official said. If Beijing fails to act, that "will put greater and greater pressure on the U.S. to respond."

"We have 10% unemployment and China is racking up huge trade surpluses with an undervalued currency—the politics [of that] are very tough," said Kenneth Lieberthal, a former Clinton administration official who now heads Brookings Institution's John L. Thornton China Center in Washington.

Officials and analysts in both countries say economic codependence and shared strategic interests over such issues as North Korea and nuclear nonproliferation are likely to ensure that relations generally remain cooperative.

But lately, that cooperation has been put to the test. In a meeting with Senate Democrats this month, Mr. Obama vowed to "get much tougher" with China on trade rules, including currency rates, to ensure that U.S. goods weren't at a competitive disadvantage.

The next big test comes in April, when, under the Omnibus Trade and Competitiveness Act of 1988, the U.S. will decide whether to label Beijing a "currency manipulator."

Such a move technically wouldn't result in U.S. actions against China. But invoking the rarely used act—no countries have been named since 1994—would likely infuriate Beijing and give Congress new ammunition to press for concrete action against China. A senior Treasury Department official said no decision on the matter has been made.

Sticking points

Among the factors contributing to U.S.-China tensions:

- U.S. concerns that China's currency is undervalued
- Multinational tech firms' complaints over law that encourages Chinese government firms to buy products with 'indigenous technology'
- U.S.'s announced $5.6 billion arms-sale deal to Taiwan
- President Obama's planned meeting with Dalai Lama, Tibet's exiled spiritual leader
- Cyberattack on Google and other foreign technology companies, widely seen as originating in China

Associated Press

U.S. President Barack Obama with Chinese President Hu Jintao in November 2009

Fed minutes show uptick in confidence

By Luca Di Leo
And Jon Hilsenrath

WASHINGTON—U.S. Federal Reserve officials last month were slightly more confident that the recovery was firming and plotted out an exit strategy that may include sales of the Fed's mortgage holdings.

U.S. central bank officials Jan. 26-27 projected the economy would expand by 3.2% this year, according to minutes of their meeting, which were released with the usual lag on Wednesday. That compares with a November 2009 forecast the economy would grow by 3% in 2010.

Given the improved outlook, Fed officials debated how to best unwind the extraordinary stimulus pumped into the economy over the past two years to combat the recession, including the sale of mortgage-backed securities.

At the January meeting, officials stuck to a vow to keep interest rates at a record low for an "extended period" since they expect unemployment to stay high and inflation to remain low this year.

U.S. NEWS

Associated Press

Stimulus money has subsidized the jobs of 325,000 teachers and schools staff, U.S. government data indicate.

More spending to come

Most of the cash so far has gone to services and government jobs

BY LOUISE RADNOFSKY

WASHINGTON—The Obama administration's economic-stimulus program has delivered about a third of its total $787 billion budget during its first year, much of that to maintain social services and government jobs and to provide tax cuts for workers. Now, the pace and direction of stimulus spending are about to change.

Infrastructure spending is set to step up in the second year of the stimulus program, which should mean more money flowing to private-sector employers.

Still, economists say that won't likely have a big effect on the unemployment rate, which most say is likely to continue a slow decline as the broader economy recovers.

The shift could be significant politically, though, because Republicans have criticized the relative lack of private business hiring directly attributed to the stimulus.

The approach this week of the stimulus program's one-year anniversary sparked a new round of partisan statements. Democrats sought to credit the effort with averting a deeper recession and Republicans said the program deserved a failing grade. But in terms of spending, the stimulus is largely incomplete.

Most of the money allocated to specific projects hasn't been paid out yet, and there are an additional $195 billion in tax cuts on the way.

Proponents of the stimulus program focused attention on infrastructure projects during the fight to win approval for it last year. But the bulk of the money proposed for projects like new rail lines and water projects—about $180 billion in all—is likely to be spent this year at the earliest.

During year one of the stimulus, only about $20 billion of money was handed out for infrastructure projects.

The ramped-up stimulus spending in 2010 will contribute 1.4 percentage points to gross domestic product growth this year, said Brian Bethune, chief U.S. financial economist for IHS Global Insight. But he says that may not translate into significant improvement in the jobless rate, a growing political threat for the administration and congressional Democrats.

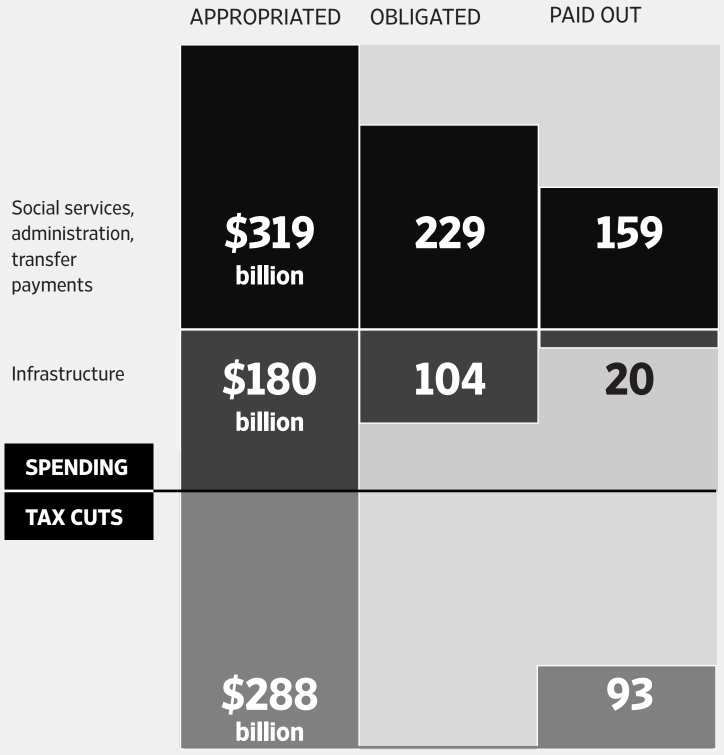
Infrastructure spending "doesn't really have a big impact on net employment, simply because a lot of the activity is mechanized," he said. "We should be careful of how many jobs we expect to be created from that."

Of the $179 billion in stimulus funds paid out last year, $112 billion was in large checks to state governments to plug holes in school, Medicaid and unemployment-benefits budgets, or to boost funding for established programs, such as food stamps, according to a Wall Street Journal analysis.

An additional $700 million was spent on administration, and about $47 billion has left Washington in transfer payments, such as $250 checks for Social Security recipients.

Where it's going

The U.S. stimulus package signed into law on Feb. 17, 2009 appropriated $787 billion for spending and tax cuts. A year later, federal agencies have 'obligated,' or decided how to distribute, 66% of the spending money. About half of the obligated funds have been paid out.



Sources: U.S. federal agency budget accounts as of Jan. 29; WSJ analysis

A stimulus success story emerges from an old idea

[Capital]

BY DAVID WESSEL

The impact of the much-maligned U.S. fiscal stimulus, now marking its first birthday, will fade over time.

Its tangible legacy, sure to be backdrops for Obama 2012 ads, will be infrastructure projects from the rehab of the Brooklyn Bridge to the new Russian River Bridge in Mendocino County, Calif.

Among the most durable changes, though, may be the way state and local governments borrow. Now, the municipal-bond market isn't on most Americans' list of top 10 things to think about.

But it's big: About $400 billion in muni bonds were sold last year, roughly equal to Austria's entire annual economic output. The market undergirds schools, roads and sewer plants in every American town. And it collapsed at the end of 2008.

Because interest on muni bonds is exempt from federal taxes and interest on U.S. Treasury debt is taxed, muni borrowers usually pay 80% or 90% of the U.S. Treasury rate. In late 2008, those muni borrowers who could issue bonds had to pay *twice* the U.S. Treasury rate.

So in an obscure corner of the stimulus bill—where only city treasurers, bond dealers and big-time investors paid attention—a two-year experiment was launched.

Cities and states could still offer traditional tax-exempt bonds, attractive only to high-tax-bracket investors.

To broaden the pool of potential investors to those who don't pay income taxes, including foreigners and pension funds, local governments also could offer bonds at higher, *taxable* interest rates—and the federal government would pick up 35% of the interest tab on borrowing done for building projects.

This was hardly a new idea. For decades, economists and tax experts had lectured Washington that what was justified as helping local governments borrow cheaply to finance projects with widespread public benefits was, in large measure, a windfall for rich investors seeking lower tax bills.

As a result, it cost the federal government more than $1 in forgone tax revenue to give $1 of help to state and local governments. Better, cheaper and fairer, they advised, would be for Washington to directly subsidize municipal borrowing.

Congress almost took the advice in 1969, but stiff opposition from mayors, governors and John Mitchell, the municipal-bond lawyer who was then attorney general, killed it.

In 2009, the driving force wasn't fairness or tax reform. It was an emergency. The bond market was closed to most cities and states. Many institutional investors weren't buying, and firms that had been insuring shaky municipal borrowers were imploding. An urgent need to draw new investors to buy muni bonds gave birth to the taxable, federally subsidized "Build America Bonds."

The experiment worked. It helped revive the muni-bond market, keeping local construction projects going. Last year, $64 billion in Build America Bonds were issued in 45 states, about 20% of all muni offerings; this year will be bigger.

Wall Street and U.S. Treasury estimates show that, after the federal subsidy, muni issuers of Build America Bonds save between one-quarter and one-half percentage point on borrowing costs versus issuing tax-exempts. That's $1.25 million and $2.5 million annually on a $500 million bond issue. New York's Metropolitan Transportation Authority figures it saved $46 million over the life of a $750 million Build America Bond issued last spring.

Bond dealers and investment bankers are happy, which, of course, makes everyone else suspicious. The more borrowing, the more money the bankers make, and new choices facing local governments means more demand for Wall Street advice.

Investors are happy, too: Build America Bonds pay more than corporate bonds with similar ratings, even though municipalities rarely default. The big losers: High-end taxpayers who have fewer tax-exempt bonds to buy.

"It was right 40 years ago, and it's right today, and it's nice that something good comes out of the stimulus," says Michael Graetz, a Columbia Law School tax professor who did a stint at Treasury during the George H. W. Bush years.

Today, beneath partisan gunfire and ideological clashes in Washington, one of the few things on which Democrats and Republicans in the Senate agree is that Build America Bonds should be made permanent. The program probably will be.

It succeeded in part because Washington was so generous, trying to stimulate local borrowing and building during the recession.

In making the program permanent, the president would broaden purposes for which the bonds can be issued and reduce the subsidy to 28% of the interest tab from 35%, mainly to reduce the cost to the Treasury.

The smaller subsidy would make issuing tax-exempt bonds attractive to local and state governments in some circumstances and make buying them attractive to upper-income investors, especially if President Barack Obama manages to raise their tax rates.

Keeping the traditional tax-exempt muni-bond market alive a while longer is prudent; the market could be an important safety valve if local and state governments meet stiff competition from corporate borrowers in the taxable-bond market when the economy revives.

Sometimes, the system works.

WORLD NEWS

Poll: China's lost momentum

BY ANDREW BATSON

Most private analysts who study China think its economic recovery lost some momentum in the fourth quarter of 2009, a new poll by The Wall Street Journal shows.

The finding runs counter to official statistics that indicate a recent acceleration in growth, and highlights the conflicting signals China's economy is sending at a time when the leadership is trying to contain potential bubbles without derailing the expansion.

The median estimate in the Journal's poll put growth in China's gross domestic product in the fourth quarter at 10.1% over the previous quarter on an annualized, seasonally adjusted basis—the way that most major economies measure growth. That is down from the median estimate of 10.7% growth for the third-quarter.

China's statistics bureau reports GDP growth in year-on-year terms, and the difference can be significant. It said last month that the nation's GDP grew 10.7% in the fourth quarter from a year earlier, a growth rate that accelerated from the third quarter's 9.1%. Even before those strong numbers were released, China's central bank had already signaled a new and tougher stage in policy by starting a series of increases in banks' reserve requirements, measures that reduce funds available for lending.

But at turning points like these, year-ago comparisons aren't that helpful: they just show that China's economy is now doing much better than it was during the depths of the financial crisis in late 2008. What's more important is how the economy is doing now relative to a few months ago. That is why the U.S. and most other big economies also use the quarter-on-quarter, seasonally adjusted measure.

In the latest poll, eight of the 10 economists who responded thought growth in the fourth quarter was slower than in the third quarter, and most are forecasting a further gradual slowdown over the rest of 2010 to around 9%. China's policy makers are aware that year-on-year comparisons will flatter current growth rates. The importance of using sequential estimates of economic growth was recently highlighted by Premier Wen Jiabao himself.

"We must take full account of the base effect from last year, strengthen the sequential analysis of major economic indicators and closely follow changes in market demand, in order to accurately appraise the trend and make macroeconomic policies more targeted and effective," Mr. Wen said at a State Council meeting on Jan. 19, according to a government statement.

China GDP poll

Quarter-to-quarter change, seasonally adjusted annual rate

Sources: The Wall Street Journal poll; People's Bank of China

Agence France-Presse/Getty Images

A government soldier passes a public transport vehicle in southern Mogadishu, as troops prepared for battle Wednesday.

Somali troops gather

Government plans antirebel offensive; residents flee Mogadishu

Somali government troops massed in Mogadishu for a planned offensive against al Shabaab, the powerful al Qaeda allied-militia that has been trying to topple the government.

*By **Sarah Childress** in **Nairobi, Kenya** And **Abdinasir Mohamed** in **Mogadishu, Somalia***

Government and African Union officials say the goal is for the Somali troops, backed by U.S.-trained African Union forces, to carve out a secure area of the capital. That would provide space for the Somali government to function, and the opportunity to win support from a fractious and insecure public, officials say.

The strategy takes a page from U.S. counterinsurgency operations in Afghanistan and Iraq, where strengthening a weak government has been seen as pivotal in the wars against Islamic militants.

The Somali government was preparing for an intense battle amid reports of Shabaab fighters moving into the city.

"We have our troops trained and equipped now, so they are ready to clear the rebels out of the country," said Somali Security Minister Abdullahi Mohamed Ali.

After nearly two decades of war, the current government barely exists beyond the tiny pocket of the capital it controls. Members of an underpaid Somali force have been known to defect or sell weapons to militants.

The United Nations has warned of increasing civilian casualties. As government troops mobilized, Mogadishu residents packed into cars and buses to flee to makeshift camps outside the city. In the past two weeks, an estimated 15,000 people have been displaced from Mogadishu, according to the U.N., and 85,000 have been displaced across the country since Jan. 1.

A recent statement from the office of the U.N.'s humanitarian coordinator, Mark Bowden, said the figures suggest "all parties"—which would include government and African Union troops—are involved in "indiscriminate and disproportionate use of force against civilians."

The government has attributed such allegations to insurgent propaganda. Gaffel Nkolokosa, a spokesman for the African Union mission in Somalia, denied any such actions by those troops—a force of around 5,300 soldiers from Uganda and Burundi.

Mogadishu resident Abdiyo Hussein was preparing to leave the city for the sixth time since 2007, to take refuge in a camp. "I'm no longer hopeful of the government or the rebels," she said. "The rebels execute people meaninglessly, and the government shells civilians. So we are hopeless."

An estimated 3.2 million people, more than 40% of the population, need emergency humanitarian assistance, according to the nongovernmental Food Security and Nutrition Analysis Unit.

Al Shabaab has been blamed for a raft of suicide bombings and other attacks targeting Somali officials and African Union troops.

A senior al Shabaab spokesman, said their fighters were "on standby" for the battle.

While the offensive isn't likely to dislodge al Shabaab, some analysts say it might weaken the group enough to encourage defections from top commanders and raise tensions among factions.

U.K. probes links to Hamas killing

The U.K. asked its Serious Organised Crime Agency to investigate the purported use of fraudulent British passports by the alleged killers of a senior Hamas leader in Dubai.

*By **Alistair MacDonald** in **London** and **Joshua Mitnick** in **Tel Aviv***

The move comes amid an escalating political storm in the U.K., where a top official on Thursday will meet with Israel's ambassador to London. The U.K. said the meeting is aimed at helping Israel-based U.K. citizens whose passports were allegedly used.

On Monday, police in Dubai released names, photographs and passport information identifying six Britons, three Irish citizens, a German and a Frenchman as suspects in the January killing of Mahmoud al-Mabhouh, a senior leader in the Palestinian militant group. Officials from all four countries have said that the passports don't appear to be genuine. Some individuals whose names were on the passports—including several British citizens living in Israel—have said they had nothing to do with the killing.

Dubai is one of seven, semiautonomous emirates in the United Arab Emirates. On Wednesday, an official there said that U.A.E. authorities believe the passports were legitimately issued by Britain, Ireland, Germany and France. "They're valid passports," the official said, adding, "there is something wrong in the system" in the European countries involved that allowed the fraudulent issue of the travel documents.

The U.K.'s Serious Organised Crime Agency said it would lead the investigation.

"We received a request from the Dubai authorities for assistance with their investigation in relation to the fraudulent use of U.K, passports" and a request from Interpol, an agency spokesman said.

Amid widespread media speculation about possible Israeli involvement, the country's foreign minister Avigdor Lieberman told Israeli Army Radio that there is no proof that the country's Mossad security agency carried out the killings. Mr. Lieberman didn't deny Israeli involvement. He said the country has a "policy of ambiguity" on such matters.

U.K. and Irish authorities have said they currently have no proof that Israel was responsible. Dubai police earlier indicated that tactics used in the case resembled Mossad tactics, but in Monday's news conference appeared to back down from implicating any particular country.

British Prime Minister Gordon Brown said the country would "fully" investigate the use of its passports.

William Hague, the foreign-affairs spokesman for the Conservative Party, wrote to Foreign Secretary David Miliband to ask whether the government will take up the matter with Israel.

In 1987, Britain said it received an apology from Israel over the misuse of forged U.K passports by "Israeli authorities" and that it had received assurances that it wouldn't happen again.

The U.K. has extended Dubai help from British police, but it isn't clear the offer has been taken up. A spokesman for the Metropolitan Police said they weren't assisting Dubai in the matter.

Analysts in Israel, while providing no proof of Mossad involvement, have drawn comparisons to Israel's botched attempt to assassinate Hamas leader Khaled Meshal in Jordan in 1997. "Again, an assassination in a friendly Arab country ... again, a diplomatic tangle," wrote military commentator Amir Oren, in the liberal Haaretz newspaper. Mr. Oren called for a "swift decision" by Israeli Prime Minister Benjamin Netanyahu to dismiss Mossad Chief Meir Dagan.

Ronen Bergman, the author of several books on Israel's intelligence services, wrote in the Yediot Ahronot newspaper that the assassination is at least a partial failure, if diplomatic fallout wasn't anticipated. "It should be remembered that in the past," he wrote, "Britain has shown zero tolerance towards actions carried out by Israeli intelligence on its soil without its authorization."

—Max Colchester contributed to this article.

France vows aid for Haiti

Associated Press

PORT-AU-PRINCE, Haiti—Nicolas Sarkozy promised €230 million ($316 million) in aid for quake-stricken Haiti on Wednesday as he made the first visit by a French president to what was once the nation's richest colony.

Separately, a Haitian magistrate said some of the 10 U.S. missionaries being investigated in connection with child-trafficking accusations would be released Wednesday, nearly a month after they were caught trying to take a group of children out of the country.

The investigating magistrate, Bernard Saint-Vil, didn't say how many would be released, but said they would be allowed to go home without posting bail if they agreed to return to Haiti for any more questions.

"We expected that," said Gary Lissade, the attorney for Jim Allen, one of the Americans. It was unclear what would happen to any missionaries that the judge decides to hold. The Idaho-based group is accused of trying to take 33 Haitian children to the Dominican Republic without proper documents. They have denied accusations of trafficking.

Mr. Sarkozy, who was greeted by Haitian President René Préval as a brass band played the Marseillaise, toured a French field hospital and viewed the earthquake-ravaged capital through the door of a helicopter.

"I want only to say to the Haitian people, 'You are not alone,'" Mr. Sarkozy said on the grounds of Haiti's National Palace, one of many government buildings shattered by the Jan. 12 quake, which killed more than 200,000 people and caused billions of dollars in damage.

"It is a pleasure to welcome the president because we want France to help us," said Ovulienne Fortis, 38 years old, sitting in front of a squalid camp where hundreds of earthquake survivors now live.

Some Haitians see France's renewed interest in their nation as a counterbalance to the U.S., which has sent troops there three times in the past 16 years. But Mr. Sarkozy's visit also revived bitter memories of the crippling costs of Haiti's 1804 independence.

Mr. Sarkozy acknowledged the "wounds of colonization" during comments at the French Embassy.

France had already said it was canceling all of Haiti's €56 million debt to Paris. The aid package also will include reconstruction money, emergency aid and $40 million in support for the Haitian government's budget.

Tensions over Falklands mount on shipping lanes

A Wall Street Journal Roundup

British Foreign Office officials on Wednesday rejected Argentina's announcement that boats carrying goods to the U.K.-controlled Falkland Islands will need permission first if they cross Argentine waters.

Oil drilling is set to start this month off the coast of the disputed Falkland Islands. Argentina's president increased tensions Tuesday by issuing a decree requiring any boat carrying goods to the U.K.'s Falkland, South Georgia and South Sandwich Islands to obtain the South American country's blessing before crossing any "waters under Argentina's jurisdiction," Cabinet Chief Anibal Fernandez said.

The announcement follows Argentina's detention last week of a vessel it claims had illegally shipped drilling supplies to the Falklands in January. That heightened tension in the spat over oil-exploration rights in the disputed waters.

After previously steering clear of stoking the dispute, the U.K. fired back Wednesday. They said Argentine policy wouldn't apply in Falkland territorial waters. Legislator Andrew Rosindell, secretary of the parliamentary committee dealing with the Falklands, said it would be dangerous to ignore Argentina's provocative stance.

"Any attempt by Argentina to claim any sort of rights of sovereignty over that region is something we should take very seriously," he said. "I don't think we should appease Buenos Aires—we found out what happens last time."