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BP plans overhaul after disaster

BP PLC on Tuesday launched a radical shake-up, including plans to sell about \$30 billion in assets, appoint a new chief executive and alter the way it does business.

The changes, which came as the company reported a massive quarterly loss in the wake of the Deepwater Horizon oil-rig disaster, will leave the company smaller and focused on restoring its battered reputation—though it will continue to pursue opportunities in deep water and plans to remain as a strong presence in the U.S., senior BP executives said.

The moves are an attempt to draw a line under an environmental catastrophe that hammered BP's shares and global reputation.

Chief Executive Tony Hayward, who will be succeeded by Robert Dudley on Oct. 1, said the planned asset sales would turn BP from a four-million-barrel-a-day oil giant to "perhaps a 3.5 million-barrel-a-day company that has higher-quality assets [and] a more focused portfolio." It would still produce more oil and gas than rival Royal Dutch Shell PLC.

Some analysts said the

disposals were a chance for BP to reinvent itself. "In the space of 18 months they could end up becoming a more finely tuned, leaner, meaner machine," said Jason Kenney, an oil analyst at ING Bank. He said it provided the company with a chance to get ahead of its peer group by focusing more tightly on the top-performing assets in its portfolio.

BP posted a loss of \$17.15 billion for the second quarter, reflecting a pretax charge of \$32.2 billion to cover future and current costs from containment, cleanup, compensation and fines relating to the

Gulf of Mexico oil spill. BP expects to receive a tax credit of \$9.88 billion on the charge, bringing the post-tax spill cost to \$21.95 billion.

BP said Mr. Hayward was to step down by mutual agreement with the company's board. Mr. Hayward said that in leading BP's emergency response to the Deepwater Horizon disaster, he had become the public face of BP and as a consequence had been "demonized and vilified" in the U.S. "The fact is that BP cannot move on as a company in the United States with me as its leader," Mr.

Hayward said.

In a statement, BP Chairman Carl-Henric Svanberg said the spill had been a watershed incident, and that BP would be a "different company going forward, requiring fresh leadership supported by robust governance and a very engaged board."

Mr. Svanberg said Tuesday he had never considered resigning. "The board have repeatedly and explicitly told me to stay on," he told a reporter who asked whether he should have stepped down instead of Mr. Hayward.

Critics say Mr. Svanberg, a

former Swedish telecom executive, kept a notably low profile in the early weeks of the disaster, and that he didn't express enough whole-hearted support for Mr. Hayward at critical junctures. That has led some to conclude his long-term tenure as chairman is not assured. Some observers say there is at least one potential successor on the BP board: Paul Anderson, the former CEO of BHP Billiton PLC.

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- Chairman survives but future is uncertain 5

Cameron uses visit to Turkey to renew push for its full EU membership



British Prime Minister David Cameron, left, and Turkey's Prime Minister Recep Tayyip Erdogan sign documents in Ankara on Tuesday. Cameron, stopping in Turkey on his way to India, slammed the slow pace of Turkey's European Union accession talks and warned against shutting out the country because of anti-Muslim prejudice.

Germany gives Basel objections

The revised Basel banking regulations are earning low marks from German officials, who say the new rules will hurt German banks, which finance many of the small and midsize companies in Europe's biggest economy.

But investors shrugged off Germany's concerns about Basel III and sent bank stocks rising since the new rules aren't as tough as initial proposals. Germany resisted the proposal partly because of concerns about Basel's impact on banking giant Deutsche Bank AG, people familiar with the Basel negotiations said. Deutsche Bank said it welcomed the new Basel rules.

- French pleas for leniency went unmet 21

The Quirk



A question of altitude... Lufthansa finds what flies on airline menus. Page 33

Editorial Opinion

Serbia's foreign minister on the Kosovo precedent. Page 14

LVMH profit rise signals luxury's return

By MIMOSA SPENCER

PARIS—Luxury-goods supplier LVMH Moët Hennessy Louis Vuitton Tuesday reported a 53% jump in first-half profit, heralding a strong return of high-end consumption and, in a break from previous cautiousness, expressed some confidence about the rest of the year.

The world's largest luxury-goods company, which owns Krug champagne and Berluti shoes, posted net profit of €1.05 billion (US\$1.36 billion), up from €687 million a year earlier, on strong revenue growth across the board.

In a sign the French company plans to solidify its position in the industry, LVMH executives pledged to employ marketing efforts and invest in fast-growing markets like China to capture a bigger share of sales.

"In the current recovery from the economic crisis, LVMH will continue to gain market share," the company said in its statement.

Revenue for the six months to June 30 was €9.1 billion, up 17% from €7.8 billion a year earlier and ahead of analyst expectations of €8.85 billion. All divisions, from perfume to wine, posted double-digit

sales growth with the highest increase coming from watches and jewelry, up 28% to €443 million. LVMH said there was a strong recovery in orders. The business was one of the hardest hit in the sector as retailers dramatically cut back on orders during the crisis.

The fashion and leather-goods division, which houses the company's star brand and one of the industry's strongest performers throughout the crisis, Louis Vuitton, posted 18% growth to €3.52 billion. Luxury consumers took refuge in more classic leather accessories, preferring staid brands to the trendy

handbags of the boom years. Still, the company declined to give full-year guidance.

"Thanks to the crisis we don't give provisions anymore," LVMH Chairman and Chief Executive Bernard Arnault said Tuesday. Mr. Arnault and other luxury executives have been wary in calling a recovery.

Mr. Arnault declined to give details of the company's future acquisition plans, except to say he isn't interested in buying the French cosmetics giant L'Oreal SA. A political scandal in France, originally stemming from a legal dispute between L'Oreal heir-

ess Liliane Bettencourt and her daughter Françoise Bettencourt-Meyers, has raised questions about the company's shareholder structure.

Profit from recurring operations was €1.82 billion, up 34%, beating analyst expectations for €1.68 billion.

LVMH shares have climbed nearly 20% over the past six months, outpacing a 2% decline in the Paris CAC-40 index over the same period. Expectations for a firm pickup in the luxury goods industry were fueled by a strong showing from smaller peers Burberry and Hermès International earlier this month.

Bahrain BD 150 - Egypt \$175 (CV)
Jordan JD 2 - Kuwait KD 1 - Oman OR 2
Qatar QR14 - Saudi Arabia SR 14

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PAGE TWO

Cameron's trade mission to India

[Agenda]

BY PATIENCE WHEATCROFT



"Turkey is Europe's BRIC," declared British Prime Minister David Cameron Tuesday. In

Ankara, on a mission to win friends and trade, he produced the statistics to show why he puts Turkey up with the growth economies of Brazil, Russia, India and China.

"Which country grew at 11% at the start of this year?" he asked rhetorically, slickly ignoring the fact that the first quarter's storming performance was aided by a comparison that saw a 14.7% fall in the same period last year. But putting aside such quibbles, Turkey is an exciting economy, with more young people than any of the 27 countries in the European Union. Mr. Cameron is as enthusiastic about bringing Turkey into that Union as many of his fellow EU citizens are about keeping it out.

Rebounding from recession, the country is on course for GDP growth of more than 6% for the year as a whole. That, though, does not put it in the league of the BRIC's two leaders, China and India, the latter being the next stop on Mr. Cameron's sales trip. Heading for growth of 8.5% this year and with a target of 10% by 2014, the business leaders in the high-powered delegation travelling with him would dearly love to benefit from that growth.

The task for Mr. Cameron, having so recently returned from what was deemed a successful effort to polish up the special relationship between the U.K. and the U.S., is to see if such a bond can be revived in India. It will not be easy. The U.K. has been losing ground in India to the U.S. and although the country is keen to encourage foreign direct investment in some areas, particularly infrastructure, it is not about to dismantle the



India is heading for growth of 8.5% this year with a target of 10% by 2014.

barriers that exist for much of the service sector. There will be no end of pleasantries to mark the visit but a true mark of success would be a change in the laws which prevent overseas law firms, for instance, being able to open offices in the country.

As Indian businesses go global, they would benefit from having easy access to the international legal firms but the local

The visit is as much geared to encouraging investment in the U.K. as it is about opening doors in India.

practitioners have proved highly successful in fending off what they see as potential competition. In other sectors, such as retail and finance, there are strict restrictions on overseas operators. Major banking groups intent on reaching India's growing wealth, are limited in the number and location of branches they are allowed to open.

Mr. Cameron's delegation may press hard for change but the Indian government may not be persuaded. It knows it needs a huge amount of investment if it is to generate the 10% a year growth that it deems essential for dealing with the poverty which still shrouds much of the country. The

financial secretary, Ashok Chawla, told a conference of the Confederation of Indian Industry this week that the public had to be persuaded to put their spare cash into financial assets rather than physical assets. It may take time to persuade the new middle class that their money has to be invested rather than flaunted.

However, according to Hari Bhartia, the CII President, Indian businesses "are maintaining their investment momentum." And Mr. Cameron's visit is as much geared to encouraging them to make that investment in the U.K. as it is about opening more doors for British businesses in India.

Over the worst?

BP is not about to go bust. The numbers the company produced Tuesday made it very clear that, while it had suffered a massive blow in the Gulf of Mexico, it is not a financial knock-out. Despite the fact that potential litigants are lining up to try and take the company to the cleaners, it is confident that the \$32.2 billion charge that it is taking against the cost of the disaster and its clean-up will be enough.

Although the results of various investigations into the leak have yet to be completed, Chairman Carl-Henric Svanberg is now confident that the company was not "grossly negligent." There is a strong implication here that others may have to step forward

and take their share of the bill.

It came as no surprise that the chief executive, Tony Hayward, is making his contribution, although the pain of leaving a company he persuasively claimed to love is well cushioned. His payout has already brought criticism from those who have seen their livelihoods wrecked by the leak.

Mr. Svanberg defended the decision to offer Mr. Hayward a non-executive directorship of TNK-BP, the Russian joint venture, saying that he was extremely well connected with the Russian leadership and would play a useful role. He insisted that he didn't know what financial reward that role would carry, however.

What is clear is that Mr. Svanberg himself has been granted a reprieve from calls that he should exit alongside his chief executive. That may only be temporary, but there appears to be a lack of appetite for another change at the top of the company right away. But with a potential successor in the shape of Paul Anderson, the former BHP Billiton chief executive, already installed as a non-executive director, Mr. Svanberg will have to demonstrate in the next few months that he really is up to the job. However much he may enjoy sailing, he will be well advised, as would have been Mr. Hayward, to stay away from his yacht for a while.

Too expensive to lose

Giving evidence to a Parliamentary committee Tuesday, a minister spelled out the difficulty facing a government intent on slimming the public sector. Francis Maude, a Cabinet Office minister, said that there were pools of civil servants who were effectively without jobs but whom it would be too expensive to make redundant. As the private sector knows, slimming down a workforce can be a costly business. So generous are the civil service contracts that it could be ruinous. Hence the need to force through changes in the terms.

What's News

■ **UBS showed signs** that a turnaround plan is working as it reported that its investment bank held up well during a choppy second quarter and the outflow of money from its huge private bank slowed further. 19

■ **Market indicators** have turned positive across Europe. The borrowing costs of deeply indebted euro members like Spain and Greece have fallen relative to Germany recently. 19

■ **Luxury-car makers** raised their outlooks for 2010 as demand recovered faster than expected, fueled by more affluent Chinese customers and a rebound in the U.S. 19

■ **Deutsche Bank reported** a 6.2% increase in second-quarter profit despite concerns of a slowdown because of the sovereign-debt crisis. 21

■ **U.K. Prime Minister** Cameron said he would push hard for Turkey to become a member of the EU. 6

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'We should have more stress tests. It seems as though the sector under scrutiny just can't lose.'

David Cottle on rising shares in banks after the release of stress-test results



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Question of the day

Vote and discuss: What effect will the leak of classified documents have on public support for the war in Afghanistan?

Vote online and share your thoughts with other readers at wsj.com/polls

Previous results

Q: Will Robert Dudley be a good leader for BP?

Yes

71%

No

29%

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NEWS



Associated Press

Spanish bullfighter José Tomás after being gored by a bull in Mexico this year. Catalonia, where bullfighting has been in decline for years, will decide Wednesday whether to ban it.

Catalonia to weigh bullfighting ban

By JASON SINCLAIR

MADRID—Parliamentarians in the Northeastern Spanish region of Catalonia will vote Wednesday on whether to ban bullfighting—the latest sign, advocates of an embargo argue, that support for one of Spain’s oldest symbols of identity is dwindling.

“The majority of Catalans oppose the cruelty of bullfighting and it makes sense for the politicians to reflect this in their vote,” said Alejandra García, a spokeswoman for animal-rights group Prou!

Formed in 2008, Prou!, which means “Enough!” in English, has played a leading role in the movement to ban bullfighting in Catalonia. It describes bullfighting, in which a bull is provoked with barbed sticks and then ritually killed with a sword, as barbaric and says the practice amounts to animal

torture.

In Spain, in the spectacle’s heyday in the 20th century, popular matadors would sell out huge bullrings, such as Madrid’s Ventas, which can hold 22,000 spectators. But football has overtaken the Corrida, as the bullfight is known. Top-flight football team Real Madrid’s 90,000-seater stadium, for example, is regularly filled to capacity.

In Catalonia, bullfighting has been in decline for years. The region’s only active bullring, La Monumental in Barcelona, hosts fewer than 15 fights a year, about half as many as a decade ago. Most of the recent fights had attendance levels below 50% and foreign tourists often make up a big part of the crowd. In the Madrid region, by contrast, there are nearly a hundred bullfights a year. The southern region of Andalusia, where most of the bulls are raised, is also home to armies of

avid bullfighting fans.

Bullfighting aficionados say Spain’s financial crisis has hit the industry in smaller cities and towns across the country. Most Spanish cities hold summer festivals, and the local city government typically pays for bullfights during the festival week. But with declining tax revenue and tight fiscal austerity measures in place, most town halls have cut their festival budgets and, along with them, many bullfights.

For some, though, bullfighting is a political issue. The Catalan parliament vote follows a decision last month by a Spanish court to water down parts of Catalonia’s autonomy charter, a decision that has rekindled nationalist sentiment and prompted protests in the region.

For Spain’s conservative Popular Party, Catalan nationalism is the real reason a ban may be in the cards. “It is all about nationalism,”

Popular Party member Rafael Luna said. “Bullfighting is part of Catalonia’s historical and cultural heritage but Catalan nationalists oppose it because it also is a symbol of Spain.” Mr. Luna is one the Popular Party’s 14 members in the 135-seat Catalan parliament. All 14 have said they will vote against the ban.

The nationalists, however, argue their stance is humane rather than political. “Bullfighting for centuries has been a part of Catalan and Spanish culture,” said Josep Rull, a spokesman for the nationalist Convergència i Unió party. “What is being decided is if we stop accepting gratuitous mistreatment of animals or we favor of preserving bullfighting as a form of artistic expression.

“We don’t want to go against Spain, but all societies evolve and we need to determine if this tradition is consistent with the values of the 21st century,” Mr. Rull said.

Observers say the poll could go either way. The parties that make up the parliamentary majority, Spain’s Socialist party and Convergència i Unió, are likely to split the vote, as neither has asked members to vote one way or the other.

Ms. García says the Popular Party has tried to generate support for bullfighting in the rest of Spain by framing the issue as an attack on symbols of Spanish culture by Catalan nationalists. “In Catalonia most people oppose bullfighting, and it isn’t just a nationalistic issue,” she says.

Ms. García says a bullfighting ban in the Canary Islands in 1991, which didn’t attract national attention, proves support for the sport is on the wane. “Anti-bullfighting sentiment is strong in other parts of Spain, too. And it should be banned anywhere it is practiced; it’s a matter of time,” Ms. García said.

Ex-governor’s defense blasts corruption case brought by U.S.

By DANNY YADRON AND DOUGLAS BELKIN

CHICAGO—Rod Blagojevich’s lead lawyer argued Tuesday that the government not only failed to make its case, but actually proved that the former Illinois governor maintained a strict fire wall between government and politics.

“I’m not trying to belittle this, much,” said Sam Adam Jr. during his closing argument in the seven-week corruption trial. “But come on, these are the feds and this is what they come up with?”

Mr. Adam told jurors that the crux of the government’s case came down to its allegation that Mr. Blagojevich tried to sell the U.S. Senate vacated by President Barack

Obama to U.S. Rep. Jesse Jackson Jr. But the conversations the government secretly recorded between Mr. Blagojevich and his associates actually proved the opposite, he said.

They showed Mr. Blagojevich was trying to negotiate a political deal by using Mr. Jackson as bait to elicit responses from both Mr. Obama and Illinois Speaker of the House Michael Madigan, Mr. Adam said.

“That man wasn’t selling any Senate seat,” Mr. Adam said, pointing at Mr. Blagojevich. “He was trying to get 300,000 people health care.”

Since his arrest, the ousted governor has repeatedly claimed that Mr. Madigan was holding up Mr. Blagojevich’s health legislation. Sending Mr. Madigan’s daughter, Il-

linois Attorney General Lisa Madigan, to Washington would have been a way to break the logjam.

Mr. Adam’s presentation was interrupted 15 times by prosecutors who objected to his failure to cite facts from the case precisely. The colorful defense attorney became frustrated as he tried to maintain a flow to his argument.

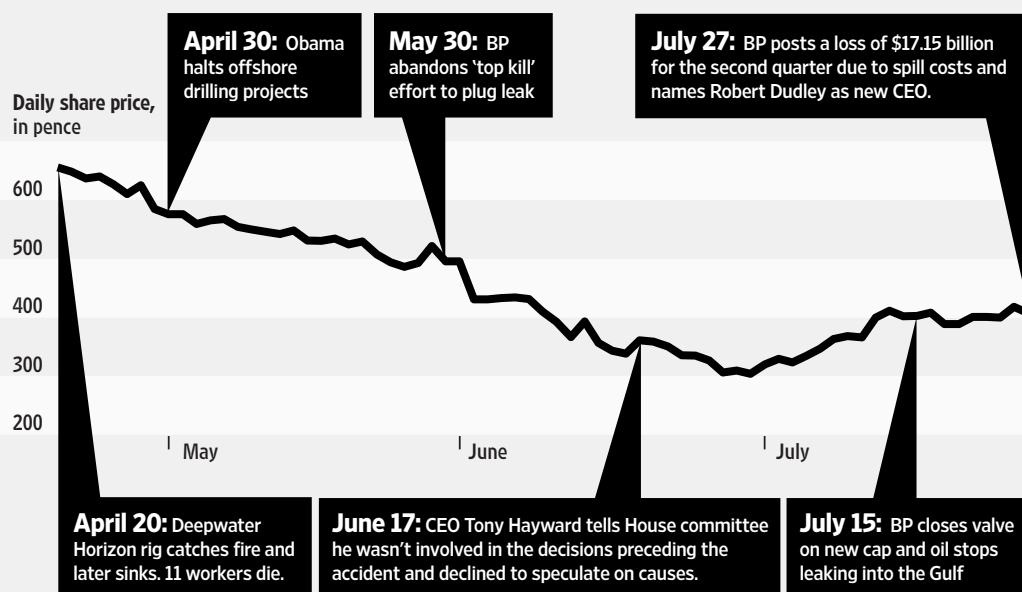
At one point, prosecutors stopped the attorney for being “totally inappropriate” after relaying a joke in an Italian accent about a woman shooting a mule. Judge James Zagel agreed. He said that if Mr. Adam hoped to convince the jury of his client’s innocence through his well-known mix of shouting, whispering and rhetorical devices, he should stick to the facts.



Rod Blagojevich greets supporters Tuesday as he arrives for court in Chicago.

NEWS

A long slide | BP's shares have tumbled since the April disaster



Source: Thomson Reuters Datastream (share price) Photos: Reuters (left), Rush Jago for The Wall Street Journal (right)



Fire boat response crews battle the blazing remnants on April 22.



A worker vacuums oil from the marsh grass in Barataria Bay, La.

BP sets new path as it logs huge loss

By GUY CHAZAN

Seeking to disentangle itself from the Deepwater Horizon disaster, **BP PLC** announced a \$32 billion pretax charge to pay for the massive Gulf oil spill, detailed plans to sell \$30 billion in assets, ditched its gaffe-prone chief executive and promised to become a different company more focused on safety.

Yet some investors complained that BP had missed an opportunity to clean house and make a definitive break with its troubled past.

For BP, the moves are an attempt to draw a line under a catastrophe that has wiped out nearly 40% of its market value and put a question mark over its future in the U.S. They came as the company unveiled a loss in the second quarter of nearly \$17 billion—one of the largest in U.K. corporate history.

BP trebled its previous target for asset sales from \$10 billion to \$30 billion, a step that will make it more tightly focused on high-growth areas like the deep waters of the Gulf of Mexico and offshore Angola and Libya. Analysts expect it to offload oil fields in Argentina, Columbia and Venezuela, and could reduce its positions in former heartlands like Alaska and the North Sea. It has already said it is getting out of Pakistan and Vietnam. In all, the \$30 billion in assets could represent nearly 10% of BP's value and about 8% of its production.

BP appears confident it will find plenty of willing buyers for its

wares—a recent deal to sell Apache Corp. gas assets in North America and Egypt netted the company \$7 billion.

BP formally announced Tuesday that it had chosen Robert Dudley, an American who has been at the company since 1998, to succeed Tony Hayward as chief executive. Mr. Dudley's task is to restore BP's reputation and credibility in the U.S., where Mr. Hayward became a lightning rod for criticism of BP's handling of the spill, caused when the Deepwater Horizon drilling rig exploded and sank in April.

In his first public statements since getting the job, Mr. Dudley, the first non-Briton to run BP, told reporters that there was no question the U.K. oil major would change and become a different company in the aftermath of the Gulf disaster.

But the main message he projected was of continuity. He praised Mr. Hayward for effecting a cultural change at BP, with a new focus on safe and reliable operations, and said only that there was now a need to accelerate that change.

Mr. Dudley added that the whole global oil and gas industry needed to review its safety systems and the equipment it used in frontier regions such as deep water, and rethink its relationship with contractors. Efforts to establish what happened aboard the Deepwater Horizon have been complicated by finger-pointing between BP and other companies present on the rig, such as **Transocean Ltd.**, which owned and operated it, and **Halliburton Co.**, which did the cementing job on the well.

But the changes announced Tuesday didn't go far enough for some investors, who had hoped the board would appoint an outsider with a mandate to carry out a root-and-branch overhaul of BP. Many have long had concerns about the safety culture at the company, which suffered a fatal blast at its Texas City, Texas, refinery in 2005 and a big oil spill in Alaska the following year.

Mr. Dudley is "not a new broom," said Ivor Pether, a fund manager at Royal London Asset Management. Though highly regarded, "as an insider, one wonders if he has the appetite to push for radical change at BP."

Another investor was hoping BP would announce a review of safety



A section of a BP oil pipeline near Prudhoe Bay, Alaska, pictured in February 2009.

across the company, similar to the independent investigation led by former U.S. Secretary of State James Baker III into BP North America in the wake of Texas City.

"It's a big ask, but BP's in a big mess," said James Bevan, chief investment officer at CCLA Investment Management.

Shareholders said Mr. Hayward and other top managers had held meetings with them last month in which they promised the Gulf disaster would trigger a fundamental change of direction at the company.

One investor who attended such a meeting and declined to be named said Mr. Hayward had promised "a clean slate" with "nothing ruled out." The investor said Mr. Hayward had even said BP might consider selling its refining assets and focusing on exploration and production, effectively removing it from the ranks of the supermajors like Exxon Mobil Corp and Royal Dutch Shell PLC.

Yet there was no hint of such an ambitious change of course in Tuesday's announcements. A BP spokesman confirmed the meetings with investors, but declined to comment on the content of Mr. Hayward's conversations.

A person familiar with the company said BP was unlikely to see a

big change in strategy under Mr. Dudley. "It's not a question of reinventing the wheel, but making it work better," the person said.

The retreat from grand rhetoric about a change in direction has coincided with an improvement in BP's circumstances since the dark days of June. Its share price has recovered and earlier this month it finally succeeded in capping its runaway well with a new containment seal. It may be close to killing it completely with a relief well, which should be finished in the coming weeks.

BP said Tuesday that it was in robust financial health, despite the Gulf disaster. Factoring out the \$32 billion charge for the oil spill, its net profit for the second quarter was \$4.385 billion. With the charge, it reported a loss of \$16.97 billion.

It also said it planned to offset all oil spill-related costs against its U.S. tax bill. That would mean the net impact to its bottom line would be \$22 billion, with the company recording a \$10 billion tax credit stemming from the cleanup costs. That effectively means the U.S. Treasury will receive \$10 billion less. A BP spokesman said it was simply applying the rules of the U.S. tax code.

Some analysts wondered whether the \$32 billion charge

might be too optimistic. In a research note, Credit Suisse said there was still a risk BP would be found grossly negligent over the spill, which could lead to much higher fines. "As the various investigations on the causes of the accident progress, we see risks that BP may take further provisions in following quarters," it said.

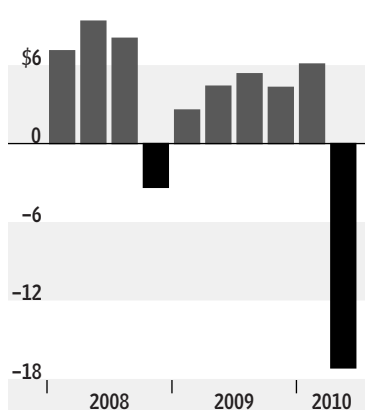
It was a sad day for Mr. Hayward, who had agreed with the board that he must move on. He acknowledged he had become the public face of the company, and "as a consequence of that I was demonized and vilified." "The fact is that BP cannot move on as a company in the United States with me as its leader," he said.

Mr. Hayward strongly defended his legacy. BP's safety record had substantially improved since he became CEO in 2007, and its financial performance was also much stronger, he said. He conceded that the Gulf cleanup "wasn't a great PR success," but the fact that the company had finally capped a well a mile below the Gulf was "an extraordinary engineering feat."

Mr. Hayward denied a claim by a reporter that the job of BP CEO was cursed. "Sometimes you step off the pavement and get hit by a bus," he said.

Deep loss

BP PLC's net profit/loss, in billions



Source: the company

NEWS

Hayward defends BP's record

BY JAMES HERRON

LONDON—BP PLC Chief Executive Tony Hayward—who was the public face of the Gulf of Mexico oil spill—defended his response to the Gulf of Mexico oil spill Tuesday but acknowledged that it was time to step down “for the good of BP.”

However, he pushed back forcefully against accusations from rival oil companies that BP's well design was unsafe and said the facts would exonerate BP when they emerged.

Mr. Hayward, 54 years old, displayed no bitterness at the premature end to his 28-year career at BP, saying that his resignation was the only way the company he led for three years had any chance of restoring its reputation and continuing to operate in the U.S.

“Today is a very sad day for me,” Mr. Hayward told reporters in a conference call. “I’ve spent my entire professional career at BP. I love the company and everything it stands for.”

However, Mr. Hayward added, “for the good of BP, and particularly the good of BP in the U.S., it’s the right thing to do for me to step down.”

Mr. Hayward’s tone was somber, but there was some relief evident in his voice. For three months he has been vilified in the U.S. His life was scrutinized. He faced a mauling before Congress; a weekend yachting trip was met with outrage; and his family received threats at their home in the U.K.

This ill feeling was due in large part to the scale of the initial tragedy and BP's repeated failure to stop the oil leak that fouled the Gulf of Mexico. However, Mr. Hayward also suffered several self-inflicted wounds stemming from ill-advised statements to the media.

His aside in a television interview that “I would like my life back” caused outrage. Mr. Hayward was also criticized for early attempts to deflect blame for that explosion onto rig owner **Transocean Ltd.** and his description of the environmental impact of the spill as “very, very modest.”

“I became, as the face of BP, the lightning rod for very understand-



From left, CEO Hayward, Chairman Svanberg and Managing Director Dudley at BP's London headquarters Tuesday.

able anger and frustration across a very broad cross section of U.S. public,” Mr. Hayward said Tuesday. “I think that was an inevitable consequence of leading the response.”

“Whether we dealt with the politics appropriately all the way through, I’ll leave others to judge,” Mr. Hayward added.

Mr. Hayward was less equivocal about his handling of the operational side of the spill and BP's approach to safety.

“We mounted the largest response to an environmental incident and industrial accident the world has ever seen. There are 45,000 people involved in that response, thousands of ships and an unprecedented subsea intervention,” he

said.

“The fact is we have dealt with it. We have stopped the well flowing, we are going to clean up the oil spill, we have put in place a \$20 billion fund for claims,” he said. “The commitment went way beyond anything anyone could have reasonably expected from a private company.”

“I think when the results of the investigations emerge it will become very evident there is nothing unusual about the well design at Macondo,” Mr. Hayward said. “Many wells drilled in this part of the Gulf of Mexico by major competitors have this well design. It is simply not right to say that this is somehow some rather unique BP well design.”

The Macondo blowout is an accident for which the whole deep water drilling industry needs to take responsibility for and learn from, not just for BP, Mr. Hayward said.

Mr. Hayward will leave BP on Oct. 1 and become a non-executive director of **TNK-BP**, the company's joint venture with a group of Russian billionaires.

Aside from its operations in the U.S., **TNK-BP** is the BP's single most important asset and has a troubled history of its own. **TNK-BP** repeatedly made headlines two years ago during a very public spat over control of the venture between the Russian billionaires and its then-CEO, Robert Dudley. Mr. Dudley now succeeds Mr. Hayward as BP's CEO.

Chairman survives, but future is uncertain

BY GUY CHAZAN

BP PLC Chairman Carl-Henric Svanberg has survived the disaster that claimed his company's chief executive. Now the question is whether his luck can hold out.

Mr. Svanberg said Tuesday that he had never considered resigning. “The board have repeatedly and explicitly told me to stay on,” he told a reporter at a London news conference who asked if he should have stepped down instead of Tony Hayward.

But his performance during the Deepwater Horizon crisis has been widely perceived as lackluster. His expression of sympathy for the “small people” on the Gulf Coast last month added to BP's public-relations woes. Some shareholders say Mr. Svanberg, a former Swedish telecom executive, kept a notably low profile in the early weeks of the disaster, and that he didn't express enough support for Mr. Hayward at crucial junctures.

That has led some analysts to conclude his long-term tenure as chairman isn't assured. Some observers say there is at least one potential successor on the BP board—Paul Anderson, the former chief executive of **BHP Billiton PLC**.

In an interview, Mr. Svanberg said that his early absence from the scene was at Mr. Hayward's request

Mr. Svanberg said that his early absence from the scene of the Deepwater Horizon spill was at Mr. Hayward's request and with the agreement of the board.

and with the agreement of the board, because he was relatively new to BP and the oil industry. He took over as chairman at the start of 2010.

Once criticism of his low profile began to grow, he changed tack, giving television interviews and meeting with spooked investors to reassure them of BP's financial health, at a time when fears about the mounting costs of the oil-spill cleanup had caused BP's share price to tank.

In those meetings Mr. Svanberg says he argued that keeping out of the spotlight had enabled him to have a productive meeting with U.S. President Barack Obama, while Mr. Hayward was already persona non grata.

That meeting, at which BP agreed to set up a \$20 billion escrow account for compensating victims of the spill, did much to relieve pressure on the company from federal authorities, which had been at boiling point.

A former chief of **Telefon AB LM Ericsson** noted for his commitment to green causes, Mr. Svanberg's selection as chairman in 2009 was a surprise to many. He says he now knows more about BP and the oil industry than he might have learned in four or five years under normal circumstances.

Protesters shut down petrol stations

BY JAVIER ESPINOZA

LONDON—The Environmental group Greenpeace shut down the fuel supplies to dozens of BP PLC petrol stations in London, in a protest timed to BP's quarterly report Tuesday, in which it announced a big loss and named a new chief executive.

On Tuesday, around 75 activists simultaneously took over about 46 stations across London in the early hours of the morning, according to John Sauven, executive director of Greenpeace U.K.

The activists removed the pump switches to disable the petrol pumps and prevent the stations from serving fuel to customers, Mr. Sauven said.

A BP spokesman, however, said only 35 sites were affected, with some of those stations being able to sell food but not able to supply fuel.

During the protests, the volunteers replaced BP's logo with an altered logo showing its green and

yellow sunflower sinking into a sea of oil.

“We want to use this opportunity to make BP think about the direction the company is taking beyond its announcement that it is switching bosses, catastrophic losses and dodgy pension deals,” Mr. Sauven said.

The protest came as BP formally named Bob Dudley as its new CEO, succeeding Tony Hayward, who is stepping down following record losses triggered by the Gulf of Mexico oil spill.

Greenpeace was dismissive of the management shake-up. “It is all very well changing Tony [Hayward] for Bob [Dudley] and before that it was John [Browne], but changing a CEO doesn't change the situation at the company. In fact, [Mr. Hayward] took the company backwards into the deep waters of Mexico,” said Mr. Sauven.

Greenpeace volunteers intended to stage their protest against BP for a day only and said the protest

wasn't targeted at some of the franchisees who run BP's petrol stations.

“This is not a protest against the franchises but against BP,” said Anna Jones, a 29-year-old Greenpeace volunteer who arrived at a BP petrol station in Camden in North London at 5:30 a.m. and who was in charge of replacing BP's logo.

“The green logo doesn't properly reflect the company, and it is time for them to admit that they are going in the wrong direction,” she said.

By the end of the day, all protesters had left the stations and there were no arrests, a Greenpeace spokesman said.

BP said it isn't sure whether it plans to press charges against the protesters.

“We are working together with the police on determining further action [against Greenpeace]. Our priority is the safety of our staff and customers and to guarantee the sites are fully operational as soon as possible,” a BP spokesman said.



Activists protested in London Tuesday.

EUROPE NEWS



European Pressphoto Agency

U.K. Prime Minister David Cameron, left, inspects honor guard with Turkish Prime Minister Recep Tayyip Erdogan in Ankara on Tuesday.

U.K. backs Turkey as EU member

U.K. Prime Minister David Cameron said he will push strongly for Turkey to become a member of the European Union, saying the country is crucial for the region's trade and security.

By Laurence Norman
in London and
Joe Parkinson in Istanbul

In a speech Tuesday during a visit to Ankara, Mr. Cameron took on the many skeptics regarding EU membership for the predominantly Muslim nation of 70 million.

"It makes me angry that your progress can be frustrated in the way that it has been," Mr. Cameron said. "I will remain your strongest possible advocate for EU membership and for greater influence at the top table of European diplomacy."

Mr. Cameron's comments were welcomed by a spokesman for Stefan Füle, European commissioner for enlargement. But numerous European governments have raised concerns about Turkey's candidacy.

Germany and France, in particular, have resisted fast-tracking Turkey into the 27-nation bloc, partly on cultural grounds but also because of objections to Turkey's hu-

man-rights record. The U.K. and the U.S. have long backed Turkey's bid for EU membership for strategic reasons.

But the rapid rebound of the Turkish economy recently is seen providing extra impetus to the U.K.'s diplomatic engagement with Ankara.

Mr. Cameron's visit to Turkey is the first leg of a three-day trip that also will take him to India. The trip is seen as a debut for the new U.K. government's pledge of a more pragmatic foreign policy, centered on pursuing commercial interests.

"Support for Turkey is nothing new, but the economy is the bottom line. One of the aims of the Cameron administration is to raise the level of exports—and Turkey is part of that," said Wolfango Piccoli, analyst at Eurasia Group, a political-risk consultancy.

In his speech, Mr. Cameron called Turkey "Europe's BRIC," referring to the acronym for the emerging markets of Brazil, Russia, India and China, and said he wants to see bilateral trade between the U.K. and Turkey, which currently totals £9 billion (\$13.94 billion) a year, to double over the next five years. "We cannot let the protectionists win," Mr. Cameron said.

The U.K. prime minister signed a "strategic partnership" with Turkish Prime Minister Recep Tayyip Erdogan during his visit, aimed at deepening trade and defense ties.

Mr. Cameron criticized opponents of Turkey's bid for EU membership as being protectionist and "prejudiced." He said some people oppose Turkey joining the European bloc because they "willfully misunderstand Islam."

Turkey began negotiations to join the EU in 2005, but the talks have made slow progress. During a visit to Germany by Mr. Erdogan in March, German Chancellor Angela Merkel repeated her view that the EU should offer Turkey a "privileged partnership" instead of full membership. Turkey has dismissed that offer. French President Nicolas Sarkozy also has said he opposes Turkey joining the EU.

The French and German governments declined Tuesday to comment on Mr. Cameron's remarks. But in an interview with Germany's Bild newspaper published Tuesday, German Foreign Minister Guido Westerwelle said he wants to see a Turkey "that's on the side of Europe." But, he said, "if we had to decide today, Turkey wouldn't be ready for acces-

sion and the European Union wouldn't be ready to admit it."

In his speech, Mr. Cameron said that just as Turkey has an important role to play in the Middle East peace process, "so it's Turkey that can help us stop Iran from getting the bomb."

The foreign ministers of Turkey, Iran and Brazil will meet in Turkey in the coming days to advance discussions on a nuclear-fuel swap proposal they agreed to in May. Brazil and Turkey voted against recent United Nations Security Council sanctions on Iran over its nuclear program. Mr. Cameron said he hoped the meeting will "see Iran move in the right direction."

Mr. Cameron also addressed the recent tensions between Turkey and Israel over the deadly commando operation against a Gaza-bound aid flotilla in May. Nine activists, eight Turks and one Turkish-American, died in the raid.

He urged Turkey and Israel not to give up on their longstanding friendship, but called Israel's attack on the flotilla "completely unacceptable." The prime minister again asked Israel to lift restrictions on Gaza, saying it "must not be allowed to remain a prison camp."

Turkey curbs its outlook for inflation

By JOE PARKINSON
AND ERKAN ÖZ

ISTANBUL—Turkey's central bank on Tuesday issued a benign forecast on inflation and interest rates and a gathering economic recovery as the country's stock prices were soaring to a record high.

Central bank Gov. Durmus Yilmaz delivered a dovish inflation report, cutting the bank's estimate for 2010 and 2011 price rises. He also said the bank's policy committee has room to keep interest rates low until the first quarter of 2011, when they will see a "limited" rise.

Economists said the bank's inflation revisions were expected, but the combination of a brightening economic outlook and returning appetite for risk pointed to an increasingly robust economic recovery.

Turkey's benchmark stock index jumped 1.89% to 60,633, an intraday record, which investors attributed to supportive global sentiment and expectations of strong second-quarter bank earnings.

"Right now it all looks like it's going Turkey's way," said Nigel Rendell, an economist at RBC Capital Markets in London. "Global sentiment is supportive of Turkish assets; inflation is going in the right direction; growth is strong, and policy makers are in no rush to raise interest rates."

Turkish stocks have been among the top gainers of any emerging market in 2010, rising 14% since the beginning of the year. Gross domestic product has risen by a sizzling 11.7% in the first quarter from a year earlier, when Turkey was still in deep recession.

Even after adjusting for the base effect in annual comparison, Turkey's outlook remains one of the brightest in the region, with most forecasts for 2010 growth pegged above 6%.

Despite the positive news, analysts warn that potential political troubles still cloud Turkey's economic outlook. Turkey faces a referendum Sept. 12 on constitutional reform, and national elections are scheduled for summer next year.

Other risks include military skirmishes with Kurdish separatists and Ankara's growing ties with Iran, which is angering many of Turkey's Western allies.

"The political-risk factors have not gone away; they're dormant, and investors should be aware," said Cristian Maggio, emerging-markets strategist at TD Securities. "There's a risk and we know something can happen, and it will exert selling pressure on Turkish assets, but it might end up being just noise."

Mr. Yilmaz, the central bank governor, said in a televised speech that the bank now estimates that 2010 median year-end inflation will be 7.5%, down from April's forecast of 8.4%.

"We confirmed our stance to hold our policy interest rate at low levels for a while ... there will be a limited rise in interest rates in early 2011 and, after this they will remain stable for three years," the governor said.

The benchmark policy rate has remained at a record low of 6.5% since November 2009, after the central bank slashed rates by 10.25 percentage points to cushion the economy against the global downturn.

—Sezin Bala
contributed to this article.

Country sees hidden hand in Kurd riots

By MARC CHAMPION
AND ERKAN ÖZ

ISTANBUL—Turkey's escalating battle with Kurdish insurgents has become caught up in the country's fiercely partisan domestic politics, as the government charged Tuesday that opponents of democratic change had triggered ethnic riots at both ends of the country.

Justice Minister Sadullah Ergin said Tuesday that intelligence services were investigating whether two episodes of unrest Monday had been engineered. In eastern Turkey, suspected guerrillas from the Kurdish Workers Party, or PKK, killed

four policemen, triggering riots. In Turkey's west, riots that followed a knife fight involving ethnic Kurds left dozens injured and detained.

"In both cases we have to take into account the probability of provocations, and the intelligence services are investigating these probabilities," Mr. Ergin told a group of reporters in Istanbul, through simultaneous translation.

Turkey is in the midst of a power struggle between its Islamic-leaning government and the military-backed, secularist establishment that effectively ruled the country for decades. Conspiracy theories abound on both sides about the machinations of the

other, and are impossible to prove. However, the accusation that members of Turkey's so-called deep state are fueling conflict with the PKK in an effort to undermine trust in the government is explosive. Turkey's war with the PKK has cost 30,000 to 40,000 lives since it began in 1984.

Mr. Ergin declined to name who he suspected of provoking Monday's riots, but said they were groups "who favor the status quo" in Turkey. Those groups, he said, were trying to block the government's efforts at democratization, including a referendum on constitutional amendments to be held Sept. 12.

The PKK stepped up attacks in

the spring after their jailed leader, Abdullah Ocalan, said he was calling off talks with Turkey's government, explaining Ankara's stated goal of improving conditions for the Kurdish minority was going nowhere.

From the outset, columnists in Turkey's pro-government media speculated that the PKK's move was being orchestrated with members of the country's so-called deep state, in an effort to discredit the government and unseat the AKP. Hundreds of Turkish bureaucrats, journalists and military officers are currently awaiting trial as alleged deep-state conspirators in proceeding that opponents see as a witch hunt.

EUROPE NEWS

Russian offer divides demonstrators

BY GREGORY L. WHITE

MOSCOW—Russian authorities this month offered to allow a demonstration by opposition activists in Moscow's Triumphal Square on Saturday, after more than a year of harshly suppressing such protests. But the concession they demanded—exclusion of the protests' original architect—threatens to split the movement, activists said.

Though the organizers rejected the offer for this month—and were denied a permit for the demonstration—debate over whether to accept the authorities' terms in the future rages on the Web and Moscow radio talk shows.

Since they started in early 2009, the demonstrations have been a rare success for the Kremlin's beleaguered and fractious opponents, attracting hundreds of protesters from a wide range of antigovernment groups, often despite official bans. Held on the 31st of each month that has as many days, the protests defend Article 31 of Russia's constitution, which ensures the right to free assembly.

Authorities in Moscow have been particularly strict, regularly rejecting applications for permits and detaining demonstrators.

But early this month, as organizers were preparing to apply for a permit, city officials indicated that they were willing to compromise and allow the protest, on the condition that the permit application not include Eduard Limonov, a veteran



Police detain a opposition activist at a protest march in Moscow on May 31 that defended the right to public assembly.

opposition leader who first proposed the 31st demonstrations, according to city officials and protest organizers.

"It was really an offer to reconsider the whole interaction with the opposition," said Alexander Muzykantsky, the Moscow city government's human-rights ombudsman and one of those who discussed the

proposal with opposition leaders.

Mr. Muzykantsky admitted the offer was essentially illegal, since Russian law allows authorities to negotiate with permit applicants only over the time and place of demonstrations. He said he was an intermediary and didn't know the government's motivation in making it.

Some opposition leaders wel-

comed the chance to finally have their protest without the threat of arrest, potentially attracting far more participants.

"The authorities made huge concessions," said Lyudmilla Alexeyeva, a Soviet-era dissident who is the doyenne of Russia's human-rights community and was detained at a Dec. 31 demonstration. "In my view,

it's not a matter of principle" for the opposition to have different names on the permit application, since Mr. Limonov and his supporters can still attend the protest, she said.

"We don't need the authorities to sow discord in the ranks of the opposition," she said. "We can do that well enough ourselves."

Mr. Limonov has long been a controversial figure in Russian politics. His National Bolshevik Party—a thinly supported hybrid of nationalism and socialism whose flag combined Nazi and Soviet imagery—was banned by court order as extremist in 2005.

But his loyal followers—known for their showy and often humorous protests—have been key supporters for the opposition in recent years, as official pressure on critics has risen. Earlier this month, they published the program of a new, more moderate party, Other Russia, calling for broad democratization and, among other things, the creation of a new capital city somewhere in southern Siberia.

He and other activists denounced the idea of allowing the authorities to dictate who can file for permits for the 31st demonstrations. "They're forcing us to kiss the sultan's slipper," he said.

Despite being denied a permit, he, Ms. Alexeyeva and the other activists say they plan to gather in Triumphal Square on Saturday. City officials have scheduled an auto race there for the entire weekend and threatened to detain demonstrators.

U.K. weighs easing corporate-tax rules

BY LAURENCE NORMAN

LONDON—The U.K. Treasury launched a series of tax consultations Tuesday, including a possible easing of rules that affect the taxation of foreign profits of U.K.-based companies.

The Treasury said it is committed to "delivering a more territorial approach to corporation tax," which could include exempting from tax the profits of foreign branches of U.K. companies.

The move would aim to "enhance the U.K.'s competitiveness and to achieve greater consistency of tax treatment between foreign branches and subsidiaries of U.K. companies," the Treasury said.

The government has set up a working group of tax experts to look at possible changes to the taxation of foreign branches. They will meet over the coming months and feed into the consultation.

The Treasury also said it is consulting on possible interim improvements to the controlled foreign-company tax rules, which aim to keep multinational companies operating in the U.K. The government has promised a broader overhaul in 2012 of the current CFC regime. This issue dogged the previous Labour government and led to the departure of several multinational firms.

However, the Treasury said it could make interim changes to the current CFC regime by the spring of 2011. These could exempt commercial activities that "do not erode the U.K. tax base."

The proposed overhauls come as the new government of Prime Minister David Cameron has pledged to show the U.K. is again "open for business." The government announced last week it was opening an Office for Tax Simplification and has promised a gradual reduction in the corporation tax.

However, plans to change the tax system could hit hurdles as the government tries to pare a €155 billion (\$240 billion) budget deficit.

Among other proposals, the Treasury promised to consult on the pay-as-you-earn tax system used by firms employing the majority of the U.K.'s 30 million taxpayers. The Treasury also issued a consultation on pension-tax credits, which could see annual tax relief fall sharply to some £30,000 to £45,000.

The Institute of Directors welcomed the intention to reform the PAYE system and the decision to consider exempting U.K. companies' foreign-branch profits. "The taxation of branches is a vital piece in the jigsaw of the taxation of multinationals. There will, however, be important ramifications for the competitiveness of the tax system and for specific industries, so it is important to take time to get the answers right," the institute said.

Vincent Oratore, president of the Chartered Institute of Taxation, said the proposed interim CFC regime changes are welcome "but the real test will be whether full reform of CFC rules can be agreed and completed by spring 2012, as the government intends."

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U.S. NEWS

Debate over stimulus is heating up

By JON HILSEN RATH

WASHINGTON—Eighteen months after President Barack Obama administered a massive dose of spending increases and tax cuts to a weak economy, a brawl has broken out among economists and politicians about whether fiscal-stimulus medicine is curing the illness or making it worse.

The debate is more than academic. It is shaping congressional decisions on whether to respond to the distressing prognosis for the U.S. economy with more government spending or a dose of deficit reduction.

One side says Mr. Obama's \$862 billion fiscal stimulus prevented an even graver recession. Cutting the deficit right now, this side insists, would send the economy into a tailspin. The other side questions the benefits of the stimulus and argues addressing long-term deficits now is crucial to avoid higher interest rates and even bigger economic problems down the road.

And then there is a camp in the middle—defending last year's stimulus, but urging a deficit-cutting plan now.

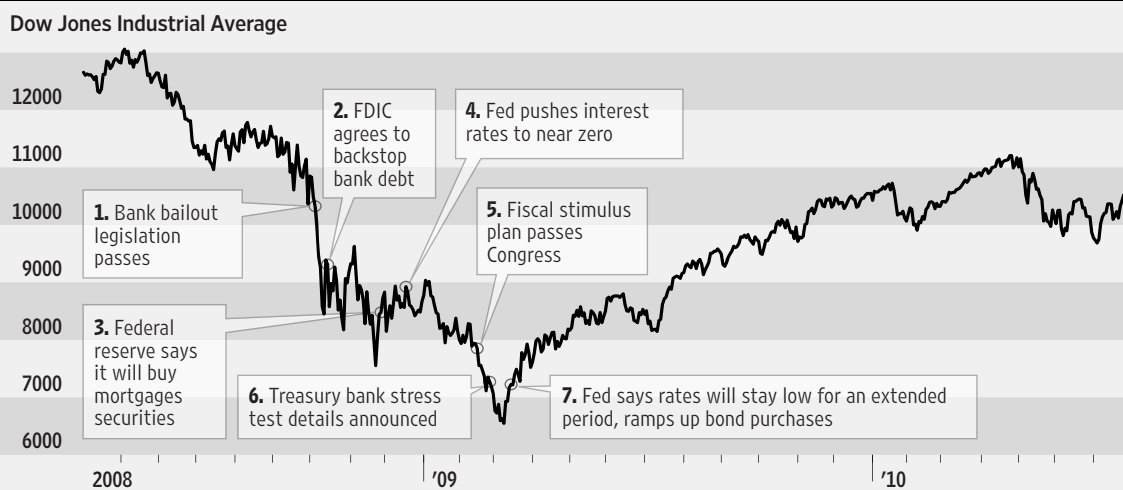
The quarrel over deficits and the economy is at the center of many congressional disputes. Republicans battled against Mr. Obama's proposal to renew the extension of unemployment compensation benefits for up to 99 weeks, insisting on spending cuts elsewhere to avoid widening the deficit, but lost last week. The president argues the benefits are vital to millions of unemployed and would bolster consumer spending.

Meanwhile, the White House says it will allow taxes to rise on families with incomes above \$250,000. Republicans and a few Democrats argue that allowing President George W. Bush's income-tax cuts on those upper-income households to expire at year-end, as the law currently provides, will choke the economy.

"Too many are searching for answers in the discredited economic playbook of borrow-and-spend Keynesian policies," Rep. Paul Ryan, a Wisconsin Republican who is pushing a long-run deficit cutting plan, said this month. "I reject the false premise that only forceful and sustained government intervention in the economy can secure this country's renewed prosperity."

Richard Trumka, president of the AFL-CIO union alliance, says if the government starts cutting deficits now, "We'll slip back into re-

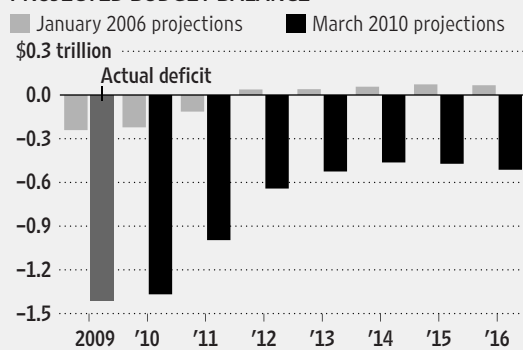
Bang for the buck | Stock prices turned after Fed intervened



Bond market message

Yields on U.S. debt keep sinking, despite worries that record budget deficits would push yields higher.

PROJECTED BUDGET BALANCE



Sources: WSJ Market Data Group; Congressional Budget Office; Ryan ALM via WSJ Market Data Group

10-YEAR TREASURY NOTE YIELD



cession and possibly depression."

Public opinion seems to be with the deficit fighters. A June Wall Street Journal/NBC News poll asked respondents which statement came closest to their views: (1) The president and Congress should worry more about boosting the economy even if it means bigger deficits; or (2) The president and Congress should worry more about keeping the deficit down even if it means the economy will take longer to recover. Some 63% chose deficit-fighting.

Most mainstream economists agree on some points: The U.S. economy needed some kind of fiscal help in 2009 as the financial system teetered and the Federal Reserve pushed interest rates near zero. The deficit has to be reined in eventually, in part by restraining the growth of spending on health and other benefits. And developing a long-term plan to do so now would reduce risks of a future financial market calamity and help hold interest rates down.

But today, neither side can say with certainty whether the latest stimulus worked, because nobody knows what would have happened in its absence.

Fed Chairman Ben Bernanke backed fiscal stimulus in early 2009. Now he says the economy still needs fiscal stimulus, but says it must be accompanied with a credible plan to reduce future deficits. Like the Obama administration, he doesn't think that plan should be implemented until the economy is on more solid footing.

Unlike the U.S., Europe has embraced, at least rhetorically, the primacy of deficit-reduction now. In some instances this is because of pressure from markets and the International Monetary Fund, such as in the cases of Greece and

Spain, and in other instances because of local politics, as in the cases as the U.K. and Germany.

"It is an error to think that fiscal austerity is a threat to growth and job creation," European Central Bank President Jean-Claude Trichet said recently. "Economies embarking on austerity policies that lend credibility to their fiscal policy strengthen confidence, growth and job creation."

The case that government deficit spending can be vital at times of recessions dates to John Maynard Keynes, the British economist whose teachings dominated economics for decades after the Great Depression.

A counter-revolution led by Milton Friedman, of the University of Chicago, de-emphasized the role of government and gave rise to Ronald Reagan and Britain's Margaret Thatcher. Keynes lost favor during the stagflation of the late 1970s and early 1980s. The Fed and its manipulation of interest rates came to be seen as the best way for governments to manage the short-term ups and downs of the economy.

One big issue: Lessons about fiscal policy in normal times aren't necessarily applicable to today, when the Fed has cut interest rates to zero and unemployment remains high. Skeptics of fiscal stimulus traditionally argue that government borrowing crowds out private investment and pushes up long-term interest rates. True, says Obama adviser Lawrence Summers, but not at times like these.

When private-sector lending was drying up and the credit markets froze, "government investment and creation of demand for consumers was a form of alternative financing, not a threat to private investment," he says.

Both camps emphasize past victories. Keynesians cite deficit spending as the cure for the Great Depression and see parallels to today and to Japan's premature deficit-cutting in 1997 as the cause for its return to recession.

The other side points to Margaret Thatcher, who in 1981—ignoring protests from hundreds of economists—raised taxes and tightened government purse strings to cut a budget deficit in mid-recession. The U.K. emerged with lower inflation, lower interest rates and a recovery.

The quarrel is shaping congressional decisions on whether to respond to the dire prognosis for the economy with more spending or a dose of deficit reduction.

Keynesians say that episode isn't relevant today because the U.S. can't cut interest rates. Another difference: The British pound lost half of its value in the 1980s, spurring exports. The dollar, by contrast, strengthened after the financial crisis hit because global investors saw it as a safe haven.

The Obama administration is stocked with heirs of Mr. Keynes, including academics Christina Romer and Mr. Summers. Ms. Romer famously projected in January 2009 that without government support, the unemployment rate would reach 9%, but with support the government could keep it under 8%. It's 9.5% today.

Some Obama administration officials privately acknowledge they set job-creation expectations too

high. The economy, they argue, was in fact sicker in 2009 than they and most others realized at the time. But they insist unemployment would have been worse without the stimulus.

In the first quarter of 2009, when stimulus was enacted, the economy shrank at a 6.4% annual rate. Since then it has grown at a 2.5% annual rate. And the U.S. recently has begun adding jobs, albeit slowly.

It's hard to isolate the impact of fiscal stimulus from other actions. Congressional approval of the stimulus in February 2009 coincided with an improvement in the economy. But before Mr. Obama's stimulus was enacted, the Fed pushed short-term interest rates to zero and began buying mortgage-linked securities to drive down long-term interest rates. Soon after the stimulus was okayed, the Fed expanded its securities purchases. A turnaround in the stock market coincided with the Fed's expanded effort and with a separate Fed-Treasury "stress test" to shore up confidence in the nation's banks.

A study of 91 stimulus programs in 21 developed economies between 1970 and 2007 by Harvard's Alberto Alesina found tax cuts were more stimulative than government spending. "I would have done more on the tax side than on the spending side," he says.

Economists who say Mr. Obama should have relied more on tax cuts cite research of an unlikely source: Ms. Romer, his adviser. In a study she and her husband, David Romer, conducted before she joined the administration, Ms. Romer found large multipliers from tax cuts, which she concluded "have very large and persistent positive output effects." Tax increases, she found, hurt growth. That study didn't address whether spending is better than tax cuts, though. And she says the gravity of the economic situation called for both tax cuts and spending.

Tax cuts haven't been a cure-all. President Bush tried \$168 billion of tax rebates in 2008, and a recession ensued anyhow. Economists note that households tend to save temporary tax cuts or use them to pay down debt, so they don't provide much short-term stimulus.

Before the debate over the efficacy the 2009 stimulus is resolved, Congress is turning to whether it's time to start cutting deficits.

Mr. Alesina says it is: In 107 periods since 1980 when governments cut deficits, doing so tended to quicken economic growth, not slow it. But his study focused on periods when central banks could offset deficit cutting with lower interest rates. The Fed has exhausted that avenue.

Carmen Reinhart, a University of Maryland economist who has studied the fiscal aftermath of financial crises, says more stimulus could be counterproductive because it could lead the public to expect even higher taxes in the future.

Instead, policy makers now need to convince the public that they are committed to reducing future deficits, without acting on that commitment right away, she says. That could hold interest rates down, without yanking money from an ailing economy too quickly.

"We are not in an easy position," she says. "Credibility is going to be difficult to achieve."



Getty Images

Economist John Maynard Keynes

U.S. NEWS

President's trip to test relations with Wall Street

By LAURA MECKLER AND BRODY MULLINS

WASHINGTON—President Barack Obama heads to New York City Wednesday for a pair of high-dollar fund-raisers—a tough task given the many Wall Street executives who have been disappointed by his rhetoric and policies.

Mr. Obama raised \$15 million in donations from Wall Street donors—a record for a presidential campaign—but his relationship with many of those donors began to fray not long after he took office, and donations have fallen.

Wall Street executives “feel like a spurned lover,” says Paul Equale, a onetime financial-services lobbyist who now advises Wall Street firms on dealing with Washington. He predicted that Wall Street will resume donating to Democrats by the 2012 election.

Two events benefiting the Democratic National Committee are planned for Wednesday evening, each with a ticket price of \$30,400, the most a person can give to a political party in a two-year election cycle. One will be at the home of Anna Wintour, editor-in-chief of

Vogue magazine, and the other is at the Four Seasons hotel. About 50 people are expected at each.

Each event will provide the opportunity for guests to talk directly with the president, who doesn't plan any formal remarks, said one Democrat involved in the planning.

The events are both sold out, planners said, but antipathy toward the Democrats will limit the number of events the party is able to put on in New York, said one longtime Democratic fund-raiser. This person said he tried to recruit Wall Street figures to attend one of this week's events but found that many were uninterested or wanted to go so they could complain to the president about policies they dislike.

The financial-overhaul law that Mr. Obama signed last week is the biggest strain on the relationship. The legislation tightened rules on some financial products such as derivatives and created a new regulator to protect consumers.

Wall Street executives say they accepted many elements of the legislation as necessary, given the role that the financial and housing markets played in the downturn in the U.S. economy. However, some have



Vogue editor in chief Anna Wintour will host one of two fundraisers in New York to be attended by President Obama

been offended by rhetoric by Mr. Obama describing Wall Street executives as “fat cats.”

For its part, the White House appears to be sensitive about its connections to Wall Street. Democrats had considered holding the Four Seasons event at the home of Marc Lasry, a founder of the hedge fund Avenue Capital Group. According to one person familiar with the planning, the White House pulled out amid concerns that it would look bad so soon after the president signed the financial-regulation law.

A Democratic National Committee official disputed that account, saying that the event was never confirmed for Mr. Lasry's house and

that the committee decided to use the Four Seasons to accommodate several people who wanted to serve as official hosts. The official declined to name the people.

Employees of Goldman Sachs Group Inc. donated a total of \$1.1 million to the DNC in 2008, making Goldman the biggest source of campaign cash to the Democratic Party. Overall, five of the top 10 sources of donations to the DNC that year were Wall Street firms, according to an analysis of campaign donations by the nonpartisan Center for Responsive Politics.

This election season, only one financial firm ranks among the top 10. Employees of Goldman have donated

about \$100,000 to the DNC so far in the 2010 congressional elections, putting them on a par with employees of the state of New Hampshire and behind employees of Burlington, VT.-based Burton Snowboards, according to data from the Center for Responsive Politics.

Meanwhile, legislation that would force greater disclosure of the political donations funding corporate and union campaign advertisements failed a key vote in the Senate on Tuesday. It is meant to blunt the impact of a Supreme Court ruling in January that struck down major portions of campaign finance laws designed to limit the influence of special interests in campaigns.

Prospects for housing market worrisome

By ROBBIE WHELAN

Sales of new homes are near 47-year lows, and the supply of new and existing homes is expected to grow in the months ahead as construction ramps up and a wave of foreclosed homes hits the market.

In June, new-home sales were running at a seasonally adjusted annual rate of 330,000 units, the Commerce Department said Monday. While that was up 24% from the all-time low of 267,000 in May, the June figures were the second-lowest on record.

“What we're really seeing here is that new-home sales are at what I'd call rock bottom,” said Steve Blitz, an economist at Majestic Research in New York. “The last time we were running these kinds of numbers was the 1982-1983 recession, when we had 100 million less people.”

LPS Applied Analytics, a firm that tracks mortgage data, said Monday that there were 4.56 million loans in default or in some stage of foreclosure in June, down slightly from May. But the number of new foreclosures initiated on properties backed by Fannie Mae and Freddie Mac increased sharply, rising 21%.

The rise in foreclosures on Fannie and Freddie properties reflects the failure of many troubled borrowers to receive permanent loan modification plans, analysts said. Having exhausted all options to rescue their homes, many troubled borrowers may now be giving up.

“Looking at the numbers you're seeing about this pickup in foreclosure starts, it's hard to see how it's not going to translate into elevated levels of [properties taken over by banks] down the road,” said Herb



Many home builders will go ahead with construction rather than write off the land's value and wait for a better market.

Blecher, an analyst at LPS.

Home builders, which began buying up land lots late last year in anticipation of an economic and housing rebound, are stuck with thousands of acres that are prone to lose value as the market struggles. Many will build homes on the land, rather than write off its value and wait for the market to improve.

“Builders are willing to pay a premium to not have that risk on their hands. They're still facing a tremendous amount of stress,” said Brad Hunter, chief economist at Metrostudy, a housing-market research firm based in Houston. “They're discounting the homes, they're making very small profit margins, but they're building homes. They're very inter-

ested in securing market share.”

Prices for new and existing homes rose in May but were expected to lose momentum with the expiration of federal tax credits. The S&P Case-Shiller 10-city and 20-city indexes increased 1.2% and 1.3%, respectively, on a non-seasonally adjusted basis. But home prices typically go up in spring, and the now-expired federal home-buyers tax credit led to brisker sales over the period.

Separately, the Conference Board's Consumer Confidence Index fell to 50.4 in July, the second consecutive decline and the lowest reading since February.

Several former bubble markets are seeing the biggest increase in home construction. According to

Metrostudy, new-home starts in the second quarter show signs of rising 68% in South Florida, 84% in Naples/Ft. Myers, Fla., 65% in Las Vegas and 60% in Denver from a year earlier.

Other indicators also point to builders preparing to increase home construction, despite lagging sales. The number of finished vacant lots, or parcels of land that have been developed and readied for building, stands at about 1.2 million nationwide, according to Metrostudy, or just 5% below the peak in late 2008.

Most metro areas are flush with vacant homes as well: Metrostudy found that of the 48 metro areas the firm covers, only four—northern Virginia, San Antonio, Houston and Baltimore—have what is considered

a “balanced” inventory of unsold homes, or about three months' supply or less.

Coastal Southern California, which includes many of the cities near Los Angeles, has an ample supply of builder-ready land—about two years' worth—owned by banks, developers, investors, the government and the builders themselves, which are starting construction in earnest.

Irvine Co., a large land developer in the coastal region, said it presold 570 homes in the northern portion of its Irvine Ranch project in the first six months of the year, and the \$300 million construction will begin soon. The company also has plans to start 700 to 800 additional homes in the coming months.

“We're doubling down,” said Dan Young, who heads Irvine Co.'s community-development and home-building division. “While the national home builder is probably still right to say things are still weak, and the mass market is not back, we are seeing improvements in local markets.”

But as inventories grow, it could put further pressure on home prices. The median price of a new single-family home has been falling steadily since its 2007 peak of \$247,000. Monday's numbers put the median price in June at \$213,400.

Credit Suisse analyst Dan Oppenheim wrote in a note Monday that sales were probably worse than the Commerce Department's initial report and predicted further declines in home prices, based on continued weak demand: “The low level of activity [even with the reported increase] is well below desired absorption levels of builders.”

—Conor Dougherty and Nathan Becker contributed to this article.

WORLD NEWS

U.S. cites better Pakistan bonds

By TOM WRIGHT
AND SIOBHAN GORMAN

The U.S. military field reports released by WikiLeaks paint a picture of Pakistan from 2004 to 2009 where the country's chief spy agency undermines and even inflames the U.S.-led war in Afghanistan.

But U.S. officials contend that in the past several months, Pakistan's stance has become much more nuanced than portrayed in the WikiLeaks reports, released Sunday by the document-publishing website. U.S. officials argue that the two nations have made strides in deepening military and civilian ties, chiefly in response to a Pakistani military offensive begun almost two years ago against Taliban militants operating on Pakistani soil. In return, the U.S. has pledged billions of dollars in new military and civilian aid.

The WikiLeaks documents, covering six years through December 2009, purportedly show in detail the involvement of the Inter-Services Intelligence military spy agency in numerous attacks on coalition forces in Afghanistan. The reports couldn't be independently verified and U.S. officials have questioned their reliability. Pakistan has denied its spies have aided the Afghan insurgency or terrorism against India.

Many experts, including some U.S. officials and analysts in India, continue to suspect Pakistan's military and intelligence of fostering military ties with the U.S. in return for aid while fomenting the Afghan insurgency and regional terrorism.

U.S. officials are concerned that Pakistan's military continues to offer shelter to Afghan Taliban leaders and their allies because it believes they offer no threat to Pakistan and could play a significant role in Afghanistan after U.S. troops pull out. And India recently presented Pakistan with what it said was evidence that the ISI was directly involved in the terrorist attacks in Mumbai in November 2008, which killed more than 160 people.

But U.S. officials say they have seen a shift in Pakistan's attitudes toward the Taliban in the past 18 months.

"We have made progress in moving this relationship forward," White House spokesman Robert Gibbs said Monday. "What the Pakistanis have found is that the extremists that once enjoyed complete safe haven in parts of their country now threaten their country."

Pakistan's military in the 1990s funded and trained the Afghan Taliban, who were largely culled from the ranks of militants who had fought the Soviets in Afghanistan in the 1980s.

Since last year, the Pakistan Taliban, who are allied with the Afghan Taliban, began to threaten the Paki-



U.S. Secretary of State Clinton speaks with Gen. Kayani on July 19.

stan state, breaking out of their strongholds in the lawless tribal areas on the borders with Afghanistan to overrun the Swat Valley in the north and threaten other settled areas.

The Pakistani military responded with a military offensive that has pushed the militants back to a few areas of the tribal regions. The military cites more than 2,000 casualties so far as a mark of its seriousness in going after militants. The U.S. has supported this campaign with drone missile strikes, which have killed scores of top Taliban leaders.

In response, the Obama administration has also upgraded military and civilian government ties.

The U.S. Congress agreed in October to a \$7.5 billion civilian aid package for Pakistan over the next five years. In March, ministers from both governments attended a high-level meeting in Washington aimed at building closer ties.

U.S. Gen. Stanley McChrystal, who commanded North Atlantic Treaty Organization forces in Afghanistan until last month, visited his Pakistani counterpart, Gen. Ashfaq Parvez Kayani, every three weeks and touted their good relations as being a meaningful breakthrough in the U.S.-Pakistan relationship.

"In the last year, we significantly ramped up consultations," said Rick Snelsire, a spokesman for the U.S. Embassy in Islamabad.

Washington is pushing for deeper cooperation on counterterrorism. It has increased the U.S. military presence in Pakistan to about 230 personnel, including 120 Special Operations Forces involved in training and advisory roles. Pakistan doesn't allow U.S. combat forces. The U.S. has trained more than 370 Pakistan military officers in counterterrorism, intelligence and other areas in the past few years.

The Central Intelligence Agency and ISI agreed this year to set up more U.S. listening posts in Karachi

along with dispatching more officers from the CIA to the port city, a trade hub of 18 million people that militant and criminal groups also frequent. That dragnet is what led to the February arrest of the Taliban's second in command, Mullah Abdul Ghani Baradar.

"There's a team of crack ISI and CIA people there now," a U.S. official said, adding that the operation is likely walled off from the wing of the ISI that U.S. officials hold with more suspicion because it maintains ties to Islamist militant groups.

The U.S. and Pakistan have also established centers to share military intelligence in cities like Quetta and Peshawar, U.S. officials said. "The partnership is guided in many ways by shared interests, especially when it comes to the problem of terrorism," another U.S. official said. "There's regular, robust, and candid dialogue between CIA and ISI officials, including when differences arise."

Still CIA officers are aware of Pakistan's historical relationships with militants, the official said. "Everyone's eyes are wide open."

In a sign of increased military cooperation, a military official at the U.S. Embassy points to an incident in February when Pakistan's Frontier Corps forced militants operating in the Bajaur tribal region to flee across the border to Afghanistan. Pakistan then informed coalition forces, which dropped precision-guided rockets on the group, killing more than a dozen militants.

To be sure, the U.S. remains deeply suspicious about Pakistan's motives. For one, it has repeatedly urged Pakistan to crack down on the remaining havens in the tribal regions from where al Qaeda-linked militant groups like the Haqqani network continue to launch attacks inside Afghanistan.

"Where we've seen good cooperation between the U.S. and Pakistanis is generally purely out of self interest," a U.S. military official said.

Tighter ties

Examples of increased U.S.-Pakistani military cooperation:

- The U.S. has trained Pakistani officers in counterterrorism, intelligence and other areas.

- Pakistani air force personnel are taking part in joint exercises at Nellis Air Force Base, Nev., that ends Friday.

- Coalition forces in Afghanistan have begun sharing surveillance imagery from a new blimp installed in May to monitor the border between Afghanistan and Pakistan.

Source: U.S. Embassy, Islamabad

That means Pakistan has been willing to help the U.S. target members of al Qaeda and the Pakistani Taliban—both of which the Pakistani government, including ISI, see as direct threats to the Pakistani state.

But there is far less cooperation in areas where national interests diverge, such as with the al Qaeda-affiliated groups like the Haqqani network that have tended to attack Afghan and Indian targets, U.S. officials said. In some cases, the U.S. has found evidence of the ISI providing Haqqani fighters with components that could be used for explosive devices as well as basic items like sleeping bags, they added.

The ISI has also provided Afghan Taliban members with financial help, intelligence, and assistance with strategic planning, the U.S. military official said.

Secretary of State Hillary Clinton publicly raised U.S. concerns on a July 19 visit to Pakistan, stating she believed someone in the Pakistan government knew where al Qaeda chief Osama bin Laden was hiding in the tribal regions. Pakistan has replied it is too stretched fighting in other parts of the tribal regions to open a new front now.

Other Pakistani moves have been harder to read. U.S. officials welcomed Pakistan's arrest in February of Mr. Baradar, the Afghan Taliban's military chief, in the Pakistani port city of Karachi. The arrest raised hopes that Islamabad was finally cracking down on the Taliban.

But Pakistan has declined to hand Mr. Baradar over to Afghanistan. Some analysts believe Pakistan may have made the arrest to stop Mr. Baradar from pursuing peace talks with the government of Afghan President Hamid Karzai without input from Islamabad. After some tussling, the CIA gained access to Mr. Baradar for questioning and obtained useful details, U.S. officials say. The U.S. has had some access in the past few months, the U.S. military official added.

One missing U.S. sailor is found dead in Afghanistan

By MARIA ABI-HABIB

KABUL—U.S.-led coalition forces recovered the body of a missing U.S. Navy sailor in eastern Afghanistan and continued their search for the second missing serviceman, thought to be alive, a military spokesman said.

The sailor's body was found Sunday night, and six Taliban fighters were arrested in connection with the abduction, said U.S. Army Lt. Col. Todd Bresseale, a coalition spokesman in Kabul.

"We continue to search for the second sailor and we have every reason to believe he is alive," Lt. Col. Bresseale said. "We're on the right trail."

The Taliban previously said they had killed one sailor in a gunfight during the assault and are holding the other.

A Taliban spokesman was unavailable to comment Tuesday. The Taliban have been trying to exchange the sailors for high-level insurgents in detention, Afghan officials said.

"The Taliban have indirectly contacted the head of the provincial council about a prisoner swap," said Abdul Wali, the council's deputy head in Logar province south of Kabul, where the two sailors were captured Friday.

The coalition hasn't been contacted regarding a prisoner swap, Lt. Col. Bresseale said.

The two sailors were ambushed as they drove in a civilian armored vehicle from their Kabul compound into a Taliban-dominated district of Logar. Following the ambush, they engaged in a gunbattle with the insurgents, resulting in the death of one of the Navy servicemen, Afghan officials confirmed.

Jim Kerr, a state legislator from the Denver area, said the sailor killed was his nephew, Justin McNeley, 30 years old, the Associated Press reported.

The district where the ambush occurred, Charkh, is a hotbed of insurgent activity. Afghan police there had warned the sailors, who appeared to be lost, not to drive further in, said provincial government spokesman Din Muhammad Darwesh, citing witness accounts.

Afghan and coalition forces quickly deployed to Logar, erecting a security perimeter around the site where the sailors were kidnapped in an attempt to prevent the Taliban from moving to more difficult terrain, Mr. Darwesh said.

While the U.S.-led coalition wouldn't speculate on the location of the missing sailor, Mr. Wali said he believed the serviceman is still somewhere in Logar, though not necessarily in Charkh.

The only other coalition service member known to be a captive of the Taliban is Specialist Bowe Bergdahl. He disappeared from his base in the eastern province of Paktika in June 2009, and militants have since posted videos of the soldier on websites.

Rescuing Spc. Bergdahl became the top priority of the military last summer, and it enlisted Pakistan's intelligence service for help, according to NATO officials.

—Habib Zahori
and Matthew Rosenberg
contributed to this article.

Rebels capture Yemeni troops

By OLIVER HOLMES

SANA'A—Rebels in Yemen's north have captured more than 100 Yemeni army soldiers in recent clashes, a senior Yemeni official said Tuesday.

The claim caps more than a week of fierce fighting between Houthi rebels and the army, allied with government-backed tribes in the region. The fighting has killed more than 70 and threatens a truce signed between the two sides in February.

Tensions heightened this week when the government dispatched fighter jets to attack rebel positions.

"Warplanes intervened for the first time since the February truce to quell the violence," a Yemeni official said. Throughout Tuesday, jets periodically roared over the capital San'a, heading northward.

Hamoud al Qaoud, a government official based in Harf Sufyan, where some of the most intense fighting has taken place, blamed the Houthis for "repeated acts of violence

against citizens."

On Monday, Houthi spokesman Dhayef al Shami said the Houthis captured "a large number" of army soldiers in al Zalah, a strategic military outpost in Amran, about 75 miles north of San'a. "We now have control of the military camp to stop the government from supporting the tribes, who continue to attack us," he said.

On Tuesday, the government official said the current estimate of those captured was now 117.

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