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BP, Lockerbie overshadow Cameron trip

BY JARED A. FAVOLE

WASHINGTON—U.K. Prime Minister David Cameron, flanked by U.S. President Barack Obama, on Tuesday said he understands the deep frustration Americans have with U.K. oil giant BP PLC over the Gulf of Mexico disaster. But he turned aside U.S. calls for an investigation into Scotland's release of the Lockerbie bomber, saying there was no indication that oil giant BP had swayed the controversial decision.

Mr. Cameron made his first official trip to Washington since becoming prime minister in May, to talk over issues such as the Middle East peace process and trade and strengthen relations with the leader of the U.K.'s biggest ally. But he found his trip at times overtaken by talk of BP and Lockerbie.

Mr. Cameron and Mr. Obama both condemned Scotland's decision to release Libyan bomber Abdel Baset al-Megrahi from a Scottish prison.

Mr. Cameron said he wants the U.K. cabinet secretary to review whether any further information about that deci-

sion should be released. He and Mr. Obama stopped short of calling for a full review of the decision, saying it would be unnecessary.

"I don't need an inquiry to tell me what was a bad decision. It was a bad decision" to let him out of prison, Mr. Cameron said at a press conference. He said Mr. al-Megrahi was the "biggest mass murderer" in British history.

Mr. Obama said: "I think all of us here in the United States were surprised, disappointed and angry."

Mr. al-Megrahi served eight years of a life sentence for the Dec. 21, 1988, bombing of Pan Am Flight 103 as it flew over Lockerbie, Scotland, en route to New York. The bombing killed 270 people, including 189 Americans. Mr. al-Megrahi was released and returned to Libya in August 2009 after doctors said he had only three months to live. A doctor now says he could live for another decade.

Mr. Cameron was asked whether BP had lobbied the U.K. government to release Mr. al-Megrahi because of business dealings the oil giant had in Libya. At issue is the British oil giant's efforts to

win ratification of a deepwater oil deal off Libya's coast.

Mr. Cameron said BP should answer questions about any lobbying related to the Lockerbie bomber. He added, "I haven't seen anything to suggest that Scottish government was swayed at all by BP lobbying."

Edinburgh has jurisdiction over London on some matters, including the prison service in which Mr. al-Megrahi was jailed for a minimum of 27 years in 2001.

Scottish Justice Minister Kenny MacAskill's controversial decision, announced last August, granted Mr. al-Megrahi a compassionate release on the grounds that the convicted bomber was suffering from terminal prostate cancer.

BP had lobbied the British government to conclude a prisoner transfer agreement with Libya. Mr. MacAskill, however, declined to release Mr. al-Megrahi on these grounds.

Among the information that hasn't been released, but may be called for to be released, will be accounts of conversations between BP and then Foreign Secretary Jack

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Britain's Cameron speaking to reporters Tuesday during his first official visit to the U.S., as President Obama listens following the pair's meeting at the White House. The leaders expressed common ground on Afghanistan and the drive for a Mideast peace, but talk of BP elbowed onto the agenda

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The Quirk



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When corporate theft is good. Page 12

Results spotlight Goldman missteps

Goldman Sachs Group Inc. posted its lowest earnings since the worst of the financial crisis, reflecting sharply lower revenue, the U.K. bonus tax and its landmark settlement reached last week with U.S. regulators.

Chief Executive Lloyd Blankfein acknowledged there have been less-than-favorable conditions to navigate, as a result of the debt crisis in the euro zone and concern about financial-sector reform in the U.S.

Goldman reported that net income slid to \$613 million, or

78 cents a share, from \$3.43 billion, or \$4.93 a share, a year earlier. Revenue slipped 36% to \$8.84 billion.

Douglas Sipkin, an analyst with Ticonderoga Securities, said Goldman "was not well positioned for moves in volatility" and that "the environment needs to improve for revenues to grow."

Last week, Goldman agreed to a \$550 million penalty to settle U.S. civil charges that it duped clients by selling mortgage securities that were secretly designed by a hedge-fund firm to cash in on the

housing market's collapse. The firm didn't admit to or deny the charges.

David Viniar, Goldman's chief financial officer, said in a conference call Tuesday that he didn't foresee any changes to Goldman's top executives in the wake of the SEC settlement. He also said he didn't know whether the U.S. Justice Department was pursuing criminal charges against the firm.

Addressing Goldman's results, Mr. Viniar said the firm was caught off guard by the market's volatility. Goldman's

equity derivatives were on the wrong side of bets that stock-market volatility would ease during a quarter when equities had wild swings.

"We didn't hedge it fast enough, let's put it that way," Mr. Viniar said. "We were reducing position size and hedging things but things spiked really dramatically really fast."

Goldman, which spent \$600 million during the period to comply with Britain's bonus-tax law on bankers, reported that second-quarter compensation fell 43% to \$3.8

billion from \$6.6 billion. Halfway through 2010, Goldman employees, typically the highest paid on Wall Street, stand to earn less this year than in 2009. The investment bank has allocated \$9.3 billion for such payouts, down by nearly one-fifth from the \$11.4 billion set aside a year ago.

Rival Morgan Stanley is scheduled to report its results before U.S. markets open on Wednesday.

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Fighting future wars in cyberspace

[Agenda]

BY ROBERT FRY

Alfred von Schlieffen died almost 100 years ago, barely months before his eponymous plan took Europe to war in August 1914. His final words were claimed to be "keep the right strong," a reference to the German attack on France that was to sweep beyond Paris and envelop the French army, government and nation in a single strategic bound.

Like all his contemporaries, von Schlieffen thought in two dimensions: land and sea; military aviation would add a third during the course of the war. Things move on in a century and today we contemplate a strategic landscape comprising five operating environments, with land, sea and air complemented in the late 20th century by space and more recently by the phenomenon of cyberspace.

The existence of these five dimensions has become a conventional wisdom, attested to by a U.S. Cyber Command and a U.K. cyber operations center at the GCHQ. But what does the existence of cyberspace mean for conflict in the 21st century? Above all, does it fundamentally change the way in which nations might choose to attack their enemies and defend themselves?

The U.K. Cyber Security Strategy explains that cyberspace "encompasses all forms of networked, digital activities; this includes the content of and actions conducted through digital networks." So far, so opaque. A more vivid description has been offered by the U.S. National Strategy to Secure Cyberspace, which characterizes it as the nervous system of the nation's infrastructure, and, pursuing the analogy, a target which, if successfully engaged, could paralyze the rest of the body.

The more apocalyptic view of cyberattack takes this further to predict the instantaneous failure of the systems that animate and



The International Multilateral Partnership Against Cyber Threats in Malaysia.

sustain modern life. At a stroke, computer systems, power grids, industrial production and financial markets could fail, with untold consequences for civil governance and social cohesion: an electronic Pearl Harbor and all without a shot being fired. And this isn't just academic hypothesis.

The attack on Estonia in the spring of 2007 saw data packets sent from one address to another, completely overwhelming the host systems. Perhaps even more significant was the combined Russian cyberspace and conventional attack on Georgia in August 2008, showing how gaps created in the virtual dimension could be physically exploited in the land and air dimensions. Little wonder then that the U.S., U.K., France, the NATO alliance, China, Israel and those habitual international recalcitrants, North Korea and Iran, all publicly concede to developing, at least, cyberdefenses, leaving unspoken a capacity for cyberattack.

Cyberattack devices are available to states, criminals, terrorists and geeks in garages, "hacktivists" as they are known in the trade. What's more, the commercial market becomes the combat developer that allows adversaries of whatever stripe to develop capability often more quickly than is possible through the clumsy research and acquisition processes used by national defense establishments.

And, we have the return of the Rumsfeld Paradox: We don't know what we don't know. How many viruses, trojans, worms and crimeware lie undetected within our national infrastructure?

So, not just two dimensions now; 21st-century conflict will be both ubiquitous and insidious and will be conducted by a complex mix of state and nonstate actors, with the latter finding the perfect medium for nonaccountable action in cyberattack.

But what's new? Every conflict since the fall of the Soviet Union has been characterized by the same levels of complexity and ambiguity. Indeed, for so long as al Qaeda remains obsessed with physical martyrdom and uses the Internet to orchestrate its operations, it will be more vulnerable to cyber operations than the nations it attacks. It may be that the fifth, cyberspace, dimension of military operations does no more than compound the existing trends in warfare, rather than offering an entirely novel form of engagement.

I buy this interpretation, with two important revisions. First, cyber operations may become the first among equals, making the effective warfare practitioner as much technician as warrior. And second, the speed of cyber operations places a premium on first strike and so inverts the Clausewitzian principle of the inherent advantage of defense. A

point which neatly leads to my next observation. Whereas nuclear weapons have been used twice in history, cyber weapons are employed daily and there is an existential need to create some form of regulatory system that allows more than implicit deterrence. This will not be easy.

Cyber weapons are easy to procure and use and so resemble chemical more than nuclear weapons, which can be counted and tracked. Also, nuclear deterrence has a framework of interstate relations and is underwritten by the certainty of mutually assured destruction.

Finding the boundary between enemy action and criminality will be difficult, but, if the 21st century is not to witness an arms race heavily influenced by the advantages of offensive action, a start will have to be made. The development of NATO's new strategic concept gives an opportunity for this and to define whether an attack against one is an attack against all. So does the U.K. Strategic Defense & Security review, which proceeds from the retention of Trident but has yet to address the more immediate issue of cyber deterrence. Such a regulatory system will probably look like the international framework of maritime law, which allows common usage but builds in obligations to assist those in distress and act against piracy.

Von Schlieffen could never have anticipated satellite technology or attacking an enemy through the electromagnetic spectrum, but he would have understood deterrence. As an officer schooled in the Prusso/German tradition, he would also have understood the simultaneous and overwhelming application of all instruments of strategic power in pursuit of victory. Whether two dimensions or five, the underlying rhythms of warfare remain the same.

Sir Robert Fry is chairman of McKinney Rogers, a business consultancy, and a former deputy commanding general of coalition forces in Iraq.

What's News

■ **The U.K. government** borrowed over \$22 billion in June, more than expected, and central government tax receipts increased 4% year-to-year, the smallest increase since January. 4

■ **Toyota said** a U.S. grand jury subpoenaed documents related to problems with steering systems, widening the panel's investigation. 20

■ **U.S. military contractors** look to expand exports in hopes of cushioning an expected decline in Pentagon spending. 21

■ **Flybe unveiled an order** for as many as 140 regional jets from Brazil's Embraer that will spearhead the U.K. airline's push into continental Europe. 21

■ **The IMF said** central banks may want to use interest rates to head off asset bubbles, weighing in as the Federal Reserve and other central banks re-evaluate their strategies. 8

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Paul Sharma on the challenges facing the next chief executive of Nokia



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NEWS



Rush Jagoe for The Wall Street Journal

Nick Collins holds dead oysters that he pulled off of his leases in Snail Bay, La. He says the drop in the marsh water's salinity is to blame.

Fresh water cure kills oysters

BY JEFFREY BALL

HOUMA, La.—Oysters are dying in their beds in the brackish marshes of southern Louisiana, but the culprit isn't oil spilling from the Gulf. It is, in part, fresh water.

In April, soon after the oil spill started, Louisiana officials started opening gates along the levees of the Mississippi River, letting massive amounts of river water pour through man-made channels and into coastal marshes. It was a gambit—similar to opening a fire hose—to keep the encroaching oil at bay.

By most accounts, the strategy succeeded in minimizing the amount of oil that entered the fertile and lucrative estuaries. But oyster farmers and scientists say it appears to have had one major side effect: the deaths of large numbers of oysters, water-filterers whose simplicity and sensitivity makes them early indicators of environmental influences that ultimately could hit other marsh dwellers too.

State officials say it's unclear to what extent the fresh water releases are responsible for killing oysters.

The oyster deaths in Louisiana—which produces more than a third of U.S. oysters, more than any other state—are the latest reminder that efforts to protect this delicate ecosystem from the oil spill could produce environmental damage of their own. Louisiana and federal officials have quarreled over an ongoing state project to build large sand berms to fend off incoming oil, with some federal officials fearful that they could intensify erosion. And chemical dispersants sprayed on the oil in the Gulf to break up oil slicks might contribute to underwater oil plumes that could harm marine life, some scientists say.

Some marshes have been so inundated with fresh water that their salinity has plummeted to levels oysters can't easily survive, some scientists say. Deprived, at least temporarily, of the salty water they need, large numbers of the two-shelled crop that has defined this region's economy and culture for generations are dying off—even in parts of the Louisiana coast that appear to have been untouched by the spilled oil itself.



Oyster danger

The Davis Pond Project Area was created to divert fresh water from the Mississippi River into estuaries to enhance the fisheries and maintain a stable salinity. When oil began flowing in the Gulf of Mexico after the Deepwater Horizon explosion, the state significantly increased the flow south in an effort to prevent approaching oil from entering the marshes. Some oyster producers and scientists say this fresh water flow is endangering oyster beds.

Full-strength seawater typically contains roughly 35 parts salt per thousand parts water, scientists say. Some of the southern Louisiana waters most productive for oysters contain 15 or more parts salt per thousand parts water, said Earl Melancon, a biologist at Nicholls State University in Thibodaux, La.

But in recent weeks, Mr. Melancon said, some waters in the vicinity of southern Louisiana's Barataria Bay have been found to have salinity levels below five parts salt per thousand parts water. Even the hardiest oysters, he said, have trouble surviving in that.

"They're dead, and they're dead because of fresh water," said Nick Collins, 38, an oysterman in Golden Meadow, La., citing government measurements of reduced salinity levels in the area.

Over the century that Mr. Collins's family has been growing and harvesting oysters in Snail Bay, near Barataria Bay, innumerable hurricanes have sunk some of his family's

boats and ripped apart their houses, he said. But no natural storm ever decimated the Collins Oyster Co.'s about 2,000 acres of oyster beds as much as the river water unleashed in recent weeks by state officials appears to have done.

Wholesale oyster prices at P&J Oyster Co. have risen about 20% since the oil spill started and they are likely to rise further, said Al Sunseri, president of the longtime New Orleans oyster processor and distributor.

Patrick Banks, the biologist at the Louisiana Department of Wildlife and Fisheries who oversees the state's oyster fishery, said his office recently found in a particularly productive section of the Barataria Bay area that roughly 60% of the oysters had died. In other nearby areas, he said, the mortality level was around 10%.

One die-off a few weeks ago was so extensive that visible masses of oyster meat were floating on the bay's surface. "It looked like a fish

kill," said Mr. Banks, explaining the kill occurred "so fast and was so large that the predators that normally would eat up the oyster meat just couldn't keep up."

He blamed the deaths on the combination of summer heat and the salinity drop triggered by the opening of the fresh-water channels, known as "diversions"—a decision made by officials in another state office attempting environmental triage. "The state took the measure to try to protect the interior marshes," Mr. Banks said. "These are some of the effects of that."

A spokesman for the Louisiana Coastal Protection and Restoration Authority, the state entity that oversaw both the berm construction and the river-water release, said it is "obvious" that the state's fresh-water releases reduced salinity in the oyster beds.

But he said those intentional releases were just one of several factors contributing to the salinity drop; others included rain and the natural flow of the river. Linking a specific number of oyster deaths to the fresh-water releases will be difficult, he said.

The authority's chairman, Garret Graves, said in a written statement that state officials "are currently evaluating all of the adverse effects associated with the oil spill" and that BP PLC "is expected to pay" for all spill-related damage.

A BP spokeswoman said the company is "committed to paying all legitimate claims" but declined to say whether the oyster deaths are among them.

In an underlying irony, the channels that ferried the river water into the marshes, apparently killing oysters, were built largely at the oyster industry's behest. Decades ago, the construction of levees along the Mississippi River effectively stopped the river from flooding adjacent land. But that meant the river's fresh water no longer inundated the marshes each spring, annual rite of ecological renewal. That sent the salinity in many marshes too high, threatening oysters.

After years of wrangling between the state and the oyster industry, officials built the channels as a way to restore some of the fresh water into the marshes.

Supervisor says BP rig had a flaw in hydraulics

BY BEN CASSELMAN

KENNER, La.—Workers aboard the Deepwater Horizon discovered a serious flaw in a key safety device about a month before the oil rig exploded in the Gulf of Mexico, a supervisor testified Tuesday.

Ronald Sepulvado, one of the BP PLC employees overseeing the rig's operations, told a federal investigative panel that workers detected a leak in the hydraulic system that controls the blowout preventer, the huge stack of valves on the seafloor that is supposed to shut down a well in an emergency.

Why the blowout preventer failed to stop the surging well is one of the most significant remaining mysteries in the April 20 explosion that killed 11 workers and set off one of the worst environmental disasters in U.S. history. A leaky hydraulic system, by itself, shouldn't have stopped the blowout preventer from working, because it had a backup system.

But investigators said that continuing to drill with a faulty hydraulic system could be a violation of federal regulations, which require companies to stop drilling if either of a blowout preventer's two control systems doesn't work properly.

The hearing is being conducted by the U.S. Coast Guard and the Bureau of Ocean Energy, Regulation and Enforcement, formerly the Minerals Management Service.

Mr. Sepulvado said he reported the problem to BP officials in Houston, adding that they should have reported it to federal regulators. But the problem wasn't mentioned in drilling reports BP sent to the Minerals Management Service.

"I guess we assumed everything was O.K. because we reported it to the team leader and he should have reported it to the MMS," Mr. Sepulvado said.

Mr. Sepulvado acknowledged he was aware of an April audit that found the Deepwater Horizon's blowout preventer was "well past" due for a major inspection that is supposed to take place every three to five years.

The blowout preventer is owned by Transocean Ltd., the offshore drilling giant hired by BP to drill the well. Transocean is responsible for maintaining the blowout preventer, and BP has argued that the drilling company is partly responsible for the disaster because of the device's failure.

Until recently, public attention has focused on BP, which designed the well and made most of the decisions about how to drill it. But in recent days, investigators have also looked at Transocean and its maintenance practices.

Mr. Sepulvado said he had raised concerns about the driller's maintenance, noting that some pieces of equipment had been out of service for extended periods of time.

"They always told me that they didn't have the parts," Mr. Sepulvado said. Transocean has defended its maintenance practices.

BP, too, drew scrutiny in Tuesday's hearing. Investigators asked repeatedly about how experienced BP's employees were.

EUROPE NEWS

U.K. borrowing is still high

By LAURENCE NORMAN

LONDON—The U.K. government borrowed more than expected in June, with central government tax receipts increasing at a much slower pace than in previous months.

The Office for National Statistics said Tuesday that the U.K. public sector borrowed a net £14.5 billion (\$22.09 billion) in June, down from £14.7 billion a year earlier. Economists had expected public-sector net borrowing of £13.5 billion.

Britain's central government tax receipts rose 4% year-to-year, the smallest increase since January. That included a 10.9% rise in value-added tax revenue from a year earlier—the smallest rise since December 2009.

Taxes on income and wealth, which had spiked ahead of the end of the last tax year in April because of tax changes, were up just 0.8% from a year earlier.

The higher June borrowing and upward revision to May's borrowing numbers wipe out some of the seeming improvement in public finances noted recently as the U.K. battles with a £155 billion deficit.

Andrew Goodwin, senior economic advisor to the Ernst & Young ITEM Club, said the June data were "disappointing."

"The strong year-on-year growth in tax receipts that we saw in the early months of the year seems to have cooled," he said. "The debt interest bill is more than double that of last June and this is only likely to increase in the coming months."

For the financial year to date, which started in April, public-sector net borrowing totaled £40.3 billion, versus £40.9 billion in the comparable period last year.

Varun Bhabha, U.K. economist at Barclays Capital, said the details of income-tax, capital-gains-tax and corporate-tax receipts in recent months "indicate that the risks to the Treasury's full-year borrowing forecasts are to the upside."

The government is expecting a public-sector net borrowing total of £149 billion for the full financial year. It has ordered some £6.2 billion in spending cuts for this year but most of that is yet to filter through to the borrowing numbers.

A Treasury spokesman said the data underline why Prime Minister

David Cameron's government has made deficit reduction its central economic objective. "The U.K. is forecast to have the largest deficit in the [Group of Seven] this year and is borrowing one pound for every four it spends. The figures for June demonstrate the urgent priority tackling the deficit represents," the spokesman said.

June's public-sector net cash requirement was £20.9 billion, up from £20.2 billion a year earlier. That is the highest June net cash requirement yet; economists had expected it to be £17 billion. June's net cash requirement was pushed higher by bigger interest payments on U.K. government bonds. June is one of the two months of the year when those interest payments are made.

Interest payments on the debt in June reached £3.8 billion, up from £1.7 billion a year earlier—an increase of 124%.

Public-sector net debt as a proportion of gross domestic product reached 63.9% in June, up from 57.3% a year earlier.

Excluding financial-sector interventions, net debt to GDP stood at 56.1% in June.

The ONS said there was a £1 billion upward revision to May's public-sector borrowing, because of an "exceptional" £2.3 billion under-reporting of local government borrowing due to an error by the Department of Communities and Local Government, an ONS official said.

The central government's May borrowing was revised down. That took May's public sector borrowing to £17.1 billion.

Other data, in a survey by the Confederation of British Industry released Tuesday, show that U.K. industrial orders hit their strongest level in almost two years in July, but manufacturers expect output growth to slow during the third quarter.

Ian McCafferty, chief economic adviser for the CBI, said the recent strength of manufacturing suggested the economy grew between 0.6% and 0.8% on a quarterly basis between April and June.

The CBI survey's headline balance for expectations of industrial output over the next three months fell to plus 6 in July from plus 15 in June, an indication that economic recovery is losing some momentum.

BP issues overshadow Cameron's trip to U.S.

Continued from first page

Straw.

"The bottom line is we all disagreed with it, it was a bad decision," Mr. Obama said.

The two leaders found themselves mainly agreeing on a host of topics, from Afghanistan to peace in the Middle East.

In particular, Mr. Cameron had been keen to bang the drum for British trade within its biggest export market. Mr. Obama promised to push the Senate to ratify a long-awaited defense trade cooperation agreement with the U.K.

Three years after a deal was reached, the U.S. hasn't signed the Defense Trade Cooperation Treaty with the U.K., with some U.S. politicians saying it could allow military technology to pass to Britain. This has angered British politicians.

One British official said Mr. Cameron was pleased with discussions on mapping out the political process for Afghanistan, where the U.K. is the second-largest contributor of troops.

Regarding the Gulf disaster, Mr. Cameron said BP is taking steps to cap the well and pay for damages done to people who rely on the Gulf.

"I completely understand the anger that exists right across America," Mr. Cameron said. He added: "The oil spill in the Gulf of Mexico is a catastrophe, for the environment, for the fishing industry, for tourism."

He said BP should "rightly be blamed" for the spill.

—Paul Sonne and Alistair MacDonald in London and the Associated Press contributed to this article.



Agence France-Presse/Getty Images

Travelers at an Air France desk at Paris-Charles de Gaulle airport this year. An air-traffic controllers' strike is disrupting flights scheduled for Wednesday.

French air-traffic controllers strike

By KIMBERLY PETERSON

PARIS—Air-traffic controllers in France, angry about a European plan to create several large air-traffic control regions, went on strike late Tuesday, causing hundreds of flight cancellations.

Four of the nine French air-traffic control unions said their members wouldn't turn up to work until Thursday morning to protest the plan, which they fear will cost jobs.

The DGAC, the French civil-aviation authority, canceled half of Wednesday's flights through Paris-Orly airport, south of Paris, and 20% of flights through Paris-Charles de Gaulle airport, northeast of the cap-

ital. National carrier Air France, part of Air France-KLM SA, said it would cancel 80% of its short- and medium-haul flights at Paris-Charles de Gaulle on Wednesday in an effort to maintain all of its long-haul flights from the airport.

The new European system will have six air-traffic control regions, instead of leaving individual countries to operate their own controls as they do now. The European Commission hopes the larger airspace blocks will improve air-traffic capacity, enhance security and lower the cost of air-traffic services.

France's airspace authorities will be combined with those of five other countries—Germany, Switzer-

land, the Netherlands, Luxembourg and Belgium—to form the Functional Airspace Block Europe Central, or FABEC.

French unions say they don't oppose greater cooperation with air-traffic controllers in other countries. But they fear the pan-European plan will mean hundreds of jobs lost in France, where the air-traffic control system employs about 12,000 people. "It's above all a question of job security," said Olivier Joffrin, national secretary for the air-traffic controllers represented by the CGT union.

The DGAC says that over the next 15 years air traffic in France will increase some 50%, meaning

fewer jobs will be lost than unions fear. "The system will change, but the point of FABEC is not to cut jobs," said Eric Heraud, press officer for the civil aviation authority.

French air-traffic controllers went on strike over the same issue in January and again in February. After those strikes the government appointed a mediator to help the unions have a voice in the creation of FABEC's structure.

The controllers in France were expected to return to work Thursday morning. Mr. Joffrin said there could be more strikes around September, when firmer integration plans are expected, if the plan moves ahead without modifications.

The economy in Bulgaria is stabilizing

By NICK SKREKAS

The Bulgarian economy looks to be stabilizing after weathering the financial crisis better than most neighbors.

The economy contracted 3.6% on an annual basis in the first quarter of 2010 from 5.9% in the previous quarter. However, the government hopes for 1% economic growth this year as recovering exports bolster the expansion. This would be a more rapid recovery than seen in the rest of the European Union.

Bulgaria is one of the few countries expected to slash budget deficits, to 2.7% in 2011, without having to resort to wage and pension cuts. The Finance Ministry, for 2011-2013, forecasts a budget deficit below 3% while the 2011 budget is underpinned by expectations of 3% growth and a deficit of 2.7% of GDP.

Also, the government says that at the end of this year the unemployment rate will be below the 11.4% forecast.

While some of its neighbors are dependent on EU and IMF loans, such as Greece, Bulgaria has declined to take a loan from the IMF.

EUROPE NEWS

Talks on forming Dutch government break down again

BY MAARTEN VAN TARTWIJK AND ANNA MARIJ VAN DER MEULEN

AMSTERDAM—The Netherlands lurched deeper into political limbo Tuesday after renewed efforts to form a coalition government broke down amid disagreements about the scope and speed of economic overhauls.

“The views of the parties involved in the negotiations on the proposed budget cuts were too far apart,” said Mark Rutte, leader of the Liberal Party, which emerged as the country’s biggest representative in Parliament after elections on June 9 produced no clear winner. “Combined with disagreement on other measures such as the reform of the housing market, [that] led to the failure of the negotiations.”

Mr. Rutte called the results of the voting “the most difficult we have ever seen.”

The center-right Liberals were negotiating with a center-left trio of the Labor Party and the smaller Democratic Liberals and Green Party.

Left out was the biggest gainer in the elections, Geert Wilders’s populist Freedom Party, which ended up with 24 seats, up from nine, after a campaign that was critical of Islam.

Mr. Rutte said the Liberals will seek to forge an alliance with Labor, which finished second in the vote, and the Christian Democrats, which finished fourth.

A mainstream coalition will make up a weak government, which could hinder the effort to reduce the national debt, said Sweder van Wijnbergen, a professor of economics at the University of Amsterdam.

“It will be difficult. But we need clarity as soon as possible because the Netherlands has a large budget deficit,” he added.

The country’s 16.6-million-strong population is aging, threatening its generous pension system.

Every Dutch citizen over the age of 65 receives 70% of net minimum wage and the country boasts one of Europe’s most lavish health-care programs for its senior citizens.

Politicians agree on the need for budget cuts, and all potential coalition partners are expected to back an increase of the retirement age.

But they have expressed diverging views on the range and depth of overhauls in other areas, such as the welfare system and housing market, which economists see as necessary to cut the Netherlands’ budget deficit.

The fiscal shortfall is set to



Liberal Party leader Mark Rutte, left, didn’t include the Freedom Party, led by Geert Wilders, right, in coalition talks.

widen to 6.6% of gross domestic product this year from 5.3% in 2009, taking the country’s public debt to 66% of GDP.

Mr. Rutte and the Liberals want to make €20 billion (\$25.9 billion) in budget cuts by 2015.

Labor wants €10 billion in cuts in that period, so any coalition in which it is involved “will probably end up somewhere at around a €15 billion reduction,” said Rick van der Ploeg, a professor of economics at Oxford University and a former Dutch state secretary of education,

science and culture.

Andre Krouwel, a political scientist at the University of Amsterdam, said that in order to be able to form a government, the Liberals will have to let go of their aim of cutting public finances by such a drastic amount over the next four years.

“There is no parliamentary majority for such a steep budget cut,” Mr. Krouwel said. “They will run into the same problems in new talks, making the formation of a government impossible.”

He added that if there is no

agreement with Labor, the Liberals won’t succeed when talks with the Christian Democrats start.

Fragmenting electorates, a trend seen in many Western European countries, make a strong Dutch government a difficult proposition, said Kees Aarts, professor of political science at the University of Twente.

Although the Dutch economy, the fifth-largest in the euro zone, is in relatively good shape, analysts warned that the Dutch government should move decisively to fix the public finances.

Mistreatment of ‘Gareth’ was just a flight of fancy

[Brussels Beat]

BY CHARLES FORELLE



We at Brussels Beat were nearly moved to tears by the plight of poor Gareth, a British football fan arrested in

Portugal, denied an interpreter by the police, provided with a court-appointed lawyer who had “limited knowledge of English” and forced to trial “24 hours later.”

The tale was told by the European Commission, in a March press release making the case for a new European Union regulation standardizing the treatment of criminal suspects facing proceedings in foreign countries in an unfamiliar language.

We used this example in our Real Time Brussels blog post Tuesday following EU Justice Commissioner Viviane Reding’s announcement of a new proposal to a require a written Miranda-warning-like notification for suspects.

Now comes more-shocking news: There is no Gareth.

The example “was made up,” wrote Ms. Reding’s spokesman, Matthew Newman, in an email. “We didn’t want to use actual people,” he said later by telephone.

Gareth [we should probably henceforth call him “Gareth”] was “inspired by actual cases,” Mr. Newman said, but didn’t represent an actual person. “Gareth” appears in fact to be a composite of events, people, and the fertile imaginations of the European Commission’s press-release-writing team.

What about “Stanislaw,” the Polish man “on trial in Germany for conspiracy to murder?” Or “Jas,” who was “pressured into signing a document written in Spanish that he did not understand?”

“All made up,” said Mr. Newman. He said the three examples given in the press release were “indicative” of the kinds of problems that could be faced by criminal suspects abroad.

Mr. Newman said that two examples given by Ms. Reding at Tuesday’s press conference [14 football fans arrested and forced to share the same interpreter, and a person arrested at an airport after her traveling companion was found with cocaine] refer to actual people—as far as the commission knows. (The information, Mr. Newman said, came from a nongovernmental organization.)

Asked whether the European Commission ought not fabricate characters in its official communiqués, Mr. Newman agreed that a “disclaimer” that the people aren’t real is in order.

WE HAVE EIGHT PSYCHOLOGISTS ON OUR FACULTY. WHAT ARE WE, CRAZY?

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EUROPE NEWS



Markel Redondo for The Wall Street Journal (2)

A patient takes a dose of methadone (pills shown by nurse, right) at a rehabilitation center in Porto. Such centers are at the heart of Portugal's decadelong experiment with drug decriminalization.

Portugal drug law draws new scrutiny

BY SUSANA FERREIRA

PORTO, Portugal—This country's move to decriminalize illicit substances—Europe's most liberal drug legislation—turns 10 years old this month amid new scrutiny and plaudits.

Portugal's decriminalization regime has caught the eye of regulators in Europe and beyond since it was implemented in 2001. Proponents credit the program for stanching one of Europe's worst drug epidemics. Critics associate it with higher crime and murder rates. Approaching a decade in force, it is providing a real-world model of one way to address an issue that is a social and economic drag on countries world-wide.

Norway's government formed a committee to look at better strategies for dealing with drug abuse and sent two delegates to Portugal in early May. Danish politicians have also talked of moving toward full decriminalization. In March, Danish parliamentarian Mette Frederiksen of the opposition Social Democrats praised the Portuguese model.

"For us, this is about the addicts leading a more dignified life," she told Danish daily Berlingske. "We want to lower the death rates, the secondary symptoms and the criminality, so we look keenly to Portugal."

Decriminalization has been criticized by United Nations bodies. In its 2009 annual report, the International Narcotics Control Board expressed "concern" over approaches that decriminalize drugs or introduce alternative treatments. "The

movement poses a threat to the coherence and effectiveness of the international drug-control system and sends the wrong message to the general public," the board wrote.

In July 2000, Portugal moved beyond previous liberalization regimes in places like the Netherlands by passing a law that transformed drug possession from a matter for the courts to one of public and community health.

Trafficking remained a criminal offense but the government did away with arrests, courts and jail time for people carrying a personal supply of anything from marijuana to cocaine to heroin. It established a commission to encourage casual users to quit and backed 78 treatment centers where addicts could seek help.

In 2008, the last year for which figures are available, more than 40,000 people used the rehab centers and other treatment programs, according to the Institute for Drugs and Drug Addiction, a branch of Portugal's Ministry of Health. The ministry says it spends about €50 million (\$64.5 million) a year on the treatment programs, with €20 million more provided through a charity funded by Portugal's national lotteries.

Before decriminalization, Portugal was home to an estimated 100,000 problem heroin users, or 1% of the country's population, says João Goulão, director of the Institute for Drugs and Drug Addiction. By 2008, chronic users for all substances had dropped to about 55,000, he says. The rate of HIV and hepatitis infection among drug users

—common health issues associated with needle-sharing—has also fallen since the law's 2001 rollout.

Portuguese and European Union officials are loath to give publicly funded treatment centers sole credit. They say the drop in problematic drug users could also be attributed to heroin's declining popularity in Portugal and the rising popularity of cocaine and synthetic drugs among young people.

At the same time, Portugal's drug-mortality rate, among Europe's lowest, has risen. Mr. Goulão says this is due in part to improved methods of collecting statistics, but the number of drug-related fatalities can also be traced to mortality among those who became addicted to heroin during the country's 1980s and 1990s epidemic.

Violent crime, too, has risen since the law's passage. According to a 2009 report by the U.N. Office on Drugs and Crime, Portugal's drug-use and murder rates rose in the years after decriminalization. The general rise in drug use was in keeping with European trends, but the U.N. noted with some alarm that cocaine use doubled and cocaine seizures jumped sevenfold from 2001 to 2006.

Murders rose 40% in the period. The report tentatively links that with drug trafficking, but points out overall murder rates in Portugal remain low.

Pedro do Carmo, deputy national director of Portugal's judiciary police, says he doesn't see link the rise in violent crime with decriminalization. Instead, he praises the program for reducing the fear and

stigma attached with drug use. "Now, when we pick up an addict, we're not picking up a criminal," he says. "They are more like victims."

The Portuguese began considering drug decriminalization following a leap in heroin addiction decades ago in the country, a major entry point for drug trafficking from Latin America and North Africa.

The then-ruling Socialist Party government of Prime Minister António Guterres launched a political debate to discuss how to resolve the problem. Members of the right-wing People's Party decried any tolerance for drug use, saying it would invite drug tourism.

Mr. Guterres's government pushed through a full decriminalization law. A subsequent center-right coalition led by José Manuel Barroso, now president of the European Commission, didn't repeal it.

The legislation was the first in a series of liberal policy shifts in this predominantly Roman Catholic country. In May, President Aníbal Cavaco Silva ratified a law allowing same-sex marriage, making it the sixth European country to do so. In 2007, Portugal went from having among the toughest restrictions on abortion to among the most liberal.

Portugal's focus on close-knit community and protecting the family may be at the heart of many of these reforms, say some observers. In a 1999 report that paved the way for new drug legislation, current Portuguese Prime Minister José Sócrates implored that "drugs are not a problem for other people, for other families, for other people's children."

Portugal's rehab clinics, called Centros de Atendimento de Toxicodependentes, are central to the strategy. In the lively northern port city of Porto, dozens of patients pop in daily to the Cedofeita rehab center to pick up free doses of methadone. Others have scheduled therapy or family counseling sessions, also free.

"The more they can be integrated in their families and their jobs, the better their chances of success," says José González, a psychiatrist at Cedofeita. Mr. González says that about half of his 1,500 patients are in substitution treatment, 500 of which take methadone daily. He says there is no defined model or timeline for treatment.

The European Monitoring Centre for Drugs and Drug Addiction, a Lisbon-based European Union agency, says methadone or other substance-substitution programs are generally viewed as successful but has observed that some Portuguese are beginning to question long-term methadone therapy.

"Now that the epidemic is under control for the most part, people start asking questions," says Dagmar Hedrich, a senior scientific analyst with the EMCDDA. "The question now is what is going to happen next? There is a part of the population who do not have the possibility of leaving the treatment."

WSJ.com

ONLINE TODAY: See photos from a clinic in Porto at WSJ.com/Health.

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Spy chief: Iraq war raised threat to U.K.

Associated Press

LONDON—British and U.S. intelligence had no credible evidence of a link between Saddam Hussein and the Sept. 11, 2001, attacks on the U.S. before the 2003 Iraq invasion, the ex-head of Britain's domestic spy agency told the country's inquiry into the war Tuesday.

Eliza Manningham-Buller, director of the MI5 from 2002 to 2007, said that nothing to connect the attacks to Baghdad was discovered

ahead of the 2003 invasion of Iraq.

The ex-spy chief said the war caused allies to lose focus on the al Qaeda threat in Afghanistan, emboldened Osama bin Laden and led to the radicalization of a generation of homegrown British extremists.

She acknowledged the Iraq war vastly increased the terrorism threat to Britain—with her officers battling to handle a torrent of terrorism plots launched by homegrown radicals in the wake of the 2003 invasion.

"Our involvement in Iraq radicalized, for want of a better word, a whole generation of young people—not a whole generation, a few among a generation—who saw our involvement in Iraq, on top of our involvement in Afghanistan as being an attack on Islam," she said.

Baroness Manningham-Buller said those pushing the case for war in the U.S. gave undue prominence to scraps of inconclusive intelligence on possible links between Iraq and the 2001 attacks, singling out the

then-U.S. Defense Secretary Donald Rumsfeld. She suggested the dispute led Mr. Rumsfeld to disregard Central Intelligence Agency intelligence in favor of work produced by his own department.

Baroness Manningham-Buller said that the focus of Britain and the U.S. on Iraq had also had far reaching consequences for the mission to tackle global terrorism. "By focusing on Iraq we reduced the focus on the al Qaeda threat in Afghanistan," she said.

U.S. NEWS

Jobless benefits advance in Senate

BY COREY BOLES

WASHINGTON—The Senate on Tuesday voted to overcome a key hurdle to extending U.S. jobless benefits, likely renewing the 99-week period that long-term unemployed people in most parts of the country can qualify for assistance.

By a 60-40 vote, senators ended a Republican filibuster, setting up a final vote on the measure.

The legislation would then have to return to the House for lawmakers' approval in that chamber, something Democratic leaders have pledged to do.

The roughly \$34 billion cost of the plan will be paid for by new borrowing.

Democrats were able to reach the crucial 60-vote supermajority to overcome Republican resistance only after Sen. Carte Goodwin (D., W.Va.) was sworn in by Vice President Joe Biden a few minutes before the vote was held.

Mr. Goodwin succeeds Sen. Robert Byrd (D., W.Va.), who died in June.

Voting with the Democrats were Maine Republican Sens. Susan Collins and Olympia Snowe.

Two other moderate Republicans who have supported benefit extensions in the past—Sens. Scott Brown (R., Mass.) and George Voinovich (R., Ohio)—declined to support the measure.

So, too, did Sen. Ben Nelson (D., Neb.), a Democrat who routinely votes against spending items unless their cost is offset.

The vote portends an almost certain end to the more than three-month ordeal that has seen the Senate gridlocked in partisan rancor over the benefits issue.

Democrats have attempted several times, both as a stand-alone measure as well as part of a wider

tax package, to pass the benefits extension. Republicans have opposed the moves, arguing that unspent funds in the economic-stimulus plan should be used to pay for the cost of the program.

Democrats have argued that spending on unemployment benefits themselves stimulate the economy and can expedite the economic recovery already under way.

Republicans have countered that federal spending is out of control and have sought to force Democrats to pay for the roughly \$34 billion cost of the benefits extension.

The issue has become a flash point in the parties' attempts to define themselves for the fall election campaigns.

Congress has voted six times since June 2008 to extend benefits, but Republican resistance has grown along with concerns about the deficit.

Democrats agreed to drop unrelated items and trim the bill to \$34 billion to win the support of Sens. Collins and Snowe.

Democrats had originally introduced a \$120 billion bill that included such items as aid to cash-strapped states

If the extension is approved, unemployed workers in the hardest-hit states would again be able to draw as many as 99 weeks of aid. That includes 26 weeks of basic aid offered by states, plus long-term federal payments. The expiration of the previous extension June 2 has had a rolling impact on the unemployed, as thousands have exhausted their benefits each week.

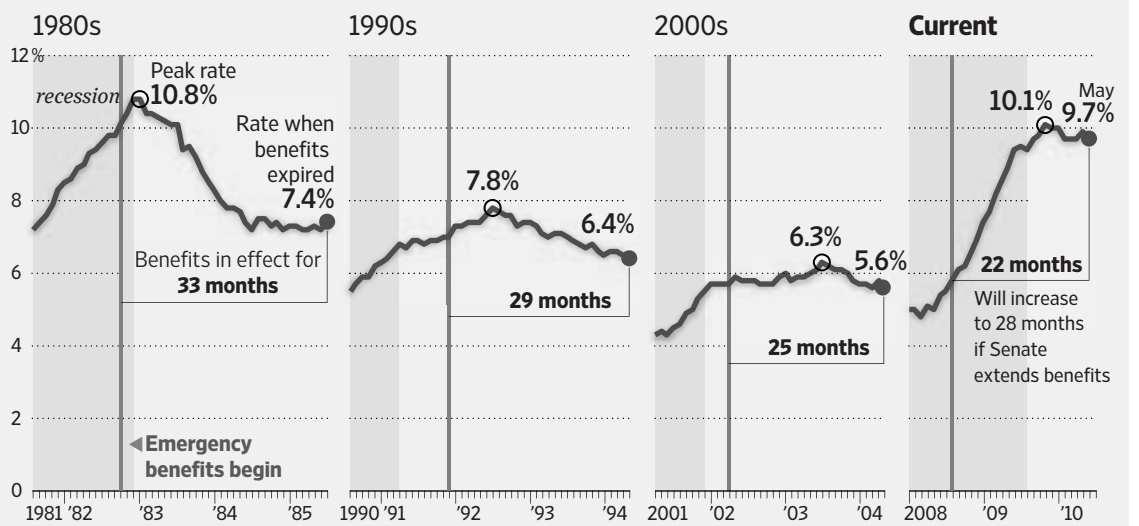
With the unemployment rate at 9.5% and about 14.6 million people out of work, the White House signaled Monday that Congress would be asked to approve an additional extension of benefits in November. The midterm elections are Nov. 2.



The unemployed attended a career fair in Los Angeles Monday. Lawmakers are close to approving a benefits extension.

Long-term payments

How long the U.S. federal government paid emergency unemployment insurance to address previous spikes in joblessness



Sources: U.S. Labor Department; Goldman Sachs US Global ECS Research

The view from Ben Bernanke's perch at the Fed

[Capital]

BY DAVID WESSEL



Until recently, attacking Federal Reserve Chairman Ben Bernanke for being too passive sounded out of touch with reality. Indeed, he has been assailed for doing too much to bail out Wall Street and for risking the Fed's independence and inflation-fighting credibility by buying \$1.5 trillion of mortgages and U.S. government bonds.

Yet the question lurking when Mr. Bernanke testifies in Congress this week is why the central bank isn't doing more now to rescue an economy that is losing momentum. After all, the Fed's forecast is for inflation below its informal target and persistently high unemployment for the next couple of years.

Here, more bluntly than Mr. Bernanke will put it if Congress ever gets around to asking, is what's going on.

The distressing economic outlook has deteriorated since the Fed's June 22-23 meeting. Mr.

Bernanke would cut short-term interest rates if he could. But he can't; rates are already near zero. So the question is whether to pursue more-unconventional monetary policy.

The Fed, perhaps prematurely, ended its purchases of mortgages earlier this year. As the minutes of the June meeting note, Fed officials are at least talking about what would justify reopening the spigot.

There are a lot of little things the Fed could do to signal concern about the economy—and Mr. Bernanke may enumerate them if pressed. But the most likely to matter would be to buy more mortgages and Treasuries to push down long-term rates.

For now, Mr. Bernanke doesn't believe potential benefits of such a move outweigh potential costs. But he and his allies on the Fed's divided policy committee aren't saying never. Whether or not he explicitly says so, the Fed will consider buying more securities if the economy gets worse or credit markets show signs of severe distress, despite the eagerness of some Fed officials to move toward "the exit strategy."

Why wait? Put yourself in Mr. Bernanke's chair. When the Fed

began buying mortgages, the gap between yields on mortgages and Treasuries was wide; now it isn't. Mortgage rates are very low and the housing sector is still moribund; it isn't clear pushing mortgage rates down another one-quarter percentage point would do much.

The Fed could buy more Treasuries, trying to push yields on 10-year Treasuries below the already low 3%. But that could backfire. With all the deficit angst around, a Fed move to buy Treasuries could provoke cries of "they're monetizing the debt" and push up long-term rates rather than lowering them.

As scary as this sounds, the Fed can't be sure of the net effect of buying more assets. It might not make things better. It would be, in short, a Hail Mary pass. And Mr. Bernanke isn't ready—yet—to throw it.

Mr. Bernanke's former Princeton University colleague, Nobel laureate Paul Krugman, has become the loudest critic of Mr. Bernanke's inaction, calling the Fed "feckless" (lacking in vitality, unthinking, irresponsible) in his New York Times column. In a prescient 1998 paper about Japan, Mr. Krugman warned that other

countries might similarly confront the feared "liquidity trap," the circumstance at which the central bank has cut interest rates to zero and the economy remains very weak. His advice then: "Monetary policy will be effective...if the central bank can credibly promise to be irresponsible"—by promising to create inflation in the future.

The textbook point: Interest rates that matter are the inflation-adjusted ones. In recessions, the Fed effectively pushes inflation-adjusted rates below zero. But with nominal interest rates at zero, the only way to get inflation-adjusted rates lower is to get everyone believing that inflation will go up.

The practical point: This is easier to advise than to do safely. It would, at the very least, be hard to explain to a public already suspicious of the Fed. And it, too, could backfire. Manipulating inflation expectations is hard to calibrate. And the move would mean higher nominal (though lower inflation-adjusted) long-term interest rates. And outside of economic textbooks, higher nominal rates can hurt, pinching cash-strapped households for instance. It's risky.

Mr. Bernanke, in a widely re-

read 2002 speech, argued that the Fed can create inflation and can thwart deflation. Mr. Krugman thinks deflation is around the corner; Mr. Bernanke isn't convinced.

If the Fed is truly out of good choices, then talk turns to fiscal policy. Both Mr. Bernanke and his deputy-designate, Janet Yellen of the Federal Reserve Bank of San Francisco, have been cautiously giving Congress advice on that. "If simultaneously Congress were to put in place meaningful measures that would phase in over time to address medium- and longer-term deficit issues...that would create greater scope in the shorter term for Congress to also contemplate...actions to address short-term weakness in the economy," Ms. Yellen said at a hearing last week, echoing similar advice from Mr. Bernanke.

In plain English, the Fed would welcome more fiscal stimulus if accompanied by a credible, specific commitment to reduce the deficit later. But the chances of Congress and the president executing that two-step maneuver are close to nil.

Which means, if things get worse, Mr. Bernanke may yet resort to the Hail Mary.

U.S. NEWS

Crist uses old allies as a new foil

Senate push gains as Florida governor sets himself off against the state's Republicans

BY PETER WALLSTEN

KEY BISCAYNE, Fla.—Florida's Republican-led legislature gathered Tuesday on the order of Gov. Charlie Crist—and then, as expected, quickly refused his call for a state-constitution ban on offshore oil drilling in Florida waters.

Despite no legislative action at the special session, the showdown has become a signal event in Mr. Crist's campaign for the U.S. Senate and in his transformation from a rising Republican star to a political centrist who at times embraces liberal views.

Nearly three months after losing his Republican allies and campaign staff by leaving his party, Mr. Crist has rebuilt his political machinery and gained a footing among many general-election voters as he runs as an independent. One reason: He has used the Republican-led state legislature as a conservative foil to increase his appeal among centrist and Democratic voters.

Mr. Crist has shored up some conservative positions, such as his support for gun rights, while shifting to the left on core issues like abortion, education and gay rights. And he has successfully courted top Democrats—including some with close ties to President Barack Obama and the White House—to work on his campaign, even though two Democrats are making serious bids for the Senate seat.

"So many of the elected politicians in Washington seem to be shackled by the fear of a primary," Mr. Crist said in an interview last week in this seaside city, where he attended a briefing on the effects of the Gulf oil spill. As an independent, Mr. Crist said, he is free to speak his mind without worrying about the most ideological voters.

"It's liberating," Mr. Crist said. "It's a lot of fun, and I'm convinced it's what the people want."

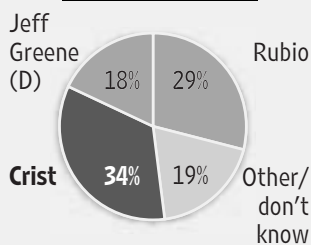
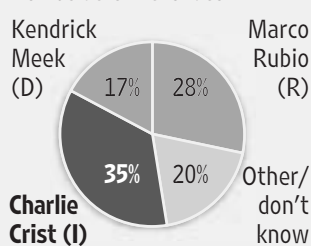
Mr. Crist believes he has stumbled on a political sweet spot, amid polls showing voters are angry at incumbents and disenchanted with both political parties.

Many here had considered his political career to be all but over, as conservatives and the tea party movement rejected Mr. Crist's Senate candidacy for that of the more conservative Marco Rubio, a former state House speaker. Mr. Crist left the GOP in late April. Now, by most measures, he is the front-runner, leading among Democratic voters and taking a third of Republicans.

Mr. Crist this year vetoed an education bill and an abortion bill sent to him by the legislature, which won

Independent run

A recent poll shows Gov. Charlie Crist ahead in Florida's U.S. Senate race, no matter which Democrat is in the race.



Source: Reuters/Ipsos telephone poll of 600 registered voters conducted July 9-11; margin of error: +/-4 percentage points



Gov. Crist has shored up conservative positions, such as his support for gun rights, while shifting to the left on abortion.

him praise from many teachers and liberal women's groups. Now, in calling a special legislative session to discuss a state-constitution ban on oil drilling in state waters, he is gambling that voters will see him as protecting Florida's tourism industry in the aftermath of the Gulf oil spill. (Florida law already bans such drilling, but opponents have sought to repeal the ban.)

Mr. Crist's opponents note that he was open to considering offshore drilling as recently as 2009. Some worry that putting a drilling amendment on the November ballot, as Mr. Crist called for in convening this week's session, would drive Crist voters to the polls. "To find the governor now changing his mind again—against it to for it, to against it again—is just comical," said state Sen. Mike Haridopolos, the incoming state Senate president. "The running joke is that his policy manual is filled with bumper stickers, and for serious people it's just untenable."

Mr. Crist has made other policy shifts. Despite pledging as a Republican to help repeal President Obama's health-care overhaul, Mr. Crist now says he does not support such a move. He has long called himself "pro-life," doing so even in the interview last week. He is now quick to add that while he personally opposes abortion, he would not seek to overturn *Roe v. Wade* and supports abortion rights.

He came out last year in opposi-

tion to the Supreme Court nomination of Justice Sonia Sotomayor, but now says that he "probably" took that position because he felt pressure from the GOP primary. Asked if he felt differently now, he said: "Perhaps."

"I want to do what is in my heart," Mr. Crist said last week. "But other influences have some effect, to a degree."

The White House and top Democrats in Florida and Washington are publicly backing U.S. Rep. Kendrick Meek in the Senate race. Yet the governor in recent weeks has populated his campaign with Democrats, bringing on a Democratic pollster and political consultant.

In addition, Alfredo Balsera, a member of Mr. Obama's national finance committee in 2008 and a top adviser to the president on Latino outreach, is now advising Mr. Crist. Mr. Balsera, of Miami, is planning a fund-raiser next month that he said would consist largely of Obama supporters. He said he informed the White House ahead of time.

Mr. Crist has retained a political consulting firm that counts Anita Dunn as a partner. Ms. Dunn was the White House communications director until November. She said she was not working on the Crist campaign herself but had stopped advising the Democratic Party, to avoid a conflict of interest.

A White House official said that the president "expected" the state's

party leaders to back Mr. Meek and that Vice President Joe Biden planned to campaign for him soon.

Mr. Crist said he had spoken twice in recent weeks with Senate Majority Leader Harry Reid. The governor said he had not offered any assurances that he would caucus with the Democrats as an independent, but the discussions with Mr. Reid signal that he may be moving in that direction.

Aides to Mr. Meek say voters will abandon Mr. Crist once Democrats begin their advertising campaign this fall. Meek spokesman Adam Sharon called Mr. Crist "a lifelong conservative." Republicans are likely to highlight statements from Mr. Crist's prior campaigns, such as his statement in a 2006 automated call that he was "pro-life."

"If he really didn't believe in these things, then why did he spend 20 years campaigning on them?" Mr. Rubio said in an interview. "With all due respect, and I mean this with no animosity, I think he'll do and say anything to win this election, and I think we already have too many people like that in Washington."

Mr. Crist said he was always more of a centrist Republican, angering his party, for example, when he pushed to make it easier to restore a felon's right to vote. "I've always had that predilection" to buck the GOP, he said. Then, snapping his fingers, he added: "It's just quicker now."

IMF suggests a new strategy for contending with bubbles

BY BOB DAVIS
AND TOM BARKLEY

The International Monetary Fund's executive board said central banks may want to use interest rates in a "limited" way the next time they encounter an asset bubble that needs to be pricked, weighing in as the Federal Reserve and other major central banks reevaluate their bubble-fighting strategies.

Before the global financial crisis, the Fed's main strategy for addressing bubbles was to mop up after they burst, lowering interest rates to cushion the blow to the economy and restart growth. That was a central conclusion of the academic work of Ben Bernanke before he became Fed chairman and was an approach embraced by his predecessor Alan Greenspan.

But the depth of the global downturn, prompted by the bursting of a real-estate bubble in the U.S., has led to a rethinking. The IMF, in a paper released Tuesday, urged central banks to use tougher regulation to head off asset bubbles, including tighter capital requirements for banks, limits to banks' use of short-term loans and tougher collateral requirements for loans they make.

The IMF also said financial regulators would have to use their judgment about whether to take more specific actions, and have the independence to enforce their efforts.

But in cases where that isn't sufficient, central banks may have to use interest-rate policy to "lean against asset bubbles," the IMF staff said. For instance, "the combination of rising asset prices and rapid credit growth may warrant a higher policy rate," the IMF paper said.

The staff warned, however, that making such determinations isn't easy. It can be hard to tell whether a big expansion of credit is a sign of economic health or overheating. Moreover, monetary policy may have contradictory outcomes. Tightening interest rates to tamp down a bubble could also choke off economic activity overall and weaken the financial position of banks, thus worsening financial stability the central bank sought to address.

Mr. Bernanke has argued that regulation and supervisory action are the best ways to head off asset bubbles, but he hasn't taken monetary policy off the table as a tool should such efforts fail. Some Fed researchers say that loose monetary policy can play a role in promoting asset bubbles by encouraging banks to take on too much leverage and that small changes in interest rates could help tame bubbles.

The Bank for International Settlements is also looking at how monetary policy could be used to deflate asset bubbles. One way may be to include risks to financial stability as part of the economic modeling used by central banks to choose optimal interest-rate policy, said the BIS 2010 annual report.

At the IMF, the 24 board members represent the institution's 187 members. According to a summary of the board's discussions, the group said that fighting inflation must remain the core mandate of monetary policy. But they said there may be "limited scope to use interest rates to 'lean against the wind,'" and discourage the build-up of asset prices.

Senate panel backs high-court nominee

BY NAFTALI BENDAVID

WASHINGTON—The Senate Judiciary Committee on Tuesday approved Elena Kagan for a position on the Supreme Court, sending her nomination to the full Senate for a likely vote in the first week of August.

Ms. Kagan, whose Senate confirmation appears probable, would join the court when its 2010-11 session begins in October and would become the fourth woman on the court. The committee vote was 13-6, with Sen. Lindsey Graham (R., S.C.)

joining all the panel's Democrats in supporting Ms. Kagan's nomination.

"What's in Elena Kagan's heart is that of a good person who has a philosophy I disagree with," Mr. Graham said.

Since President Barack Obama nominated Ms. Kagan in May, Republicans have objected to her lack of experience as a federal judge and courtroom lawyer, saying she is more of a political figure than a legal one. They also criticized her role in restricting military recruitment when she was dean of Harvard Law School, in response to the Pentagon

policy of forbidding gays from serving openly.

Republicans raised those complaints again Tuesday, although given the Democrats' 12-7 majority on the committee, the vote's outcome wasn't in doubt. "She supports an activist judicial philosophy, and her political views drive her legal views," said Sen. Orrin Hatch (R., Utah).

Democrats said Ms. Kagan's real-world experience would be an asset on the court, and they said her actions at Harvard were an attempt to meld her respect for the military

with the school's antidiscrimination policy.

They also cited Ms. Kagan's legal reputation and experience. She served as a clerk to the late Justice Thurgood Marshall and adviser to former President Bill Clinton before becoming the first woman dean of Harvard Law School, and solicitor general under Mr. Obama, arguing the government's position before the high court. If Ms. Kagan is confirmed, the court would have three women for the first time. She would join Justice Sonia Sotomayor and Justice Ruth Bader Ginsburg.

WORLD NEWS

Nations endorse Afghan handover

KABUL—President Hamid Karzai won international backing for his plan to have his government take the lead in securing Afghanistan by 2014 and play a greater role in deciding how billions in development dollars are spent.

By *Matthew Rosenberg,
Maria Abi-Habib
and Jay Solomon*

The endorsement of Mr. Karzai's plan by delegates from more than 60 countries at a conference in Kabul on Tuesday reflected the increasing impatience among the Afghan public and Western nations with what many fear has become an open-ended war that may not be winnable under present circumstances.

U.S. and allied troop deaths and civilian casualties have jumped this year amid a pair of problematic military offensives in southern Afghanistan, the Taliban's heartland. Corruption is widespread, and billions of dollars in cash—some is believed to be diverted aid and reconstruction money—is being flown out of Kabul's airport every year.

Western officials lauded the Afghan push to take a leading role in their own affairs. But they, along with some Afghan officials, stressed that 2014 wasn't a hard deadline and would instead depend on progress in battling the Taliban and shoring up Mr. Karzai's foundering government. It also wouldn't mark the end of the international military or development role in Afghanistan, they said.

"The transition process is too important to push off indefinitely," U.S. Secretary of State Hillary Clinton, in Kabul for the conference, said in her remarks. But "we have no intention of abandoning our long-term mission of achieving a stable, secure, peaceful Afghanistan."

Security for Tuesday's international conference, the first since the 2001 ouster of the Taliban regime, was extraordinary. Kabul's airport—Afghanistan's only international terminal—was shut to all commercial flights. Streets were largely devoid of cars; police and soldiers manned checkpoints across the city.

The one-day conference concluded with delegates agreeing to



Hillary Clinton, center, tours an Afghan products expo in Kabul with President Hamid Karzai, left, on Tuesday.

fully hand responsibility for securing all 34 of the country's provinces to the Afghan government by 2014.

Yet Afghanistan's security forces—riddled by poor discipline, corruption and ethnic factionalism—have a long way to go before they can operate without direction and support from coalition troops.

Opening the conference, Mr. Karzai committed to improving the army, police and intelligence services. Critics say their misdeeds help to fuel support for the Taliban.

"Our goal is to transform the three organs of our national security forces into trusted national institutions," Mr. Karzai said. "We shall strive to create a culture of accountability in our security institu-

tions. We must acknowledge that historically, abuse of force by persons occupying state positions has alienated the public from the government."

There are also fears of Taliban infiltration in Afghanistan's security forces. On Tuesday, Afghan and U.S. officials said an Afghan soldier opened fire at a training area in the northern city of Mazar-e-Sharif. Two American civilians and two Afghan soldiers, including the shooter, were killed. Officials said they were investigating the shooting.

Another Afghan soldier killed three British troops in southern Afghanistan earlier this month, and escaped. The Taliban later said the soldier had afterward defected to

their ranks.

The 2014 timeline, first laid out by Mr. Karzai in his inauguration speech last year, is highly symbolic, signaling to his own people that foreign troops won't indefinitely control the fight against the Taliban and potentially easing war-weariness in the U.S. and Europe.

But the deadline is essentially hollow. Dutch and Canadian troops are already getting ready to depart Afghanistan, and President Barack Obama has said American soldiers will start pulling out next summer, although many troops are expected to remain in Afghanistan for years to come.

The Afghan government and its backers also endorsed plans to dis-

burse through Afghan authorities the billions of dollars flowing into the country, instead of using a patchwork of aid organizations and branches of the coalition military forces. Afghan officials say the current setup often fuels corruption and leads to programs and projects that are at cross purposes with each other and government priorities.

Ahead of the conference, Afghan and Western officials said they hoped to increase within two years the portion of aid channeled through the Afghan government to 50% from about 20% now.

The plan won't be easy to execute. Poor security is a hindrance, as is the Afghan government's feeble presence in many parts of the country. Government corruption is another concern, and Mr. Karzai reiterated his commitment to battling graft Tuesday.

The issue of corruption later provided a tense moment between Mr. Karzai and U.N. Secretary-General Ban Ki-moon. Asked about corruption at a joint news conference, Mr. Ban began criticizing Afghan efforts to battle the problem.

He was quickly interrupted by Mr. Karzai, who said of the reporter: "She was talking about corruption in the international community. We have to be fair!" He then laughed and moved on.

Mrs. Clinton, in her speech Tuesday and in comments made en route to Kabul Monday, also stressed that Washington's failures have played a large role in Afghanistan's problems, citing bloated American aid operations and corruption among contractors. "We also have to take a hard look at ourselves, because it's very clear that our presence, all of our contracting, has fed this problem," Mrs. Clinton said Monday. "This is not just an Afghan problem. It's an international issue."

Mrs. Clinton took her trip to Kabul as an opportunity to voice strong solidarity with Afghan women, many of whom fear peace efforts with the Taliban will lead to a curtailing of their rights.

"Your interests will be recognized and protected," Mrs. Clinton told 15 women's rights activists Tuesday morning at the U.S. Embassy. "This is a special commitment of mine."

—Habib Zahori
contributed to this article.

New guidelines issued to shield babies from AIDS

By *RON WINSLOW*

VIENNA—The World Health Organization issued new guidelines aimed at strengthening efforts to prevent pregnant women from transmitting the AIDS virus to their babies and improving care for infants born with the infection.

The recommendations call for earlier HIV testing for pregnant women and earlier treatment with antiretroviral drugs for both their own health and to halt transmission to their newborns. They also urge that infants born to HIV-positive mothers be tested for the virus between four and six weeks after birth. Treatment for those testing positive should begin immediately.

Few children under the age of one year have received HIV treatment, according to WHO. Most tests look for antibodies to HIV. Since ba-

bies are often born with their mother's antibodies, it had been impossible to know for up to 18 months if the baby was infected. A new test can tell if a newborn's antibodies are his or her own.

Each year, more than 400,000 infants in low- and middle-income countries become infected with HIV either in the womb, during birth or while breast-feeding, according to WHO. The risk of transmission ranges from 15% to 45%. More than a decade of research shows that the risk can be almost entirely eliminated if women take AIDS drugs during pregnancy.

Despite recent progress, less than half of HIV-positive expectant mothers currently get the medicine. Eliminating the problem by 2015 is a major goal of WHO, the Joint United Nations Programme on HIV/AIDS (UNAIDS) and other public-

health organizations.

"These guidelines are important to scale up efforts to eliminate mother-to-child transmission," said Gottfried Hirschsall, director of HIV/AIDS at WHO. The recommendations were released Tuesday at the XVIII International AIDS Conference.

The guidelines also say that as long as either the mother or the child is on antiretroviral drugs, it is safe for women to breast-feed their babies, an issue that has been a source of controversy. Dr. Hirschsall said the very small risk of transmission is more than offset by the often life-saving nutritional benefits of breast-feeding.

The Global Fund to Fight AIDS, Tuberculosis and Malaria, a public-private partnership in Geneva, is a major supporter of programs to reach more HIV-positive pregnant women with medicines and other

care. The Fund is due for a three-year replenishment from donors this October and is seeking commitments for as much as \$20 billion, amid an economic climate in which many nations are curbing such contributions. Christoph Benn, director of external relations at the Fund, said the goal of ending mother-to-child transmission of HIV is a prominent feature of its current fund-raising efforts.

"We have the technology," he said. While 400,000-plus is "a big number, it doesn't sound impossible. We believe it's doable," he said.

Paul De Lay, deputy executive director of programs at UNAIDS, estimated that the new guidelines, by expanding the use of drugs and some services, will roughly double the annual cost of reaching women who need the medicines to between \$1.2 billion and \$1.5 billion.

"We're talking about saving [over 400,000 babies a year]," he said.

About one-third of infants born with HIV die in their first year of life if they aren't treated; half are dead by age 2. Getting them tested and beginning treatment within the first 12 weeks quadruples their chances of reaching age 2, said Jimmy Kolker chief of HIV and AIDS for UNICEF.

By age 2, if a child has been treated properly from the start—so that the amount of virus in the blood is suppressed to undetectable levels—the prognosis is excellent, said Anthony Fauci, director of the National Institute of Allergy and Infectious Diseases.

Dr. Hirschsall said the new guidelines would require additional training of medical staff in developing countries to administer them properly.

WORLD NEWS

Zijin apologizes for fouling river

By JAMES T. AREDDY

SHANGHAI—A major Chinese mining company offered a rare public apology for its role in polluting a local river, while fishing vessels helped clean up a large oil slick off the major port city of Dalian, as China continues to grapple with a spate of industrial accidents.

In a series of statements this week, China's Zijin Mining Group Co. backtracked from earlier explanations that weather caused wastewater from its copper processing plant in China's southeastern Fujian province to leak into the Ting River and kill fish. Company failures were to blame as well, Zijin Chairman Chen Jinghe said in a 10-minute appearance late Monday on Fujian province television.

Zijin's board of directors followed up with an apology that expressed regret for the accident, blamed the company's "weak" management, and pledged unspecified compensation and remediation.

"The Company was overconfident, had a lack of crisis awareness and didn't properly handle the balance between economic efficiency, ecological benefit and public interest," the board letter said.

The move came amid increasing official pressure on Zijin. Zijin said this week it would cooperate with the China Securities Regulatory Commission, which is looking into a possible breach of disclosure rules related to the incident.

Pollution that originated with Zijin's Fujian plants is now being found in rivers in neighboring Guangdong province, state media said Tuesday, threatening to kill more fish.

Meanwhile, near the northeastern Chinese city of Dalian, officials said around 500 fishing vessels were



Fishing boats were dispatched to help clean up an oil spill in northeastern China on Tuesday.

using absorbents and dispersants to help soak up oil on a 183 square kilometer stretch of ocean.

The Xinhua news agency said it could take up to five days to clean up the oil, which poured into waters after a pipeline explosion late last week.

Though the area's oil port is partially closed, Xinhua said supplies won't be disrupted.

In another ongoing challenge for China, in western Gansu province rescue efforts were trying to reach 11 coal miners trapped underground. It is the latest misfortune in an industry that has claimed 44 lives since July 17.

Zijin's apologetic statements were unusual. When disaster strikes in China, top executives—who are often Communist Party offi-

cial—rarely accept blame or make personal appearances. The nation lacks forums in which officials can publicly question executives, as U.S. lawmakers did when they requested that BP PLC Chief Executive Tony Hayward appear before them over the Gulf of Mexico oil spill.

The leak of copper-tainted wastewater primarily dates to July 3, when a Zijin containment pool failed during heavy rains. But the company now concedes contamination was exacerbated by its own lax environmental controls, and admits there is merit in complaints from fishermen that it was polluting waters far earlier than this month.

For instance, on Tuesday, Zijin said it had ignored an environmental watchdog's order last September to close a runoff channel that was

seeping chemicals into the Ting River, and which made the July problems worse.

At least three Zijin plant managers have been detained by police and the copper plant that produces about 13% of its output has been shut.

The comments from Mr. Chen, 52 years old, which were televised in Shanghang county, where the company is based, and covered nationally in print media, did little to assuage local fish farmers who continued Tuesday to complain about their losses.

The statement may have played better in Hong Kong. Zijin shares there surged 7.4% on Tuesday, ending at 4.80 Hong Kong dollars (about 62 U.S. cents), after falling nearly 24% since the end of June.

China moves to ease worries of vendors from abroad

By LORETTA CHAO

BEIJING—China offered to increase foreign companies' access to its government purchases as it seeks to overcome international complaints that it discriminates against foreign vendors, but analysts said the move still may not go far enough toward easing their concerns.

The offer was presented in the form of a new proposal for membership in the World Trade Organization's Agreement on Government Procurement, which requires nondiscriminatory access to government purchases.

The proposal, which makes revisions to China's first proposal in 2007, comes amid intense criticism of China's government by foreign companies and governments for new rules governing access to its massive government-procurement market. Chinese officials estimate that such procurement contracts exceeded \$100 billion in 2009.

China had promised upon its accession into the World Trade Organization in 2001 that it would initiate a bid to join the GPA, but the U.S. and other WTO members rejected its first proposal, submitted at the end of 2007. Those parties have been pushing regulators to submit a revised one since, and China agreed in May at the U.S.-China Strategic and Economic Dialogue to do so by this month.

The GPA is an agreement among more than a dozen parties, including the U.S. and the European Union, and has more than 20 observers.

The contents of the new proposal haven't been made public, and Yao Jian, a China Commerce Ministry spokesman, didn't provide details. People who have seen copies of it or have been briefed on its contents said it reduces a requested transition period for implementing the accord to five years from 15 years, for example, and adds 15 more central-government agencies whose purchases are covered by the pact, said a person who saw the proposal.

But foreign business representatives said the proposal still appears to fall far short of their requirements on several accounts.

State-owned enterprises and agencies under provincial or local governments aren't covered by the new proposal.

And China's proposed value thresholds for contracts that would fall under the GPA are still higher than the thresholds of other members, they say.

—Liu Li and Gao Sen contributed to this article.

Beijing disputes IEA's energy assessment

By SHAI OSTER AND SPENCER SWARTZ

BEIJING—China's government disputed the International Energy Agency's assertion that China surpassed the U.S. as the world's largest energy consumer last year, highlighting the lack of clarity in China's energy sector as well as the country's unease at its growing global impact.

"By our calculation, the U.S. was still the world's largest energy user in 2009," said Zeng Yachuan, a spokesman with China's National Energy Administration. Zhou Xi'an, a director with the agency, said that "the IEA data can be used as a reference but are not very reliable."

The IEA said that last year China used 2.252 billion tons of oil equivalent, a measure of energy including oil, gas, coal, uranium and all other sources. That figure is about 4% more than the U.S., which the IEA said burned 2.17 billion tons of oil equivalent. On a per capita basis, Chinese energy demand is still around a third of the average of industrialized nations, according to IEA data.

The IEA quickly defended its analysis Tuesday. "All the relevant sources of statistics indicate that China has surpassed the United States to become the world's largest energy consumer," IEA chief economist Fatih Birol said.

The exchange continues a long-



China says it isn't the world's largest consumer of energy. Above, workers install insulators on electric pylons in Hangzhou, Zhejiang province.

standing disagreement between China and the IEA. The Paris-based group's forecasts, which are widely followed, rely on extensive data on oil demand, storage and exports provided by member countries including the U.S.

But the IEA has complained repeatedly that China, which isn't a member country, provides inadequate or unclear data, and it says this lack of transparency contributes to volatility in global oil markets as traders try to second-guess Chinese buying. China is working with the IEA to improve data collection. But in its closely watched monthly report, the IEA this month repeated

"its concerns with Chinese data," pointing out a mismatch between China's energy demand and gross domestic product.

Chinese officials say the IEA doesn't understand China's energy sector and underestimates the effectiveness of aggressive energy-efficiency drives and increasing use of renewable sources like wind, solar, hydro or nuclear power.

The IEA's Mr. Birol said that Chinese energy demand would be even higher if the government hadn't made progress in building solar and wind power industries—helping to ease the energy intensity of China's economy. Ultimately, the discrepancy isn't

of great consequence. China calculates that it used 3.066 billion tons of coal equivalent last year, equal to 2.146 billion tons of oil equivalent. That is about 5% below the IEA's calculation of China demand, but just 1% below U.S. consumption. Given China's rapid economic growth, which exceeded 10% in the first half of this year, it is likely that China will erase the gap with the U.S. this year even by its own measurements. And Mr. Zeng conceded that China was the world's largest "primary energy producer," suggesting some of that is exported.

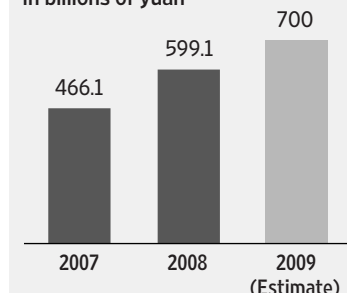
China's reluctance to accept the mantle of world's top energy consumer also reflects unease with its growing global influence—and the responsibilities that could come with it, such as greater calls for it to limit its energy use. In addition, increasing energy imports have spurred an overseas buying spree by Chinese natural-resources firms, forcing Chinese leaders to consider how to guarantee energy security when supply lines are stretched far.

China's rise has yet to translate into more pricing power in global energy markets. And China's rise as the world's biggest energy consumer leaves it actually more vulnerable than ever to factors it can't control: instability in the Middle East, piracy off the eastern shores of Africa and conflict in central Asia.

—Jing Yang contributed to this article.

Supply lines

Spending on government procurement in China, in billions of yuan



Source: China's Ministry of Finance