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Thousands flee Kyrgyzstan

By Kadyr Toktogulov

BISHKEK, Kyrgyzstan—More than 75,000 ethnic Uzbek refugees have fled violence in southern Kyrgyzstan, officials said Sunday, amid reports that clashes between ethnic Uzbek and Kyrgyz groups have claimed more than 100 lives since they began Thursday.

Most of the refugees are elderly people or women and children, and many have gunshot wounds, the Uzbek Emergencies Ministry said Sunday in a statement carried by Russia's RIA Novosti news agency. Refugee camps were being set up for them in several areas of Uzbekistan, the ministry added.

Russia Sunday sent a battalion of paratroopers—about 300 troops—to reinforce security at its airbase in Kyrgyzstan, the Interfax news agency reported. Kyrgyzstan's interim government asked Russia for military help to quell the rioting, but the Kremlin said Saturday that it would discuss the issue with other members of the Collective Security Treaty. Russia dominates the security pact of several former Soviet nations, which also includes Armenia, Belarus, Kazakhstan, Kyrgyzstan, Uzbekistan, and Tajikistan.

Kyrgyzstan hosts both U.S. and Russian military airbases, but they are in the north, away from the ethnic rioting.

In addition to the more than 100 slain, more than 1,000 people have been reported wounded in the impoverished Central Asian nation since the violence began Thursday night. Doctors said that death toll is low because it was based on the number of people admitted to hospitals.

Thousands of Uzbeks have fled in panic to the border with Uzbekistan after their homes were torched by roving mobs of ethnic Kyrgyz men. Ethnic Uzbek women and children were gunned down as they tried to escape, witnesses said.

Fires set by rioters have destroyed most of Osh, and mobs have attacked many of its shops, another resident of Osh said. Many buildings in the city were burned. They appeared to belong to ethnic Uzbeks, she said. Triumphant crowds of ethnic Kyrgyz men took control of most of the city on Sunday while Uzbeks

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European Pressphoto Agency

Uzbek men begin the grim task of preparing graves for victims of the ethnic clashes between Kyrgyz and Uzbek communities in the southern Kyrgyz city of Osh.

The Quirk

Russian communists unite to try to save a Bolshevik icon: the Cruiser Aurora Page 29

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The Gaza flotilla hypocrisy revealed an old hatred. Page 15

Chevron sets itself apart from rival BP in the Gulf

By Ben Casselman

Chevron Corp. has come out swinging in its fight to continue drilling in the deep waters of the Gulf of Mexico, arguing that not all oil firms should be tarred with the brush of **BP** PLC's Deepwater Horizon disaster.

In an interview with The Wall Street Journal, Chevron chairman and CEO John Watson said he accepts the need for tighter drilling regulations in the wake of the spill, which since April has fouled the waters and coastline of the Gulf. But Mr. Watson, 52, called unnecessary the six-month moratorium on deep-water drilling imposed by the Obama administration.

The second-biggest U.S. oil company after **Exxon**, San Ramon, Calif.-based Chevron owns more Gulf of Mexico drilling leases than any other company and is the third-biggest oil producer there, after BP and **Royal Dutch Shell** PLC. It was considered a growth area for Chevron.

Now, access to deep water may be in jeopardy. In addition to the six-month moratorium on drilling in more than 150 meters of water in the Gulf, President Barack Obama has put on hold plans to expand drilling off the coast of Alaska. Norway, too, has put a temporary halt to new deep-

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Reuters

Chevron CEO John Watson

PAGE TWO

The G-20's bickering won't matter if the yuan stays at its current level

[Agenda]

By Irwin Stelzer

Pity the world's leaders as they converge on Toronto later this month, and equally pity the Canadian city, which will spend millions to cope with the violence that demonstrators might rain upon it, as they have on past such gatherings. The leaders, or at least the conscientious among them, are starting to meet with their diplomatic sherpas for briefings on the world's economic situation. Good luck to them if they can peer through the fog of conflicting reports.

There is general agreement that the Greek financial fiasco cannot be confined to that too-small-to-fail country. The seizing up of bank credit, as bankers still in shock from the aftermath of the collapse of Lehman Brothers once again refuse to lend to each other, is proof enough that the ripple effects of Greece's problems can capsize even the larger vessels of its euro-zone partners, not to mention other countries. That's about the extent of agreement.

Some advisers are telling their masters that the situation is now under control. Greece has an austerity program in place, it is being monitored, and the euro-zone countries will make cash available until the deficit is under control. As proof, they will argue that recent bond sales by Portugal, Spain, Italy and Ireland went rather well.

Others will be telling a different story. Greece, they say, might squeeze through this year and next with a little help from its friends, but by the end of 2011, it will surely have to restructure its debt, which will be well above 100% of gross domestic product. The European and U.S. banks that hold Greek paper will take a haircut on the order of 30%, their balance sheets will shrivel, reducing their ability to lend, and Europe will return to recession—the dreaded double dip. As for those "successful" bond sales: Portugal had to pay 5.2% in order to borrow, 0.7 percentage points above the rate investors previously charged, while Spain's new three-year bond yields 3.32%, a full 2.5 percentage points more than less risky German bunds.

Reuters

A vendor counts yuan banknotes in Shanghai. If only they were worth more.

These interest-rate premia are no small matter, especially if they spread to other nations' bonds.

These interest-rate premiums are no small matter, especially if they spread to other nations' bonds. The World Bank estimates that a one-percentage-point increase in bond yields would slow world growth from the 3.3% forecast for this year and next to an anemic 2% and 0.7% in 2010 and 2011, respectively, with high-income, developed countries clocking in at the trivial rates of 0.9% and 0.6%.

Sherpas will also be telling different stories about the policies needed to keep global recovery on track. German Chancellor Angela Merkel will hear that she must stick to her plans to reduce Germany's deficit, running at about 5% of GDP, lest the sort of inflation that destroyed German democracy in the 1930s be unleashed. She is listening.

Fortunately for the prospects of avoiding another recession, the €80 billion ($96,75 billion) of cuts will be spread over four years, with most of the savings scheduled for 2013 and 2014. Still, austerity it is most likely to be, partly to show other countries it can be done. History trumps economics.

That policy might suit Germany, which is growing rapidly on the back of an export boom fueled by a devalued euro, but it certainly doesn't suit French President Nicolas Sarkozy, whose budget deficit is 8% of GDP. "If we add austerity to austerity, we are going into recession," he said. With heavily debt-ridden Club Med countries taking large chunks out of their spending, Germany should be acting as consumer of last resort, stimulating domestic spending to avoid the predicted anemic growth rate from turning negative. But the tax increases Ms. Merkel has scheduled —economists agree most such increases are the least efficient way to tackle a deficit—will reduce businesses' incentives to take up some of the demand slack created by government cutbacks. So, again, austerity it is to be and history trumps economics.

The G-20 is also split on the question of what measures are necessary to reform the financial sector. Germany and France want to regulate short selling; Britain and America are unenthusiastic. America wants German and Spanish banks to publish the results of U.S.-style stress tests. They refuse.

On one thing all save one of the leaders will agree: China's insistence on pegging its currency to the dollar is causing serious imbalances in world trade. Like President Barack Obama, European leaders are looking to exports to lead a job-creating recovery. The undervalued yuan makes that unlikely. The Chinese regime is keeping its export machine in high gear: exports in May were 48.5% above year-earlier levels. The displeasure of trading partners unwilling to retaliate is of no consequence to Chinese über-realists. A nervous election-year American Congress might just move from threats to action, changing the cold war over trade into a hot one.

So don't bother reading the G-20 communiqué. It will tout agreements reached even though the really important issues will remain unresolved.

—Irwin Stelzer is a director of economic-policy studies at the Hudson Institute.

What's News

■ **French and German banks** continued to hold the greatest exposure to euro-zone countries facing market pressures at the end of last year, underscoring their interest in restoring investor confidence in the region. 4

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Question of the day

Q: Would you drop England goalkeeper Robert Green after his World Cup fumble against the USA?

Vote online and discuss with other readers at wsj.com/dailyquestion

Previous results

Q: Do you expect BP to suspend its quarterly dividend?

Yes	**50%**
No	**50%**

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NEWS

The ultimate business meet revives

A charity auction to have a three-hour steak lunch with Warren Buffett won $2.6 million—beating 2008's record

BY GEOFFREY A. FOWLER

SAN FRANCISCO—What is surely the most costly steak lunch in the world just got more expensive.

The 11th annual charity auction of lunch with **Berkshire Hathaway** Inc. CEO Warren Buffett brought in more than $2.6 million on Friday night.

That tally broke the previous record, set in 2008, of $2.1 million by investor Zhao Danyang.

Proceeds from the auction, conducted online by **eBay** Inc., benefit the Glide Foundation, a charity serving the homeless in San Francisco's Tenderloin district.

Mr. Buffett decided to make the annual donation of his time because his late wife, Susan, had been a volunteer at Glide.

The high bidder in the auction for what some say may be the world's most valuable lunch asked to remain anonymous, according to Glide staff. Last year's high bidder, who spent $1.68 million, was the Canadian investment firm Salida Capital.

Much of the bidding action happened in the last three minutes, when the bids rose from $2.5 million to a final tally of $2,626,311.

Rev. Cecil Williams, Glide's founder, said the proceeds were needed to feed and support the poor.

Reuters

Zhao Danyang, left, his son Zhao Ziyang, and Warren Buffett after Mr. Zhao's winning bid for the lunch in 2008.

Rev. Williams said the charity had seen an almost 30% rise in the need for its services since the economic downturn but also a 20% decrease in donations.

"I'm very excited," Rev. Williams said. "I think there is a groundswell talking place for people to be more concerned with nonprofit groups."

He had yet to speak with Mr. Buffett, who didn't make it to San Francisco for an auction count-down celebration.

"We are going to put the money where it counts," said Rev. Williams, especially services for young people who were being drawn into violence, and for housing.

The winner of the annual auction is allowed to bring a party of as many as eight people to the lunch, which typically takes place at Mr. Buffett's favorite New York City steakhouse Smith and Wollensky. Previous winners have said the investment themes they discussed with Mr. Buffett during the meal turned out to be helpful.

The Buffett lunch index

Last year's fall was attributed to investors' focus on making their money back rather than giving it away and the bad publicity of spending so much on lunch.

- 2003 — $250,100
- 2004 — $202,100
- 2005 — $351,100
- 2006 — $620,100
- 2007 — $650,100
- 2008 — $2.1 million
- 2009—$1.7 million
- 2010—$2.6 million

Thousands flee Kyrgyzstan

Continued from first page

remaining in the city barricaded themselves in their neighborhoods. The rampages spread quickly Sunday to Jalal-Abad, another major southern city, and neighboring villages, as mobs methodically set ethnic Uzbek houses, stores and cafes on fire. The rioters seized an armored vehicle and automatic weapons at a local military unit and attacked police stations, around the region seeking more firearms. Police and the military appeared to be on the defensive across the south, avoiding clashes with mobs.

The unrest poses a severe challenge to the interim leadership that came to power in a bloody popular revolt against President Kurmanbek Bakiyev in April. It threatens to overshadow a June 27 referendum to legitimize this Central Asian nation's current government, led by interim President Roza Otunbayeva.

Ms. Otunbayeva appealed for Russian military help Saturday, underscoring the weakness of her regime and the geopolitical stakes in the conflict. The U.S. and Russia maintain military bases in the northern part of Kyrgyzstan, and the U.S. base is a major hub for ferrying North Atlantic Treaty Organization troops and supplies into the battle zone in Afghanistan.

"The situation in the Osh region has spun out of control," Ms. Otunbayeva told reporters Saturday. "Attempts to establish a dialogue have failed and fighting and rampages are continuing. We need outside forces to quell confrontation." Ms. Otunbayeva also spoke by phone on Saturday with Russian Prime Minister Vladimir Putin.

Russia's strategic interests in Central Asia suggest it would be open to playing a stronger role here, but its leaders sounded reluctant to get involved.

"It's a domestic conflict, and Russia now doesn't see conditions for taking part in its settlement," Kremlin spokeswoman Natalya Timakova said in Moscow. Ms. Timakova said Russia would send a plane to Kyrgyzstan to deliver humanitarian supplies and help evacuate victims of the violence.

The U.S. Embassy in Kyrgyzstan on Sunday voiced a deep concern about the raging violence and called for the "immediate restoration of order and a respect for rule of law." It said it was discussing humanitarian aid with the interim government.

The rise of ethnic nationalism and worsening economic conditions before the breakup of the Soviet Union led to an earlier deadly standoff. Soviet troops put an end to the fighting by separating the rivals. Today many fear the authority of the Kyrgyz government is too feeble to halt an all-out ethnic conflict.

Ms. Otunbayeva has struggled to extend its rule in the south, where ethnic tensions have been apparent for weeks. Kyrgyz media reported that a fistfight broke out between a Kyrgyz and Uzbek youths at a slot machine parlor in Osh, and that hostilities escalated from there as both sides armed themselves. Southern Kyrgystan borders Uzbekistan and includes a part of the volatile Ferghana Valley.

Ethnic tensions have been building since Mr Bakiyev's departure left a power vacuum in the south. Leaders of the new government have charged in recent weeks that allies of Mr. Bakiyev are stirring ethnic tensions to plot a return to power.

Banks face euro-zone risks

By Natasha Brereton

LONDON—French and German banks continued to hold the greatest exposure to euro-zone countries facing market pressures at the end of last year, underscoring their interest in restoring investor confidence in the region.

Data released Sunday by the Bank for International Settlements showed that banks based in the 16 countries that use the euro accounted for $1.58 trillion, or 62%, of all internationally active banks' exposures to residents of Greece, Ireland, Portugal and Spain.

That included $727 billion of exposure to Spain, $402 billion to Ireland, $244 billion to Portugal and $206 billion to Greece, with about half of the Greek exposure held by France.

By far, France and Germany held the greatest exposure to the group, collectively carrying 61% of the total euro-area burden: $493 billion and $465 billion, respectively.

"French and German banks are the most exposed overall with $958 billion of exposures, of which $174 billion by our reckoning is sovereign, and $784 billion is private," said Stephen Cecchetti, BIS economic adviser and head of the monetary and economic department at the bank for central banks.

Of that total exposure, almost half was to Spain—$248 billion for France and $202 billion for Germany—with French banks particularly exposed to the Spanish nonbank private sector, while more than half of German banks' foreign claims on the country was on Spanish banks.

British and German banks had exposures to Ireland of $230 billion and $177 billion, respectively, while Spanish banks had the greatest exposure to Portugal, at $110 billion.

Government debt in Greece, Ireland, Portugal and Spain, meanwhile, accounted for only around 16% of euro-area banks' exposure, with $106 billion belonging to France and $68 billion to Germany. Of that, $48 billion of French exposure was to Spain, $31 billion was to Greece and $21 billion to Portugal, while in the case of Germany it was $33 billion, $23 billion and $10 billion, respectively.

As a percentage of Tier 1 capital, German, French and Belgian bank exposure to Spain, Greece and Portugal's public sectors amounted to 12.1%, 8.3% and 5%, much higher than other countries.

European Union finance ministers and the International Monetary Fund agreed last month to commit €750 billion ($907 billion) to support euro-zone governments that have difficulty borrowing in the international bond markets, while the European Central Bank began to buy euro-zone government bonds in an effort to bring down borrowing costs.

The U.S. Federal Reserve also simultaneously reopened dollar swap lines with several major central banks.

The unprecedented package of measures was agreed on in response to concerns that strains linked to the Greek debt crisis could spread further afield.

The BIS noted that although moves in asset prices immediately following the announcement of the measures suggested that contagion had been stopped, confidence soon deteriorated anew on concerns about the possible interaction between public debt and growth.

On a more positive note, it pointed out that government-bond auctions in the second half of May saw strong demand, and that participation in dollar auctions by non-U.S. central banks was limited.

"The modest participation suggests that banks were more concerned about counterparty credit risk than access to U.S. dollar funding," it said.

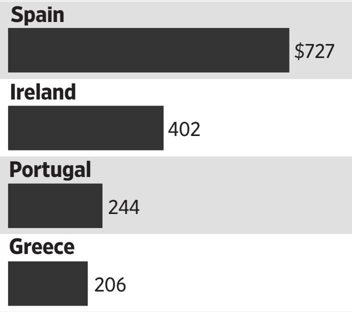
The BIS noted that despite sharp moves in euro-area spreads in sovereign credit-default swaps, stemming from investor concerns about the region, relatively little sovereign credit risk was actually reallocated via the CDS markets.

In a separate report, it also found that while large depreciations in currencies tend to be associated with substantial permanent losses of output, since the losses usually take place before the fall in the currency, it is likely the factors that spur the drop in the currency's value rather than the depreciation itself that is the trigger.

Taken alone, the currency depreciation can actually be good for output, it said.

Foreign claims

Euro-zone banks' exposures to countries facing market pressures, in billions



Note: Data as of Dec. 31
Source: Bank for International Settlements

A rosier forecast for the U.K. ahead of new office's report

By Nicholas Winning
And Laurence Norman

LONDON—The Confederation of British Industry on Monday raised its forecast for the U.K.'s growth, just ahead of an expected downward revision of official growth forecasts and a display of unity from the coalition government on tough spending cuts.

The CBI, a lobby group representing British business, said rising industrial output and overseas demand for U.K. exports meant it expected gross domestic product to grow 1.3% this year, up from its March forecast of 1%. But it said it was sticking to its prediction for 2011 of 2.5% growth.

The forecast's arrival on Monday comes just before the coalition government's Office for Budget Responsibility is expected to take the opposite tack and revise down the previous Labour Party administration's predictions for the economy from 2011 onward. Vicki Redwood, U.K. economist at Capital Economics, said she expects the OBR to keep this year's growth forecast at 1.25% but to lower the 2011 growth estimate to 2.5% from the current 3.25% prediction. She also expects it to cut growth predictions for 2012 onward to 2.75% from the current 3.5%.

The coalition—made up of the Conservative Party and the Liberal Democrats—is due to present its first budget June 22. Chancellor of the Exchequer George Osborne has pitched the OBR as a powerful, independent fiscal council that will hold the Treasury's forecasts to account.

The OBR was created to police the coalition's tax and spending plans.

One of its key tasks is to draw up the growth and borrowing forecasts for budget and prebudget statements, a job that used to be the Treasury's responsibility.

Mr. Osborne has pledged that his government will "fix the budget to fit the figures, not fix the figures to fit the budget."

Agence France-Presse/Getty Images

George Osborne

In a speech Monday, the leader of the Liberal Democrats, Deputy Prime Minister Nick Clegg, will outline his support for the tough fiscal policy that the Conservative-led administration had pledged to take. The new government's promise to cut spending early has been particularly difficult for Mr. Clegg's party, which before last month's election had warned that early austerity measures could throw the economy back into recession.

However, Mr. Clegg will say the crisis in European bond markets have made it clear Britain can't afford to avoid tackling its huge budget deficit head on.

"The choices that were available to us just two months ago are no longer available. We have to take action now so that we can still be in control of our future," Mr. Clegg is due to say at the Institute for Government.

"By taking action, we do something hugely important: We give ourselves the chance to shape outcomes: to do all we can to bring down the deficit in a way that delivers fairness."

The CBI said inflation, which has picked up more than expected due to a value-added tax rise, higher oil prices and sterling's depreciation, is likely to ease back below the Bank of England's 2% target in the second quarter of next year.

It said it expects the BOE to start nudging interest rates higher later this year, pushing them up to 2% by the end of next year from the current record low of 0.5%.

The unexpected resilience of inflation in the U.K. suggests that the production capability of businesses has fallen during the recession, but the degree to which economic potential is permanently stunted going forward depends heavily on credit conditions, a report by the Bank of England released Monday finds.

The paper, in the central bank's Quarterly Bulletin, noted that despite unexpectedly small rises in unemployment and corporate insolvencies during the recession, business investment has fallen, while constraints on working capital are likely to have restricted companies' output potential.

Judging the difference between what a country is actually producing and what it is capable of producing without creating sustained inflationary pressures—so-called spare capacity—is crucial for policymakers. When, as in current conditions, output falls below the economy's potential, that pushes down on prices.

But measuring the amount of slack is notoriously difficult, and some economists are critical of the BOE's central view that a huge amount of spare capacity in the economy will dramatically cool inflation in the coming months.

In an article written for the Sunday Times of London, BOE Monetary Policy Committee member Andrew Sentance on Sunday voiced his own doubts over the ability of spare capacity to push down on prices, saying there appears to be less slack in the economy than expected.

—Natasha Brereton contributed to this article.

France plans to cut its public spending

By Sebastian Moffett

PARIS—France said it would cut public spending by €45 billion ($54.48 billion) over the next three years and raise its retirement age, following other European nations that have announced austerity measures.

Saturday's announcement came ahead of a week in which President Nicolas Sarkozy is scheduled to have talks with German Chancellor Angela Merkel in Berlin, and the French government is expected to announce details of a rise in the current standard retirement age. French Prime Minister François Fillon said the cuts were aimed at bringing France's public deficit back down to the European Union's limit of 3%.

"We've made a commitment to bring down our deficit [to 3% from 8%] by 2013 and we will concentrate all of our efforts on it," Mr. Fillon told a gathering of members of his and Mr. Sarkozy's center-right UMP party. "It would be cowardly of us to tell the French people that their pensions could be maintained without lengthening their working lives and without altering the symbolic retirement age of 60."

Prime Minister François Fillon said the government would reduce its public deficit by €100 billion.

Paris has lagged behind its neighbors in imposing cuts, as other major European economies have rushed to reduce their budget deficits after Greece's debt crisis.

In particular, Germany's willingness to make public-spending cuts has pressured France to take similar measures.

In all, Mr. Fillon said the French government would reduce its public deficit by €100 billion. In addition to the €45 billion in spending cuts, another €5 billion would come from closing tax loopholes; €35 billion from increased tax revenue as the economy recovers; and €15 billion from stopping temporary extra spending designed to boost the economy.

Reuters

French Premier Fillon on Saturday.

The government based its tax-revenue estimate on an expectation that the economy will grow 1.4% this year.

The Bank of France last week forecast growth of 0.5% in the second quarter, following an expansion of 0.1% in the first.

An announcement on raising the standard retirement age—likely to either 62 or 63 from 60—is expected Wednesday.

The opposition Socialist Party has been campaigning against a rise in the retirement age. Ségolène Royal, Mr. Sarkozy's opponent in the 2007 presidential election, told the Canal Plus TV channel that the government plan was a "swindle.

"By putting back the retirement age, they are preparing the way for 'Work more to earn less,' " she said, playing on Mr. Sarkozy's election slogan, "Work more to earn more."

EUROPE NEWS

Belgian vote reflects linguistic split

By Charles Forelle

BRUSSELS—A right-leaning Flemish nationalist party and francophone Socialists both had strong showings in federal elections on Sunday, suggesting linguistically riven Belgium faces weeks or months more without a government.

As voters went to the polls, a sour economy and the precarious state of public finances were overshadowed by a spat over the structure of the wobbly federal system that uneasily binds Dutch-speaking Flanders and French-speaking Wallonia.

Flanders turned in stunning numbers to the Nieuw-Vlaamse Alliantie, or N-VA, which didn't even field candidates on its own in 2007 elections. With about two-thirds of the ballots counted Sunday night, it claimed 19% of the nationwide vote—more than any other party.

Exit polls and media surveys suggested the French-speaking Socialist Party will vie for the lead in parliamentary seats once all the results are in, but the N-VA's strong showing will give fresh impetus to demands from the Dutch-speaking north to devolve more power—and money—to regional governments.

The split election results set up grueling negotiations to form a federal government, just as Belgium prepares to take over the rotating presidency of the European Union and as it tackles a public-debt mountain that is among the loftiest in Europe.

Associated Press

Voters cast their ballots in St. Joris Weert, Belgium, on Sunday. The results set up tough negotiations to form a coalition.

Finding agreement will be hard. There are no national political parties in Belgium. Christian Democrats, socialists and classical liberals on both sides of the language divide will jockey for spots in the government and concessions on policy.

The richer Flemings, who make up about 60% of Belgium's population, have for decades pushed for constitutional overhaul, but progress has been halting.

Under its leader, Bart De Wever, the N-VA has positioned itself as a more moderate alternative to the often xenophobic, extreme-right Vlaams Belang, which mingles anti-immigrant language with demands for an independent Flanders.

The strategy paid dividends. By late Sunday evening, it appeared that Vlaams Belang had lost about a third of its support—much of it likely to the N-VA.

An outright schism of Belgium remains only a far-flung possibility. The N-VA, which supports a "confederation" of two loosely attached regions, will instead press gradually to remove power from the federal government.

Just how much will be the No. 1 topic in coalition talks beginning Monday among the major parties. It remains unclear who will eventually be prime minister. Analysts say that post could wind up in the hands of Elio Di Rupo, the mayor of Mons, a city in Wallonia, and the president of the French-speaking Socialist Party.

At his victory party in Brussels, Mr. De Wever struck a conciliatory note. "We need a reform as big as possible," he said. But "we extend our hand to the francophones."

Mr. Di Rupo, speaking across town, signaled his agreement to a project of "state reform" and said "French-speaking elected officials must take a step toward Dutch-speaking officials, and Dutch-speaking officials must take a step toward French-speaking officials."

Sunday's elections were precipitated by the collapse of Belgium's multiparty coalition, which had taken months to assemble, over the alignment of electoral districts.

Under a 1963 deal between the two sides, Brussels, which is officially bilingual but overwhelmingly francophone, is grouped for electoral purposes with surrounding counties in Flanders.

Several suburban Brussels towns are majority French-speaking, despite being physically in Flanders. The electoral grouping means residents of those towns can vote for French-speaking politicians in Brussels. The N-VA and other Flemish parties want to split the electoral district, which would effectively limit the suburban francophones to choosing only among Flemish politicians. Belgium elects its parliament under a party-list system, in which voters choose parties, and seats within a district are divided up among parties in proportion to percentage of votes each gets.

—Matthew Dalton contributed to this article.

Slovakia looks set for change at helm

By Gordon Fairclough And Leos Rousek

PRAGUE—A group of right-leaning political parties dedicated to shrinking state spending looked set to form the Slovak Republic's next government after weekend elections, easing fears of deficit trouble in the euro zone's poorest country.

Four relatively conservative parties, led by the Slovak Democratic Christian Union, together won 44.1% of the vote, enough to take 79 seats in the 150-member parliament. That would put power in Bratislava, the capital, back in the hands of politicians who led a major privatization push and restructured welfare and pension programs in Slovakia from 1998 to 2006.

Slovak voters marched in step with a general rightward shift in European politics. Center-right parties also dominated May elections in the Czech Republic.

The party of the current prime minister, Robert Fico, the Smer-Social Democrats, which promised not to cut benefits to close the budget gap, took 34.8% of the vote, but it appeared highly unlikely Mr. Fico could form a viable coalition in a legislature dominated by right-leaning parties.

Slovak voters marched in step with a general rightward shift in European politics. Center-right parties also dominated in elections late last month in the neighboring Czech Republic. The two countries, which used to make up Czechoslovakia, separated amicably in 1993.

"Slovakia chose the path of responsibility that will help tackle its current problems," said Iveta Radicova, leader of the Slovak Democratic Christian Union, known by its Slovak acronym, SDKU. Ms. Radicova is likely to emerge as Slovakia's next prime minister. She would be the first woman to hold the post.

The SDKU and its allies have promised to rein in deficit spending. But they will face opposition from Mr. Fico, who in televised remarks Sunday promised a "very tough" fight against any moves to "change current labor laws and other social-protection rights."

Slovakia, which joined the euro zone at the start of 2009, had a government budget deficit equal to 6.8% of gross domestic product last year, more than two times the zone's limit of 3% of GDP. The country's national debt hit 41% of annual GDP this year, up from 28% in 2008. Still, the total debt is well below the euro zone ceiling of 60% of GDP.

As Slovakia's main export markets suffered last year, the country's economy contracted about 4.7%, after growth of 10.4% in 2007 and 6.8% in 2008. Ms. Radicova pledged in comments televised Sunday to "again turn Slovakia into Europe's tiger."

GULF OIL SPILL

Bloomberg News (2)

British Prime Minister David Cameron speaks by phone Saturday with U.S. President Barack Obama. Mr. Cameron expressed his "sadness" at the "human and environmental catastrophe" caused by the spill.

Obama pressures BP on damage fund

Company weighs call to nix dividend, set funds aside for those affected by spill; U.S., U.K. leaders try to ease tensions

By Amy Schatz
And Jeff Bater

WASHINGTON—President Barack Obama will demand that **BP** PLC create a special reserve account to pay for damages caused by the Gulf of Mexico oil spill, as the administration continued to push the company to act more aggressively to contain the spill.

White House adviser David Axelrod, speaking on NBC's "Meet the Press" Sunday, said Mr. Obama would call for the special fund in a Wednesday meeting with BP officials, including Chairman Carl-Henric Svanberg, after the president returns from a trip to assess cleanup efforts in Alabama, Mississippi and Florida on Monday and Tuesday.

The president "wants to lay out the steps that we're going to take from here to get through this crisis," Mr. Axelrod said.

"We're preparing our response and we want to respond constructively," a BP spokesman said Sunday. The company expects to discuss the issue with Mr. Obama on Wednesday, he said.

Mr. Obama will also address the nation on the spill after his trip to the Gulf.

House Minority Leader John Boehner (R., Ohio) said Congress should change the law so that there would be no restrictions on the amount BP could potentially pay in economic damages. "I think lifting the liability cap on BP and for this spill is appropriate," he told **ABC**'s "This Week." "BP needs to pay for the entire cost of this," he said.

The new demands come as BP board members prepare to meet Monday to discuss the spill and the Obama administration's call for BP to nix the company's second-quarter dividend payout. White House officials want the money to be placed in an escrow account for those affected by the oil spill. The fund should be administered by an independent third party, Mr. Axelrod said.

State officials in the Gulf Coast region have also demanded BP put billions of dollars into an escrow account to cover current and future claims by residents affected by the spill.

Florida Gov. Charlie Crist said he favored the establishment of such a fund. "What we can do is focus on making the people whole," he told CBS's "Face the Nation" on Sunday.

Coast Guard Adm. Thad Allen, who is overseeing the federal response to the spill, also addressed the idea of a third party-managed fund. "We've been very concerned about the claims process," he said on the same show. "This is not a core function of an oil-producing company."

Mr. Axelrod on Sunday declined to say whether the Obama administration wanted to use part of a proposed, \$50 billion aid package for state and local governments to help Gulf Coast residents.

The White House on Saturday sent a letter to Capitol Hill lawmakers asking them to approve the package to help state and local governments cope with weak economic conditions and avoid layoffs. It isn't clear if Congress would agree to such a package, given growing concerns among voters and many lawmakers over the federal government's rising budget deficits. Mr. Boehner on Sunday such raised concerns about the request.

On Saturday, the Coast Guard gave BP two days to come up with a more aggressive plan to contain the oil spill. Oil has been gushing into the Gulf of Mexico since April 20, when BP's Deepwater Horizon rig exploded.

More capacity to control the leak was "urgently needed" and BP's current plans don't provide enough redundancy measures, U.S. Coast Guard Rear Admiral James Watson told the company in a letter on Friday that was released publicly on Saturday.

"I am concerned that your current plans do not provide for maximum mobilization of resources to provide the needed collection capacity consistent with the revised flow estimates," Adm. Watson wrote.

U.S. officials now estimate that as much as 40,000 barrels of oil are spilling into the Gulf each day, despite BP's efforts to cap the well.

A BP spokesman on Saturday said the company was reviewing the Coast Guard's demand.

On Saturday, Mr. Obama spoke with British Prime Minister David Cameron about the oil spill, as officials on both sides of the Atlantic sought to ease tensions over the issue.

British investors have expressed concern over Mr. Obama's demands that BP cancel its dividend. Many Americans say the company shouldn't be rewarding shareholders while oil continues to spill into the Gulf and wash onto U.S. shores.

"The state of Alabama is being negatively affected," said Alabama Gov. Bob Riley on CNN's "State of the Union" Sunday morning. "It's going to have to be taken care of, either by BP or someone else."

Mr. Riley and other officials in the region are expressing increasing impatience with the federal government's response to the spill, which could continue until August, when relief wells to divert the oil are scheduled to be completed.

A Federal Reserve report on the U.S. economy last week said business contacts indicated that the potential impact on the tourism industry along the coastlines of Louisiana, Mississippi, Alabama and western Florida could be substantial.

Rep. Steny Hoyer (D., Md.) said, "BP has not been accurate in its representations. It has been misleading...[and] what has happened is outrageous and the American public are, correctly, very, very angry."

Rep. Mike Pence (R., Ind.), also appearing on "State of the Union," said the Obama administration was slow to respond to the spill. "That's our coastline and the president should be marshaling every resource," he said.

Rep. James Clyburn (D., S.C.) defended the administration's efforts. "There must be 12, 14, almost 20 entities involved. Managing that gets clumsy," he told CNN. "But I do believe the president is much more hands on at this point than he was at the beginning."

—Andrew Morse contributed to this article.

Scientists try to gauge risk to region

By Robert Lee Hotz

Dissolving into patches, sheens, tarballs and microdrops, the oil slick spreading from BP PLC's damaged well in the Gulf of Mexico is creating a unique mosaic of potential hazards that has experts scrambling to understand its potential impact.

It is a spill like no other, taking place far under water and spreading in layers of more-shallow water and on the surface, unlike more-common spills that occur on the surface alone.

The oil and the dispersants being used to dissolve it are potent variables in the biochemical equation of life across the Gulf, said several marine biologists, oceanographers and wildlife experts are working to understand how large or long-lasting the region's problems may become. "This is a three-dimensional spill," said Columbia University oceanographer Ajit Subramaniam. "The physics, the chemistry and the biology action are very different when you have oil released from below."

The well's location some 80 kilometers off Louisiana's coast, in an area marked by extensive marine diversity, has heightened scientists' concern about potential damage. Around the spill zone, marine researchers have cataloged 1,728 species of plants and animals. Of those, 135 are unique to the area and 74 species are endangered, according to a comprehensive marine survey.

Ideally, the scientists said, eddy currents may continue to sequester much of the oil offshore, where naturally occurring bacteria can safely break down the toxic petroleum compounds.

Under the worst-case scenario, however, the oil spill could fundamentally alter the marine chemistry of the Gulf, making it less hospitable to the marine life that makes the region a valuable commercial fishery .

What Deepwater teaches us about assessing near misses

[The Numbers Guy]

By Carl Bialik

While there never has been an oil spill in the Gulf of Mexico quite as large as the current disaster, there have been other terrible mishaps and, as in every industry, near misses.

These close calls are what Scott Shappell, professor of industrial engineering at Clemson University, looks for when he works with airlines on quantifying their risk from human errors.

"All you hear about are crashes, but it's the near misses that are telling," Prof. Shappell says. "If you only knew how many near misses there are in aviation, you would never fly again."

Near misses can be studied by statisticians to estimate the probability of an event that hasn't occurred before. Estimating the probability of unlikely disasters has become standard practice for nuclear and space regulators. Such an exercise, experts say, could help companies involved in deep-sea drilling evaluate risks and possibly prevent catastrophes like the Gulf oil spill.

Nuclear-power companies have used a tool for quantifying risk known as probability risk assessment, or PRA, since the 1970s; the National Aeronautics and Space Administration adopted the process in the 1980s. PRA takes into account the many possible failures of machines and people. It can be used to set a ceiling on allowable risk, and to identify and repair trouble spots.

"It's been really handy," says Robert Doremus, manager of the NASA shuttle program's safety and mission assurance office. "It has helped us step back and say, where are our high-risk areas?"

BPPLC didn't analyze its drilling in this way before the Deepwater Horizon explosion created a massive oil spill in the Gulf of Mexico, says spokesman Jon Pack. Instead, the company concluded, based on the history of drilling in the region, that a blowout was a "low-likelihood" event. "We don't grade the risk in terms of percent likely to happen," Mr. Pack says. "It's not quite as scientifically hugely detailed." Minerals Management Service, which oversees offshore drilling, didn't respond to requests for comment.

The probability estimate is just one piece of a risk assessment. The other is quantifying just how much damage a rare event, like a massive oil spill, would cause. "What is important is, what is the damage?" says Manfred Gilli, an economist at the University of Geneva. "If something happens with high probability but just a few fishes die, well, sorry for the fishes."

The nuclear-power industry takes a somewhat different approach, one that analyzes the engineering of the plant and tabulates every possible series of unfortunate events that could lead to the release of dangerous radioactive material, including equipment failure, operator error and extreme weather. Statisticians tabulate the probability of each disastrous scenario and add them together.

For the 104 nuclear reactors in commission in the U.S., the probability of core damage ranges from "several chances in a thousand per year of operation for a reactor, all the way down into the one-in-10-million-per-reactor-year range," says Scott Burnell, spokesman for the Nuclear Regulatory Commission. Core damage doesn't guarantee release of radioactivity, which the agency sets a goal of keeping below a one-in-a-million long shot at each plant.

While the probability of any single reactor melting down in any one year may be low, the chance of a nuclear accident somewhere at some time is far higher. The same applies to the BP spill.

For NASA, the risks are much higher. The agency puts the chance of any one shuttle mission ending in disaster—loss of crew and vehicle—at one in 89. That's better than the demonstrated reliability of one in 66—two shuttle disasters, Challenger and Columbia, in 132 completed missions, as Mr. Doremus notes.

Yet the estimated risk for shuttles has crept up at times over the years, even as NASA has worked on safety, because the agency has incorporated more possible risks and changed the statistical formula it used. The latest calculation, produced by a team of NASA staffers, takes into account the risk that orbiter-flight software might fail or that a bad event could unfold during a space walk. That creates the seemingly paradoxical situation in which missions might get safer even as reported risk increases.

There also is some danger in producing risk assessments that are too precise. "Most laypeople want a single number," says Todd Paulos, chief technology officer for **Alejo Engineering** Inc. in Huntington Beach, Calif., but "we can't predict anything to that accuracy."

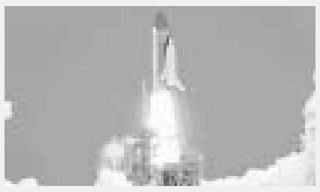
The wild card in all these estimates is human error. Nuclear-power companies for years have sought to calculate and reduce risk by evaluating how people respond to simulations of potentially dangerous situations.

In light of the spill in the Gulf, it wouldn't be surprising if drilling companies examined their own risk levels. "Now there is going to be a burst of PRA in the oil business," Dr. Paulos predicts. Of course, "doing it after the fact doesn't help you before the fact."

Learn more about this topic at WSJ.com/NumbersGuy. Email numbersguy@wsj.com.

OIL RIGS: The risk of problems increases as companies move to drill in deeper and more remote places.

NUCLEAR POWER: The U.S. sets a goal of less than a one-in-a-million chance of any reactor releasing radioactivity each year.

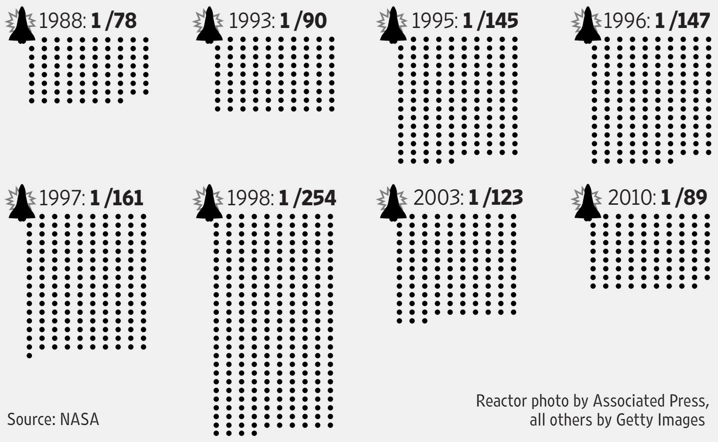


SPACE SHUTTLE: NASA estimates the chance of a shuttle disaster is 1 in 89. Two of 132 missions have been lost in flight.

AVIATION: Airlines study near misses to estimate crash probabilities and understand how human fallibility can increase risk.

Risky business

NASA frequently has changed the odds of a space shuttle flight resulting in the loss of vehicle and crew. (More dots = lower risk)



Source: NASA

Reactor photo by Associated Press, all others by Getty Images

Chevron presses for deep-sea oil

Continued from first page

water exploration.

While Mr. Watson wouldn't directly criticize BP, he said that even before the current disaster, Chevron had in place policies and procedures that might have avoided the oil-well blowout that caused the spill.

"This incident was preventable," Mr. Watson said.

In the early days of the Gulf disaster, the oil industry mostly presented a united front, with little criticism of BP and the other companies involved in the well. But as the crisis has dragged on, companies have begun to distance themselves from BP.

Mr. Watson and the CEOs of several other big oil companies are almost certain to try to draw distinctions when they face questions from a Congressional panel on Tuesday.

Chevron has a powerful incentive to make its case strongly. Its shares have fallen nearly 10% since the Deepwater Horizon drilling rig caught fire April 20; though that drops is small compared to the BP's market valuation, by comparison, has declined 46%.

Mr. Watson said he understood the decision to halt drilling in the immediate aftermath of the disaster, which he called a "humbling experience for the industry." But he said the industry's overall safety record is strong, and that both industry and government panels have drawn up new safety recommendations in light of the spill.

"We favor rapid adoption of those recommendations," Mr. Watson said.

Environmental groups, however, oppose a quick return to drilling. David Goldston, director of government affairs for the **Natural Resources Defense Council**, said drilling shouldn't resume until a presidential commission appointed to investigate the disaster completes its work.

"We don't really understand a lot about what happened here," Mr. Goldston said. "We don't really understand how endemic the problems are, and that all needs to be sorted out before drilling is resumed."

BP has been criticized by some industry experts for using a risky well design that could have made it easier for natural gas to get into the well and cause the explosion.

Chevron uses a safer well design, said Gary Luquette, who heads North American exploration and production for Chevron.

"I think that if we'd have had best practices employed on this well we wouldn't have this situation that we have today," Mr. Luquette said.

BP has said its well design wasn't unusual and that its engineers evaluate many different factors in deciding how to drill.

Many Gulf coast residents and politicians have also accused BP of being unprepared for the spill. Chevron has a "robust" system in place to deal with major spills, Mr. Watson and Mr. Luquette said, but they acknowledged that it, too, would have had difficulty dealing with a disaster of this magnitude.

U.S. NEWS

A most upsetting victory

DeMint came from nowhere to win South Carolina race. But how?

BY VALERIE BAUERLEIN

Sen. Jim DeMint's re-election in South Carolina is one of the easiest political predictions of the year. But the race for his seat has suddenly turned into a mystery.

The rise of unemployed veteran Alvin Greene as the Democratic nominee for U.S. Senate is befuddling Democrats and delighting Republicans.

State Democrats have been swapping theories about how it came to pass that voters chose an unknown candidate, with no website, no yard signs, no money and no staff. He didn't even show up at the party convention where other candidates spoke.

Mr. Greene, a 32-year-old unemployed veteran who was recently charged with felony obscenity charges, seems to have benefited from unusual circumstances. His name appeared first alphabetically on a ballot for U.S. Senate, a contest that was an afterthought to the hotly contested governor's race.

Mr. Greene, who lives with his father in rural Manning, population 3,900, stunned the state Tuesday night when he won 58% of the Democratic primary vote for the Senate with 100,362 votes. He defeated Vic Rawl, a former state judge and Charleston legislator.

Mr. Greene's chances of victory in the November elections are slim. Mr. DeMint remains popular in the state, he has a large fund-raising machine and few Democratic candidates have done well in statewide elections in South Carolina.

U.S. Rep. Jim Clyburn of South Carolina, a Democrat who is the third-ranking member in the House, has asked for a federal investigation, saying he suspected someone may have illegally put Mr. Greene up to run. He also questioned whether the challenger in his own primary was a plant. The challenger, Gregory Brown, couldn't be reached for comment.

The State Law Enforcement Division is investigating the Senate race. SLED Director Reggie Lloyd and U.S. Attorney William Nettles declined to comment.

Mr. Clyburn and others are questioning how Mr. Greene paid a $10,400 party filling fee when he had no visible means of support, beyond unemployment-insurance checks. Mr. Greene has been assigned a public defender in his court case, which stems from alleged sexual advances he made on a University of South Carolina student last year. Mr. Greene declined to comment on the pending charges.

He was emphatic, though, that no one put him up to running. "I funded my campaign in the primary with my personal money," he said, adding that his platform focuses on jobs, education and justice.

"I am the best candidate for South Carolina in the U.S. Senate race."South Carolina Democratic Party Chairwoman Carol Fowler said that during the filing period in March, Mr. Greene walked into the party's Columbia headquarters and handed her a personal check for $10,400. She asked him for a campaign check instead and he soon returned with a check from a new account with "Alvin M. Greene for Senate" hand-written in the upper-left-hand corner. Ms. Fowler said she tried to dissuade him from running, but he was determined.

Ms. Fowler asked Mr. Greene to withdraw this week after he won the primary when she learned of the pending criminal charge, but he has refused.

"I was accepting of Alvin Greene's nomination until I found out that he has been indicted for a sex crime," she said. "At that point, I said, 'We want our candidate to be the kind of people South Carolinians can happily vote for.'"

Democratic Rep. Todd Rutherford went an hour to Manning on Thursday to meet Mr. Greene for himself. "It was like talking to a child," Mr. Rutherford said. "It became very clear to me that this guy is special. If there's a joke, he's not in on it."

Mr. Rutherford, who is black, said several of his family members voted for Mr. Greene because they weren't familiar with either candidate and they thought Mr. Greene had the more African-American name.

South Carolina is 28% black, and Democratic leaders estimate blacks represented as much as 70% of Tuesday's primary turnout. But there is also precedent in the state for the type of interference alleged by Mr. Clyburn.

GOP consultant Rod Shealy was convicted of failing to report campaign donations to a destitute black fisherman he recruited to run in the 1990 primaries for Congress on the GOP ticket, in part to motivate white voters. Mr. Shealy, who was fined $500, continues to be one of the state's most sought-after consultants. He did not respond to a request for comment.

Federal election officials say Mr. Greene hasn't filed any financial disclosure forms, or campaign-finance disclosures, though he isn't required to if he doesn't raise or spend more than $5,000. Neither the party nor Mr. Rawl, whom he defeated, has filed a complaint, a spokeswoman for the Federal Election Commission said.

But election-law experts say it would be difficult to prove malfeasance, since it isn't a crime to give someone $10,400 as a gift, even if that person in turn decides to use the money to file for office.

Mr. Rawl's campaign is questioning the election results, including potential voting-machine malfunctions and what Rawl campaign manager Walter Ludwig described as "odd turnout results," such as Mr. Greene receiving 75% of the vote in more than 300 precincts. The campaign said Friday a statistical analysis by two outside experts showed unusual voting patterns.

State Senate Minority Leader John Land said the Greene home is three miles from his Manning law office, and he has been acquainted with the family for more than 50 years. Still, he didn't know Mr. Greene was running for Senate until he won.

"I don't believe that he would've run for the wrong purpose," Mr. Land said. "It's just the craziest thing I've ever seen in politics."

Alvin Greene, shown this past week, won the Democratic nomination for U.S. Senate in South Carolina. His opponent questions the results.

Uphill fight

$6.3 million
Amount Sen. Jim DeMint has raised this election cycle

54%
DeMint's share of the vote in the 2004 election

1998
Last time a Democrat won the seat (Ernest Hollings, who was first elected in 1966)

16, 17 and 9 points
Republican margin of victory in the three most recent presidential elections

Sources: Center for Responsive Politics; Congressional Quarterly
Photo: Associated Press

Kagan played a role in Clinton sex suit

BY JESS BRAVIN

WASHINGTON—Supreme Court nominee Elena Kagan, as a White House lawyer in the 1990s, played a role in President Bill Clinton's efforts to stall a sexual-harassment lawsuit stemming from his time as Arkansas governor.

Ms. Kagan's role in fighting the suit is one of dozens of issues covered in documents released Friday by the William J. Clinton Presidential Library.

The documents illustrate the vast range of topics she touched as a White House lawyer and domestic-policy aide, as well as Ms. Kagan's own ambition. The materials include her unsuccessful application for nomination as assistant attorney general, and her later effort to secure a federal judgeship, which failed in 2001 when Senate Republicans let her nomination expire without taking action.

The harassment lawsuit was filed in 1994 by a former Arkansas state employee, Paula Jones, who alleged that in 1991 then-Gov. Clinton propositioned her in a Little Rock hotel. Mr. Clinton contended the suit, partially funded by a conservative foundation, was a political effort to disrupt his presidency, and sought to have it dismissed or at least delayed until he left office.

After losing before the federal appeals court in St. Louis, Mr. Clinton appealed to the Supreme Court.

The Clinton Library, an arm of the National Archives, withheld many documents related to the Jones case, so the full extent of Ms. Kagan's work on it is unclear. However, in materials that were released, she monitors and comments on legal developments as the case approached the high court.

"Some ambiguous news on the Paula Jones front," she wrote in a June 1996 memo, as the justices were weighing whether to hear the president's appeal.

"The worst-case scenario is that the court has decided to deny" the president's petition, but had yet to issue an order "because someone is writing a dissent from the denial." But "the best-case scenario is that one or more justices asked to postpone consideration" of the matter.

The court did take the case and heard argument in January 1997. In a unanimous decision, the court rejected Mr. Clinton's appeal.

The president's "effort to construct an immunity from suit for unofficial acts grounded purely in the identity of his office is unsupported by precedent," the court found. The opinion's author was Justice John Paul Stevens, whom Ms. Kagan could succeed on the high court.

The court dismissed Mr. Clinton's argument that defending against the suit could interfere with his duties as president. "It appears to us highly unlikely to occupy any substantial amount of petitioner's time," Justice Stevens wrote, a prediction that proved unfounded as related proceedings, including an investigation by independent counsel Kenneth Starr, led to Mr. Clinton's impeachment and acquittal. The Jones case eventually was settled.

An Obama White House aide said Ms. Kagan wasn't crafting litigation strategy in the Paula Jones case and focused on more routine work such as reviewing documents.

As a White House aide, Ms. Kagan, now the solicitor general, took part in many of the policy debates that defined the Clinton era. In one memo, she took on a case in which a landlord argued it would interfere with her religious views to rent to an unmarried couple.

Associated Press

Supreme Court nominee Elena Kagan on Capitol Hill in May.

Obama makes plea for state aid

BY JEFF BATER

President Barack Obama urged lawmakers to approve more measures to aid state and local governments hit by the economic downturn, but concern over the U.S.'s mounting debt could snarl passage.

Mr. Obama on Saturday sent a letter to lawmakers calling for swift action to help U.S. small businesses and state and local governments facing budget cuts, as the country continues to grapple with the aftereffects of the global financial crisis.

"It is essential that we continue to explore additional measures to spur job creation and build momentum toward recovery, even as we establish a path to long-term fiscal discipline," Mr. Obama said in the letter to congressional leaders, a copy of which was seen by The Wall Street Journal. It said that the economic impact of budget cuts at the state and local levels were leading to "massive layoffs of teachers, police and firefighters," and that 84,000 jobs in state and local governments had already been lost so far this year. Mr. Obama said "hundreds of thousands of additional jobs" could be lost.

Workers challenge Beijing's authority

Labor unrest is dilemma for Communist Party

BY NORIHIKO SHIROUZU

BEIJING—Some workers at a **Honda Motor** Co. plant in southern China pressed ahead with a strike Sunday as part of a wave of labor unrest that poses a political challenge for the Communist Party, whose authority in the workplace is being undermined by independent labor activists.

A number of workers at the plant agreed to a new wage-and-benefits package offered by the factory's management and returned to their jobs to resume some production Saturday, Honda spokesman Takayuki Fujii said.

But he said it was "far too early to declare an end" to the strike at Honda Lock (Guangdong) Co., which produces vehicle-key systems near the industrial city of Guangzhou. Many of the plant's more than 1,500 workers were still on strike.

The success of strikers at three Honda parts factories near Guangzhou in winning concessions is creating a dilemma for the Communist Party, which wants to be seen as supporting better conditions for workers yet is fearful that strikes led by militant workers could escalate into broader demands for more autonomous unions and pose a threat to its unchallenged rule.

All three strikes have been led by workers acting outside the state-sponsored All China Federation of Trade Unions, which, together with company managements, usually selects the leaders of state-controlled unions at such plants, according to labor experts.

Labor experts monitoring disputes in China said that one of the demands of workers at the key-systems factory is to elect their own leaders in their government-sanctioned union, according to Geoffrey Crothall, spokesman for China Labor Bulletin, a Hong Kong-based labor-rights group.

"Workers at the Honda parts plant are openly stating that the official trade union in their factory is useless," said Mr. Crothall. "That's what workers have told us. It is in the Internet chat rooms. They are very open about it."

Reports of such a move couldn't be independently confirmed by The Wall Street Journal, however.

Labor experts believe the party's leaders are very concerned about a scenario like that in Poland in the late 1980s in which an independent labor-union movement led to the overthrow of the Polish government and contributed to the dismantling of the entire Eastern bloc under the Soviet Union.

Labor experts say the question that the Communist Party needs to ask is whether suppressing the move toward allowing more independent labor unions also risks fanning more discontent. "The recent spate of labor unrest is the result of pent-up unhappiness among China's low-wage workers bubbling up to the surface," said Andreas Lauffs, head of law firm Baker & McKenzie's employment-law group in Hong Kong. "The fact that workers reportedly have started demanding the right to set up independent labor unions adds a political dimension to the labor unrest."

Last month, Honda gave striking workers at a gearbox supplier, who had paralyzed Honda's manufacturing operation in China for 10 days, a 24% increase in pay and benefits. The wildcat strike was led by a group of leaders who rivaled the factory's official, state-led and management-friendly union, which took the side of the company's management and tried to persuade the striking workers to return to work.

Tan Guocheng, one of the strike leaders who was fired along with another worker May 22, said that one of the group's major demands was that "the work union's representatives should be elected by workers." Mr. Fujii, the Honda spokesman, said the two workers were let go for violating the plant's in-house work and contract rules but not for leading the walkout.

Encouraged by the success of the strike at the gearbox plant, workers at two additional Honda parts plants near Guangzhou walked off the job last week. One strike was resolved midweek after the workers accepted a wage increase.

Mr. Fujii said the workers at the gearbox factory, which was established in 2006, were given a chance at the outset to select leaders for the official union but opted instead to receive a leader from a local chapter of the All China Federation of Trade Unions. "Some of the workers are so new at the plant that they apparently don't know that history," Mr. Fujii said. He declined to comment on the situation at the other two parts factories, citing lack of knowledge.

Labor experts say the federation has a target to start collective bargaining across the board in all companies around China by the end of 2011. Currently, wages and other conditions are generally set by management.

However, the global economic crisis has derailed those plans, and there has been little progress towards that objective.

From the workers' point of view, "these state-controlled unions don't do anything. And where they exist, they are management-friendly and they don't really represent the employees," said a Western expert who declined to be quoted because of the sensitive nature of his comment.

Workers at the Honda parts plants in southern China decided, in the absence of help from the official union, to press the issues on their own, calling for higher wages, better work conditions and, in some cases, a new election to install their own leaders in the official unions.

At the gearbox factory, the strike leaders made their demands to management through the official state-controlled union. Honda executives said the union is trying to persuade the strikers to return promptly to work.

Many experts deem it highly unlikely that the government will allow workers such as those at the Honda Lock factory to install labor representatives of their choice. If China's workers were able to elect their union leaders democratically, it would mark a watershed in the country's labor movement.

Real change will come when "the Chinese government tolerates a more autonomous worker organization," said Mary Gallagher, a University of Michigan professor who is an expert on Chinese labor issues.

Bloomberg News

A manager at a Honda Lock (Guangdong) Co. plant near Guangzhou ries to persuade workers to return to work Saturday.

Europe's problems vex Asian exporters, and pain could worsen if demand falls

[The Outlook]

BY ALEX FRANGOS

HONG KONG—Economic woes in Europe and the accompanying decline in the euro are already digging into the profits of Asia's manufacturers. The worry is that the pain will spread more broadly if European demand for Asian exports falters.

Companies based in Asia that sell everything from sweaters to solar panels in Europe are feeling the pinch already.

Orders placed last year when the euro was 20% stronger against local currencies are now forcing Asian businesses to take losses or renegotiate prices with European customers.

"For euro-based orders, we could lose our shirts and pants and underwear," says Willy Lin, managing director of **Milo's Knitwear International** Ltd., a 52-year-old, family-owned sweater maker based in Hong Kong that caters to high-end European labels.

The euro's move could prove a temporary annoyance. The bigger question is whether a slowdown in Europe will sap demand over the longer term for Asian goods.

It's critical because Asia's manufacturing economies have become the engines of global growth. And Asia needs Europe as a customer. The European Union accounts for around 13% of exports from Asia's 10 largest economies, excluding Japan, according to Singapore-based bank DBS. The U.S. makes up 11%.

Trade data don't show ill effects from Europe's stumbles yet.

China's May exports grew 48.5% from the year before, or 10.9% on a seasonally adjusted basis from the month before. Korea and Taiwan have also reported strong May trade figures. But exports don't respond instantly.

Cuts in European government spending could have "very negative effects on developing countries that rely on exports for growth," said International Monetary Fund Managing Director Dominique Strauss-Kahn, speaking earlier this month at the Group of 20 meeting of ministers in Busan, South Korea.

Asian economies, especially China, have been criticized for their export-oriented economic models. The countries have pledged to make their economies more reliant on internal demand, creating policies that encourage businesses and consumers to save less and spend more.

"Emerging-market countries have to take actions to advance their own growth to compensate," for a downturn in Europe, said Mr. Strauss-Kahn.

But those shifts could take years to show results. For now, Asia still needs the developed world to sustain its growth. Hence the worry about Europe.

China's solar panel industry has been particularly affected. **Solarfun Power Holdings Company** Ltd., a Shanghai-based solar-equipment manufacturer, gets 85% of its sales in Europe.

The euro's move added a cloud to strong recent profits, among the best since Solarfun was founded in 2005.

The company even recently lifted its earnings forecast for 2010, on expectations for continued strong demand despite the euro's drop.

Solarfun figures for every percentage-point decline in the euro versus the Chinese yuan, its profit margins shrink 0.4%, even after accounting for currency hedging.

"It's disruptive," says Solarfun Chief Financial Officer Gareth Kung. The euro's move has forced the company to renegotiate prices with customers in Europe and work harder to diversify its customer base to China and the U.S. "Long term, our concern is that the financial crisis in Europe will actually weaken the support for the European government to provide subsidies for the renewable industry," he said.

Some fear Asian banks and corporations that rely heavily on European banks for funding could be hurt by a credit crunch in Europe, or a return of the evaporation of trade finance seen during the 2008 financial crisis.

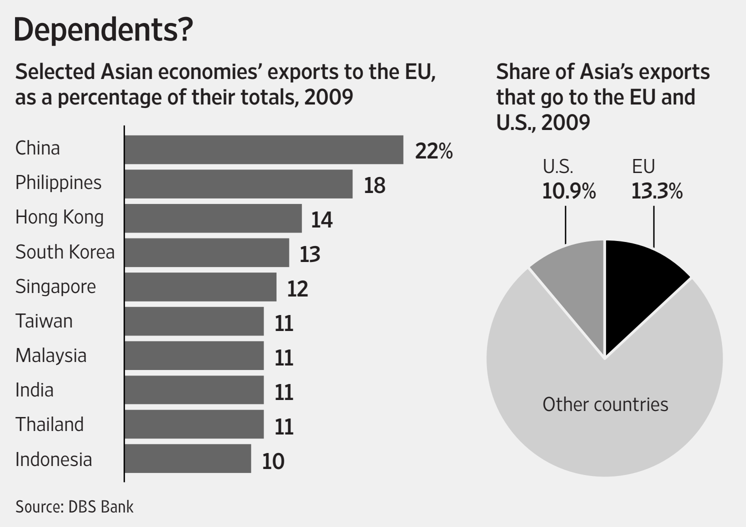
Of course, it's possible that Europe's debt woes won't cause too much damage in Asia. Some say Asia's export economies will do fine so long as the U.S. keeps growing, even if Europe slows.

Europe's most important economy, Germany, continues to show healthy growth and is likely to benefit from the weak euro. Intra-Asian trade has also picked up on the back of strong local consumer spending.

"You'll see continued pressure on Asian export growth, but it's not enough to be qualitatively less optimistic on Asia overall," says Eric Fishwick, chief economist at CLSA Asia Pacific Markets.

Still, the fears are real. Mr. Lin, whose company makes around a million sweaters a year in factories in China and Hong Kong, says its financial position is strong and the short-term pain is endurable.

Longer term, he worries that the euro's plunge will make his goods more expensive compared with those of competitors in north Africa. And the quick currency moves have made European customers more wary than Americans.



Seoul tries to calm the won's volatility

BY EVAN RAMSTAD

SEOUL—South Korean financial regulators on Sunday proposed new measures to level out swings in the value of the won, though officials took pains to say they didn't want to shock the currency market.

A sharp drop in the won turned out to be the most significant impact of the 2008 global financial crisis in South Korea. Last month, the country got another taste of currency volatility, when the won plunged suddenly over fears about debt levels in Europe and a verbal flare-up between the two Koreas over a ship sinking.

South Korean leaders and policy makers have often complained about the won's wild swings since 2008, but were reluctant to do something for fear of creating the appearance that they were interfering in capital markets. The currency's sudden drop last month pushed them to action, officials said.

"We want to introduce a minimum safety mechanism at a time when there is no big impact to the capital market or the real economic sectors," said Kim Yi-tae, director of the foreign-exchange division in South Korea's finance ministry.

The proposed regulations include limits on currency hedges, or forwards, and other derivatives by both domestic banks and international banks operating in South Korea. For domestic banks, the limit on forward positions, which includes all derivatives such as currency swaps and nondeliverable forwards, will be 50% of their capital measured at the end of the preceding month. For foreign banks operating in South Korea, the limit on forwards will be 250% of capital.

There were previously no limits on currency hedges in South Korea. One result was that the country's short-term debt grew sharply as South Korean shipbuilders, which booked record orders from 2005 to 2007, hedged the value of those orders with help from international banks. When the crisis hit, South Korea's high level of debt fueled a perception that the country might be a repayment risk, which helped drive a plunge in the won's value.

Policy makers on Sunday also proposed tightening the foreign-currency liquidity ratio of domestic banks and requiring the local operations of foreign banks to create a liquidity-risk management mechanism similar to one in the U.K. All the proposals must be reviewed and approved by a presidential committee on regulatory reform, a process that could take several weeks.

The effect of the measures is difficult to gauge because regulators created some loopholes to diminish the prospects of an immediate market impact. For instance, they said they would adjust hedging limits quarterly to accommodate market conditions. Kwon Goo-hoon, Korea economist for Goldman Sachs, said in a note published Sunday that he expects the rules will lead to a "reduction in liquidity in the Korean won forex markets" but won't have a significant effect on the value of the won against the U.S. dollar.