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Nine activists killed off Gaza

By JOSHUA MITNICK

TEL AVIV—At least nine activists were killed when Israeli commandos boarded a six-ship flotilla headed to the blockaded Gaza Strip early Monday, plunging Israel into a diplomatic crisis that could impede its goals on issues including Palestinian peace talks and sanctions against Iran.

The incident triggered rebukes from foes and several friends who questioned whether Israeli troops used excessive force in halting the flotilla, for which it had weeks to prepare.

Israel defended its actions, saying armed activists attacked soldiers as they were being lowered from a helicopter onto the deck of one of the ships. The Israeli army said at least one soldier's weapon was taken and turned against Israeli forces. An Israeli military spokesman said later in the day that some activists also appeared to be armed with their own guns.

Details of the boarding and the fighting that ensued weren't clear, with almost all information about the incident being provided by Israel's military.

Prime Minister Benjamin Netanyahu, in Canada Monday, canceled a visit slated for

Please turn to page 6



Palestinians burn an Israeli flag during a protest at Gaza's seaport against Israel's interception of ships bound for Gaza Monday.

Banks still stressed despite ECB moves

By DAVID ENRICH AND STEPHEN FIDLER

In the latest indication that European banks are in ill health, the European Central Bank warned late Monday that euro-zone banks face €195 billion (\$239.26 billion) in write-downs this year and the next due to an economic outlook that remained "clouded by uncertainty."

The ECB news, part of its semiannual financial-stability report, comes on the heels of a campaign by governments and central banks to ease

sovereign-debt problems in southern Europe. The efforts have failed to calm worries that a banking crisis may be forming on the Continent.

European governments already have cobbled together a €110 billion bailout for Greece and a €750 billion rescue for other weak economies of the euro zone. The ECB in May launched a series of initiatives, including the purchases of government debt from banks and the renewal of a program to give cheap six-month loans to banks, while the U.S. Federal Reserve

reactivated a swap line to provide European banks with dollars.

The moves helped provide some stability to the banks, but Europe's intertwined banking system remains stressed. Investors have hammered the sector, banks are stashing near-record amounts of deposits at the ECB—€305 billion as of Friday—instead of lending the funds to other institutions, risk-wary U.S. financial institutions are reducing their exposure to euro-zone banks, and U.S. government officials are

pushing their case for Europe to disclose publicly the results of stress tests for euro-zone banks.

ECB Vice President Lucas Papademos defended the central bank's approach and said results of European Union-wide stress tests of banks should be completed in July, providing further details on the capacity of the region's banks to withstand shocks. The results of stress tests last year of individual banks weren't released publicly. Some European countries are opposed to the public release

of results.

At the same time, the ECB warned Monday that the "continued reliance" of some midsize banks on credit from the central bank remains "a cause for concern." It didn't identify the banks nor say how many were too reliant on the ECB for funding.

European banks collectively hold hundreds of billions of euros of public and private debt in countries such as Greece, Spain and Portugal. Much of the private debt is tied to depressed real-estate markets.

Please turn to page 4

The Quirk

Kitty wants her pizza as flarf carries poetry to a new web dimension. **Page 33**

World Watch

A comprehensive rundown of news from around the world. **Pages 34-35**

Editorial & Opinion

A tea party in Prague. **Page 15**



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PAGE TWO

Rare blessing of the black economy

[Agenda]

BY BILL JAMIESON

Three weeks after the launch of a €750 billion (\$921.15 billion) emergency package to bolster the euro zone's debt-stricken economies, there is little sign of a turning of the tide.

Policy makers struggle with dire official figures on the state of Greece, Spain, Portugal and Italy. But it may be the unofficial, or underground, economy in these countries which may provide a cushion against social convulsion—and hope of salvation.

Certainly there is little in official circles to give cause for comfort. President Nicolas Sarkozy of France is proposing new financial governance machinery to prevent future debt crises. But his own country's triple-A credit status looks to be next in the crosshairs of the rating firms.

Doubts persist over whether the German Constitutional Court will back the arguments deployed by Chancellor Angela Merkel to justify her government's participation in the rescue package.

In Spain, there are fresh doubts over labor reforms demanded by the International Monetary Fund, the country's own central bank and others. The country's embattled socialist government under Prime Minister José Luis Rodríguez Zapatero has had to extend a deadline on agreeing the reforms. An opinion poll shows most Spaniards now want early elections in which the conservative opposition would be likely to emerge a clear winner. And as if these problems weren't enough, the two largest trade unions are calling a general strike.

Euro-zone countries such as Spain, Portugal, Italy and now France have almost fallen over themselves in their anxiety to announce austerity packages before apprehensive bond investors leave them no alternative. But the very austerity



Spanish Prime Minister José Luis Rodríguez Zapatero in Madrid last week.

programs intended to cauterize the rise in debt are as likely to make it worse, as domestic spending is depressed, tax revenue falls and more citizens become dependent on state welfare.

After Greece, the next economy in the single-currency area likely to fall victim to this austerity Catch-22 is Spain. Its budget deficit at 11.2% of gross domestic

The wonder is that there has been so little labor protest to date in Spain, despite high unemployment.

product is the highest after Greece. Friday, rating agency Fitch & Co downgraded its country debt rating from triple-A to double-A-plus. In its explanatory note, Fitch argued that "the process of adjustment to a lower level of private-sector and external indebtedness will materially reduce the rate of growth of the Spanish economy over the medium term."

A slower growth rate—and with the economy growing at just 0.1% in the first quarter, a relapse into recession is a risk—would be lethal for Spain. One of the factors influencing the latest rating downgrade is the country's extremely high unemployment

rate of 20.5%. Out of the 4.6 million unemployed, 3.2 million receive some form of federal benefit. All told, payments relating to unemployment totalled €40 billion last year, equivalent to 3.9% of GDP or 10% of the budget deficit.

Moreover, this 4.6 million total is before the latest package of spending cuts forced through the Cortes. The clear and present danger is that further austerity will enlarge rather than shrink the deficit: a perverse and deadly spiral that could entrap the economy in low growth for years.

Arguably the bigger question is how economies with such high rates of unemployment can avoid deep social unrest. Considering that unemployment in Spain was running at more than 10% two years ago and that it has never fallen below 8% in recent history, the wonder is that there has been so little labor protest to date.

One key reason, necessarily absent from the official statistics, is the size of the informal or twilight economy. Official figures show unemployment to be upwards of 10% in Greece, 8.8% in Italy and 10.1% in Portugal. Common to these economies is a large tourist and leisure services industry. Spain has long been the world's second-biggest tourist destination, catering for almost 60 million foreign visitors annually. Prior to the crisis, tourism contributed more than

11% of Spain's GDP and represented more than two million jobs.

In this sector, many day-to-day transactions, for ease, convenience and speed, are typically undertaken in cash. But the preference for cash settlement spreads wider. U.K. citizens with property in Spain speak of almost all household requirements—plumbing, wiring, decorating, repairs and maintenance—being undertaken for cash. "You would get a very odd look", says one semi-retired British subject with property in southern Spain, "if you offered a check. Almost all our household needs are settled in cash."

By its very nature the underground or invisible economy is impossible to measure with precision. But across southern European countries, the settling of bills for goods and services tends to be a cash transaction, sustaining livelihoods in tourism and the service economy that don't show up in the official statistics.

A 2002 study by Prof. Friedrich Schneider, of the Johannes Kepler University of Linz, estimated that the informal economy in developing countries was equivalent to 41% of their official GDP. The share of the informal economy was lower in OECD countries, but still far from negligible at 18%.

His study also found that the more expensive and complicated are taxes and regulations, the bigger is the informal economy as a share of GDP. That explains why, among rich countries, Spain, Greece, Italy and Belgium have some of the largest gray economies and why America, Canada and Switzerland have much smaller ones.

This may also provide the best hope for Spain and others to avoid a vicious social explosion. But it will also provide further impetus for those who see labor market deregulation as the long-overdue way out of despair.

—Bill Jamieson is Executive Editor of *The Scotsman*

What's News

■ **German President** Horst Köhler resigned unexpectedly, throwing his country into political confusion, after saying that criticism of his views on German military deployments abroad had shown a lack of respect for his office. 9

■ **U.S. and EU regulators** are monitoring the world's biggest container shipping lines for any evidence of price fixing as rates continue to rise even as the supply of new ships increases. 21

■ **BP began** its third attempt to contain oil from its leaking well in the Gulf, but the operation could make the spill worse in the short term. 10

■ **Steel mills are increasing** production quickly, prompting concern that excess supply will restrain prices. 24

■ **Georgian President** Saakashvili's ruling party was headed for victory in municipal elections, but observers said the vote was marked by "significant shortcomings." 12

Inside



The man behind constant reinvention at Pitney Bowes. 31



Global quest for North Korea's elusive World Cup shirt. 32

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1. Comic's Party Bests Rivals in Iceland Vote
2. A Tale of Two Students
3. More Than 10 Dead After Israel Intercepts Gaza Aid Convoy
4. After Debt Crisis, New Tension Between ECB, Germany
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NEWS

Pizza has a new king—from Japan

Akinari Pasquale Makishima credits his nation's attention to detail for his recreation of the authentic pie

By YOREE KOH

It's official: The world's best maker of traditional Neapolitan pizza goes by the name of Pasquale. Akinari Pasquale Makishima, to be precise.

The 33-year-old Japanese chef beat out a Naples-based pizzaiolo to win the top prize in an international bake-off in the Italian city, organized in May by the Associazione Verace Pizza Napoletana (Association for Genuine Neapolitan Pizza). Mr. Makishima's achievement marked the first time a Japanese chef took the title, topping a field of 150 chefs in a Renzo Piano-designed mall-cum-leisure center within erupting distance of Mount Vesuvius, including representatives from Italy, Spain and the U.S.

Despite some huffing and puffing in the local press — "How Humiliating, The King of Pizza Is Japanese", moaned one site — it was still, arguably, a very Italian win.

When it comes to Neapolitan

pizza, a dish where loyalty to tradition is absolute and entertaining creative thoughts like "fusion" and "deep pan" are blasphemous, the only trace of Mr. Makishima's Japanese background is in his strenuous attention to minute detail, a strength to which he attributes his recent victory and the rise of Neapolitan cooking in Japan. Indeed, the number of Japanese participating doubled to about 20 chefs in this year's competition, now in its ninth year. It's an attention to detail in reproducing non-Japanese food that's echoed in the quality of restaurants on offer in Tokyo, helping to make the city one of the world's top food destinations for both high- and low-end grub.

"The Japanese are very good at seriously studying every last detail," says Mr. Makishima. "I earnestly copied absolutely every aspect of how to make a traditional Neapolitan pizza so that mine tasted like a true Neapolitan pizza as much as possible." More than just relying on



Akinari Pasquale Makishima

the best ingredients available, Mr. Makishima, who has been spinning dough into pie for 10 years, said his ability to copy the craft helped him learn the proper way to break down tomatoes and remove water from

mozzarella cheese, fine techniques that if executed poorly can render the finished product with a sappy middle. Mr. Makishima worked at a restaurant in Naples—where he adopted the nickname Pasquale in tribute to a mentor—prior to his current gig as a chef at Cesari, an Italian restaurant in the not particularly Italianized city of Nagoya — better known as the home of Toyota.

Pizza is becoming a more familiar staple in Japan, which, despite matching Italy when it comes to maintaining the authenticity of its national cuisine, has increasingly embraced foreign foods at the expense of such mainstays as rice. A new-found taste for Western staples such as toast and pizza drove Japan's total grain imports up 71% in five years to \$7 billion in 2007.

Western companies are keen to exploit the shift. Global private-equity firm Bain Capital said in January it would buy the master franchise of Domino's Pizza Inc. in Japan

and expand the U.S. chain beyond Tokyo and Osaka.

The Japanese pizza-delivery segment has eked out an average 1.6% sales growth in recent years, even as the world's second-largest economy flirted with recession and restaurant chains battled deflation. Domino's managed to raise its prices in Japan in 2008 to help offset a 46% rise in cheese costs the previous year.

The franchise has protected its pricing power partly because pizza delivery is seen as an indulgence in Japan, compared with the casual affair of dialing up a late-night snack. Pizza-delivery makers combine unusual toppings and careful presentation to attract the discerning Japanese customer.

"When you buy a treat you are not trying to save every yen," said David Gross-Loh, a managing director at Bain in Tokyo during an interview.

—Alison Tudor and Hiroko Tabuchi contributed to this report.

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EUROPE NEWS

Germans, ECB spar over bond plan

Bundesbank sees European central bank's purchases of Greek bonds as stealth bailout for lenders holding the debt

BY DAVID CRAWFORD
AND BRIAN BLACKSTONE

BERLIN—The European Central Bank's intervention in European debt markets is exacerbating tensions with Germany's Bundesbank, where officials worry that the bond-buying program is being used for a stealth bailout of euro-zone banks holding Greek debt, according to people familiar with the matter.

Senior Bundesbank officials have questioned the ECB's rationale for intervening in the Greek bond market instead of focusing its support on other vulnerable countries, such as Portugal and Spain, that unlike Greece still depend on debt markets to fund their budgets, according to the people.

Greece received a financial rescue from other European countries and the International Monetary Fund of up to €110 billion (\$135 billion) last month, ending its reliance on capital markets for funding until at least 2012.

Since the European Central Bank began purchasing government bonds three weeks ago, it has spent about €25 billion on Greek debt, according to a senior Bundesbank official.

An ECB spokeswoman declined to comment. The ECB said Monday that a total of about €35 billion in euro-zone bond purchases settled through Friday. It doesn't provide a country breakdown, but market participants said the ECB also has purchased bonds issued by Portugal, Spain, Italy and Ireland.

ECB President Jean-Claude Trichet insists the central bank isn't financing deficits in Athens or anywhere else, but rather making dysfunctional segments of the markets work more smoothly. In a speech Monday, Mr. Trichet said lower bond prices "imply valuation losses" on bank balance sheets, which in



Bundesbank President Axel Weber (left) has criticized the bond-buying plan, while Jean-Claude Trichet defends it.

turn "may mean that they can supply fewer loans to the economy."

Lending figures from the ECB Monday showed that despite access to cheap ECB credit, commercial-bank lending to the private sector rose just 0.1% in April from one year ago, and loans to nonfinancial businesses continue to slide.

The ECB's bond purchases come amid concern over the integrity of European bank balance sheets. Risk indicators on European banks have risen in recent weeks as investors worry about the exposure the banks have to some euro-zone countries with heavy debt.

ECB critics within the Bundesbank said the price of Greek bonds is now largely irrelevant to Athens, making the main beneficiaries of the bond purchases the banks that hold

much of Greece's roughly €300 billion in outstanding debt. The Bundesbank's concerns were first reported by Germany's Der Spiegel magazine over the weekend.

Selling the Greek debt likely would be an attractive option to banks eager to avoid a debt restructuring that would force them to book losses. French banks are the largest holders of Greek debt, according to Bank for International Settlement estimates, followed by German lenders.

Some investors and economists believe that—despite the efforts of the EU, IMF and ECB—Greece eventually will have to restructure its debt, as a stagnant economy made worse by austerity measures is unable to generate the revenue needed to finance Athens's outstanding ob-

ligations.

The Bundesbank criticism signals a rift between the ECB and the conservative German central bank on which the ECB was modeled.

Bundesbank President Axel Weber attacked the bond-purchase plan within hours of its announcement on May 10, telling a German newspaper that he viewed the move "critically" and that it carried "substantial stability risks." He isn't backing down.

But Mr. Trichet hit back at the ECB's critics, saying that its program to buy government bonds in the market doesn't represent any weakening of its policy or independence.

"In simple words: We are not printing money," Mr. Trichet told a conference hosted by the Austrian

National Bank.

The ECB bought more than €26 billion of bonds, mainly from highly indebted countries such as Greece and Portugal, in the first two weeks of the program, which was announced May 10.

That amount has since increased, and the ECB said Monday that it will seek to absorb the €35 billion it has added to the system through those purchases of sovereign debt. It said it will conduct a tender on Tuesday to collect one-week, fixed-term deposits and another one next week.

"We haven't gone beyond our goal of re-establishing a more correct transmission mechanism of our monetary policy," said Mr. Trichet. He reminded the audience the bank is using other operations to take out all the money it puts into the market by buying bonds from banks.

While Mr. Trichet launched his detailed defense of the program Monday, Mr. Weber repeated in a speech at one of the Bundesbank's branches that he still sees the program "in a critical way."

Jürgen Stark, another prominent German central banker who sits on the ECB's executive committee, has echoed those concerns.

Others on the ECB have struck back at Germany's response to the crisis. In remarks Friday that private-sector economists said were clearly aimed at Germany, ECB member Lorenzo Bini Smaghi said that "one large euro-area country" thought public support for action could only be gained by "dramatizing the situation" and using rhetoric about the future of the euro being at risk or about possible expulsion from the euro zone, rhetoric that he said "could only increase" the cost of the rescue.

—Geoffrey T. Smith
and Roman Kessler
contributed to this article.

Banks still stressed despite central bank's moves

Continued from first page
tate markets, especially in Spain, and with growth prospects anemic, the pressure on outstanding bank loans isn't expected to diminish anytime soon.

The actions taken so far, while large in scale, "may not be enough," said Philippe Morel, a senior partner at Boston Consulting Group in Paris. "What's at risk is the banking system and the ability of banks to provide financing to the economy."

Like the financial crisis two years ago that was sparked by the unraveling of the U.S. subprime-mortgage industry, Europe's banking problems originated in a tiny patch of the global economy: Greece.

But the problems run deeper than the highly publicized fiscal woes facing Greece, prompting similar concerns about Portugal, Ireland and Spain.

Credit-ratings firms have reduced these countries' ratings and have warned about possible future downgrades, with Fitch reducing Spain's triple-A rating by one notch on Friday.

All told, more than €2 trillion of public and private debt from Greece, Spain and Portugal is sitting on the balance sheets of financial institu-

tions outside the three countries, according to a Royal Bank of Scotland report last week. Investors, bankers and government officials are worried that as that debt loses value, banks across Europe could be saddled with losses.

"Make no mistake: This is big," said Jacques Cailloux, RBS's chief European economist and the report's author. "We're talking about systemic risk [and] the potential for contagion."

The U.S. and U.K. moved aggressively in 2008 and 2009 to replenish their banks' capital buffers, sometimes with taxpayer funds.

Most of Europe didn't follow suit, because their banking systems were largely spared the carnage of their Anglo-American counterparts.

But as a result, most European banks today have thinner capital cushions and heavier debt loads than their U.S. and U.K. rivals, leaving them vulnerable to an economic slowdown.

"Some European banks have less capital and more leverage than their U.S. counterparts and...the crisis in Europe seems to have lagged behind that in the U.S. in both the writing off of losses and in the speed of raising more capital," said Angel

Gurria, secretary-general of the Organization for Economic Cooperation and Development, in a speech in May.

OECD figures show that a selection of major U.S. banks are operating with leverage ratios—the ratio of assets to common equity—of between 12 and 17. By comparison, the same ratio for a group of major European banks ranged from 21 to 49, according to the OECD.

European policy makers have been trying to address that disparity by working on a global overhaul of banking regulations, to be enacted in 2012, that would require banks to hold more capital and liquidity.

"But the regulatory fixes aren't going to solve the problem right now," said Michael Ben-Gad, an economics professor at City University London.

European governments and central bankers had hoped that bailing out Greece and launching a liquidity program would relieve immediate pressure on other governments and the banking sector. But that hasn't happened, and new pressures could arise soon.

The ECB last summer doled out €442 billion in one-year loans to eu-

ro-zone banks. Those loans come due June 30, potentially causing banks to scramble for a fresh source of cash this month.

European officials face calls from the banking industry, the investment community, and foreign government leaders, including U.S. Treasury Secretary Timothy Geithner, to redouble efforts to stabilize the banking system through new initiatives.

RBS's Mr. Cailloux argued that the ECB should expand its recently launched program to buy government bonds and should broaden the effort to include private-sector debt as well.

That could ease concerns that banks will suffer heavy losses, potentially blowing holes in their balance sheets, on their portfolios of sovereign and corporate bonds tied to some European economies. But such a move also could expose the central bank to potential losses.

Citigroup Inc. last week circulated a paper calling on the ECB to launch a sort of insurance program to allow holders of government bonds—a group largely consisting of European banks—to sell the securities to the ECB in case of default. "Time is now of the essence and the

authorities should continue to be bold and innovative in working to accelerate the impact of the available lines of support," Nazareth Festekjian, a Citigroup managing director, wrote in the paper.

The ECB had no comment on calls to increase the size of the bond-buying program or on the Citigroup recommendations.

Others want local European bank regulators to play a more proactive role monitoring their banks' exposures to troubled countries.

In the U.K., the Financial Services Authority has been conducting repeated stress tests of major British banks' exposures to southern Europe. Similarly intense efforts don't appear to be under way elsewhere in Europe, said Pat Newberry, chairman of the U.K. financial-services regulatory practice at PricewaterhouseCoopers LLP.

Mr. Newberry said conducting such tests would help European governments and banks get a better handle on their individual and collective vulnerabilities and to understand "how a series of unfortunate events can aggregate to turn a problem into a catastrophe."

—Brian Blackstone
contributed to this article.

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GAZA FLOTILLA

Deadly confrontation

Sunday afternoon

A six-ship flotilla sets sail for Gaza, departing a rendez-vous point in international waters, off the coast of Cyprus, in the Mediterranean Sea.

After nightfall Sunday

Three Israeli naval vessels depart Israeli port of Haifa, with orders to intercept the flotilla.

Two hours later

Israeli navy makes radio contact with flotilla and orders it to turn away from Gaza.

"If you ignore this order and enter the blockaded area, the Israeli navy will be forced to take all the necessary measures in order to enforce this blockade," the ships warned, according to the radio message broadcast on Israeli Army Radio and quoted by Associated Press.

4 a.m. Monday

Activists onshore lose satellite phone and email contact with the ships.

Israeli commandos begin boarding. They face peaceful resistance on five ships, violence on the last one, the Marmara, according to Israeli military.

Israeli soldiers, being lowered to the deck of the ship by helicopter, are attacked by activists with knives and clubs, military says. Firefight ensues.

Midday Monday

Israeli navy reports the first of the flotilla's ships reach the Israeli port of Ashdod.



An Israeli soldier, top left, wheels a pro-Palestinian activist into a Tel Aviv-area hospital after Israelis stormed the aid flotilla. Before the incident, activists wearing life jackets, top right, prayed aboard the Turkish ship Marmara in the Mediterranean Sea. Later an Israeli naval gunship, bottom, escorted the Marmara to the port in Ashdod, southern Israel.

Agence France-Presse/Getty Images (left); Reuters (right); European Pressphoto Agency (bottom)

Nine activists die as Israelis board ship

Continued from first page
Tuesday to meet U.S. President Barack Obama in Washington, a meeting that Israeli and U.S. officials hoped would mend a recent rift between the two allies. An Israeli official said the prime minister "feels he has to be home to deal with this."

White House spokesman Bill Burton said Monday the administration was "working to understand the circumstances surrounding this tragedy."

Israel heightened security across the country on Monday in anticipation of Palestinian demonstrations. Thousands of Turks protested against Israel in Istanbul, as Turkish officials condemned the incident and Ankara withdrew its ambassador to Israel. Ankara had publicly backed the flotilla, which included Turkish ships and was partly organized by a Turkish organization.

By late Monday, Israel hadn't allowed access to passengers aboard the ships, which state-controlled Israel Radio said had been escorted

by Israeli naval vessels to the Israeli port of Ashdod. Israel Radio said passengers from the flotilla were being interviewed to determine whether they should be deported or detained.

Israel Radio said at least a dozen activists had been injured, as well as several Israeli military personnel.

Organizers of the flotilla maintained their voyage was peaceful and disavowed violence. Bianca Shana'a, a Paris-based spokeswoman for the Free Gaza Movement, a group that helped organize the flotilla, said in a phone interview that the organization hadn't been in contact with participants since Sunday.

The incident threatens to further dent Israel's international reputation after a series of recent diplomatic setbacks. Israeli officials had said they were sensitive to the possible public-relations fallout from appearing too heavy-handed in dealing with the flotilla.

Last week, Israel said if the ships docked at an Israeli port first, it would allow the full shipment of humanitarian cargo to reach Gaza, after undergoing security checks. Israeli officials have for days warned that they wouldn't let the flotilla reach port in Gaza.

The death toll from Monday's action dramatically heightened the stakes, however, while raising questions about the planning and execution of the operation by Israeli defense officials.

Uzi Dayan, a former general who spent 17 years in the Israeli special forces, said that helicopters are used to achieve an element of surprise, and because it is the only way to take over a ship that is sailing without endangering the entire vessel—though it leaves commandos outnumbered in the first minutes of

the takeover.

Colette Avital, a former Israeli Consul General in New York and a former Israeli parliament member with the Labor party, said the navy shouldn't have tried to board the ships in the first place, to avoid any risk of violence and diplomatic fallout. She said the boats should have been surrounded by the army and they should have tried to negotiate a surrender with the help of international diplomats.

"This is a big diplomatic setback," she said. "We have managed to put ourselves in the media as the violent kid in the Middle East."

France and Spain quickly concluded the Israeli use of force was excessive. French President Nicolas Sarkozy said he "condemns a disproportionate use of force." Spain called the Israeli actions "unacceptable."

The European Union called for a full enquiry. Flotilla organizers, before setting sail, had said passengers would include several European parliamentarians, but a European parliament spokesman said no EU lawmakers took part.

At the U.N., British Ambassador Mark Lyall Grant said the U.K. government had urged its nationals not to take part in the aid effort because of the risks involved. "But at the same time, there is an unambiguous need for Israel to act with restraint and in line with its international obligations," Mr. Grant said, calling on Israel to give a full account of what happened and why the death toll was so high.

The raid could set back Israeli efforts at promoting what it sees as its defensive military stance towards Hamas, the militant Palestinian group that controls the Gaza Strip. Britain's Foreign Secretary

William Hague said called on Israel to lift the blockade of Gaza.

Dan Diker, a fellow at the Jerusalem Center for Public Affairs, a think tank headed by a former policy aide to Mr. Netanyahu, said the naval action could "delegitimize" its blockade of Gaza—which Israel has said it enforces to prevent the smuggling of arms and fighters into the territory.

Israel and Egypt began restricting the flow of goods into and out of the territory in 2007, after Hamas seized control. Human-rights activists have long alleged Israel was keeping out crucial aid and basic materials, a claim Israel has denied.

Egyptian President Hosni Mubarak issued a statement condemning what he called "excessive use of force" in the raid on the ship, according to Egypt's state news agency, but gave no indication Egypt would ease its own restrictions of goods going into Gaza.

The crisis is especially challenging coming at a time when Mr. Netanyahu's ties with Washington have frayed. "This is a very delicate time to test what has been traditionally ironclad support of Israel" from the U.S., Mr. Diker said. The U.K. envoy called on Israel to inform all embassies whose nationals were involved and to "open the crossings to allow unfettered access for aid to Gaza."

The bloodshed risked enflaming tensions across the Middle East, with Arab and Palestinian officials strongly condemning Israel's action. Turkey also reacted angrily to the incident, heightening recent tensions between the two regional powers.

Palestinian negotiator Saeb Erekat said Monday that indirect peace talks with Israel, mediated by the U.S., would continue.

The six-ship flotilla—carrying hundreds of pro-Palestinian activists from various countries, as well as 10,000 tons of construction material, medical equipment and school supplies, according to organizers—started heading to Gaza Sunday afternoon, embarking from a rendezvous point off the coast of Cyprus, after several delays over the weekend. After nightfall Sunday, three Israeli naval vessels left their base in Haifa, Israel, to intercept the ships, according to the Associated Press.

The Israeli military operation to board the vessels began at 4 a.m. Monday, according to Israel Defense Force spokesman Brig. Gen. Avi Benayahu, in an interview with Israeli Army Radio.

He said the boarding took place after the flotilla ignored calls to change course and head away from the Gaza coast. During the boarding, passengers on five of the ships resisted passively and peacefully, he said.

But on one of the ships, called the Mavi Marmara, with about 600 passengers, the IDF encountered "difficult violence," Gen. Benayahu said. Dozens of activists attacked Israeli soldiers with steel clubs and knives as the soldiers were being lowered onto the deck from helicopters, he said. The army then used antiriot measures against the activists, he said. When the violence escalated, soldiers opened fire, he said. Activist also used their own fire arms to shoot at the Israelis, he said. It wasn't clear from his comments who Israel believed shot first.

—Marc Champion in Istanbul, John W. Miller in Brussels, David Gauthier-Villars in Paris and Kathy Chen in Washington contributed to this article.

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GAZA FLOTILLA

Raid complicates U.S.'s Mideast strategy

[Capital Journal]

BY GERALD F. SEIB



U.S. President Barack Obama and Israeli Prime Minister Benjamin Netanyahu were to meet at the White House Tuesday for what officials from both countries hoped would be a kind of public kiss-and-make-up session.

In a few violent minutes at sea Monday, that all went out the window. The Israeli operation that unexpectedly turned violent now will back both leaders into corners they had hoped to vacate. The Obama-Netanyahu relationship, which already had a kind of soap-opera quality to it, is under new strain. The American dream of easing Arab anxieties over the Palestinian question so all can focus on the threat from Iran has faded just a bit more.

All this began unfolding before the sun had even risen over Mr. Obama's Chicago home, where he was spending the Memorial Day weekend. Israeli commandos stormed a convoy of ships headed for the Gaza Strip to deliver humanitarian supplies to Palestinians there in defiance of an Israeli naval blockade of Hamas-run Gaza.

The humanitarian flotilla had been warned repeatedly not to try to run the blockade. It ignored the warnings. Mr. Netanyahu's government ordered Israeli soldiers to board the ships. Shots were fired. At least nine activists died and a similar number of Israelis were wounded.

The American dream of easing Arab anxieties over the Palestinian question so all can focus on the threat from Iran has faded just a bit more.

Within hours, the Netanyahu-Obama White House meeting was canceled so the Israeli leader could return home. Senior White House aides said Mr. Netanyahu, not the Americans, called off the visit to deal with the crisis.

Either way, the chance to put a better face on the relationship between the leaders evaporated. From the first weeks of the Obama administration, the two men have been famously feuding over the president's demand that Israel stop all building in East Jerusalem to smooth the way for peace talks with Palestinians.

In reality, the relationship between the two men hasn't been quite as bad as often suggested. "I would describe it as actually very solid, very productive," said one senior Obama administration official over the weekend, before news of the raid at sea. "It is quite at odds with the popular portrayal."

Their feuding actually has had an element of theatrics—with the theatrics suiting both men's interests. President Obama's strategy has been as much about

Iran, his paramount security concern, as Israel or the Palestinians. He calculated at the outset of his term that he needed to get tough with Mr. Netanyahu to push him into peace talks with the Palestinians.

Forcing talks, Mr. Obama figured, was crucial to his dream of knitting together a kind of loose American-Arab-Israeli front to stand up to Iran and its nuclear program.

Without movement on the Palestinian question to ease Arab public opinion, the president calculated, moderate Arab leaders would be less willing to cooperate on Iran.

Palestinian leader Mahmoud Abbas is so weak he needs all the help he can get. If that meant getting tough with Mr. Netanyahu, it was a price worth paying.

From Mr. Netanyahu's point of view, standing up to a new, young American president trying to enhance American relations with the Arab and Islamic worlds wasn't all bad either. Doubts about Mr. Obama (whose approval in Israel has plunged) only strengthened Mr. Netanyahu's hand in standing up to him.

But for both men, this feuding had reached the point of diminishing returns, and they've been trying to turn things around. Israel apologized for embarrassing Vice President Joe Biden by announcing more East Jerusalem construction just as Mr. Biden was visiting.

The Obama administration has been talking up security ties to Israel.

Two weeks ago, the president met with 37 Jewish Democrats in Congress and told them that he had spent more time one-on-one with Mr. Netanyahu than any other world leader, and that ties were solid.

Now, the seaborne raid and its tragic outcome. Smiling Obama-Netanyahu pictures from the Oval Office will be supplanted by international pressure on the White House to condemn Israel.

Worse for the administration, this twist complicates its Iran strategy. The United Nations Security Council has been moving toward a resolution imposing new economic sanctions on Iran, but that's now in danger of being slowed or sidetracked by the inevitable clamoring to condemn Israel.

The raid particularly complicates dealing with Turkey. The Turks once were Israel's best friend in the Islamic world. They've been drifting away, though, and essentially sponsored the Palestinian relief flotilla that Israeli forces confronted Monday.

As it happens, Turkey also occupies one of the rotating seats on the Security Council right now, and has been maneuvering to help Iran escape more economic sanctions. The U.S. is trying to dissuade the Turks from giving aid and comfort to Iran. Monday's tragedy at sea won't make those conversations with Turkey any easier, proving anew that the law of unintended consequences is always in effect in the Middle East.

Write to Gerald F. Seib at jerry.seib@wsj.com.



Prime Minister Benjamin Netanyahu, front, prepares to leave Canada after meetings on Sunday to return to Israel.

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GAZA FLOTILLA



European Pressphoto Agency

Turkish protesters shout slogans during a demonstration against Israel's attack on the Turkish ship

Raid further frays Turkey-Israel ties

Sea battle is the latest in long line of conflicts that has strained relations between the once-strong security allies

BY MARC CHAMPION

ISTANBUL—Countries around the world expressed shock and concern Monday at the deaths of Gaza activists at the hands of Israeli commandoes, but the most lasting damage may be done to Tel Aviv's relations with one-time regional ally Turkey.

Turkey's Prime Minister Recep Tayyip Erdogan and its military chief cut short trips abroad in response to the maritime raid, while Ankara canceled joint military exercises with Israel, recalled its ambassador and demanded an emergency session of the United Nations Security Council—where Turkey currently holds a seat—to discuss the events.

Mr. Erdogan, in televised remarks as he left Chile, said Israel had carried out an act of "inhuman state terror." Eschewing the cautious response of most Western leaders, Mr. Erdogan dismissed as "lies" the Israeli military's claims that the ships had guns and other weapons on board. He said he also would call a meeting of the North Atlantic Treaty Organization to discuss Israel's action in what he said were international waters. Turkey has the second largest military in NATO, after the U.S.

The strength of Turkey's response appears to stem from close involvement in the Gaza relief convoy—a direct challenge to Israel's blockade of the Gaza strip. Deputy Prime Minister Bulent Arinc said

Monday that 400 of the 581 passengers on the Mavi Marmara were Turks, making it likely that some of the dead were Turkish citizens.

Thousands of Turkish protesters gathered Monday in Istanbul, waving Palestinian and Turkish flags and chanting anti-Israel slogans in the city's central Taksim Square, where some had marched after attempting to storm the Israeli consulate. Police drove the protesters away from the consulate, and later from the consul's residence.

The Gaza convoy, in part, was organized by a Turkish charity, the Humanitarian Relief Foundation. The group, known as the IHH, its Turkish-language acronym, was formed to provide aid to Bosnian Muslims in the mid-1990s. Mr. Arinc

denied any official instructions were given to the IHH, but Ankara had acted as the convoy's unofficial sponsor, urging Israel to let it pass.

The IHH has drawn controversy in the past. A 2006 report by the Danish Institute for International Studies described the group as a front for funding terrorist organizations and for sending mujahedeen to fight in countries such as Afghanistan, Bosnia and Chechnya.

The IHH, which is not on US or European terrorist lists, vehemently denies accusations of ties to terror groups and says it is active in charities in more than 100 countries.

Relations between Turkey and Israel were badly strained even before Monday's raid, with the security-based alliance they had enjoyed

in the 1990s in tatters. But with the possibility that some of the dead were Turkish, further deterioration looked certain. The Turkish foreign ministry warned in a statement of "irreversible consequences in our relations."

Still, Turkish officials appeared anxious not to wholly destroy a relationship that involves significant trade and tourism. After listing measures to be taken, including canceling three military and maritime rescue exercises planned for this year and calling home a youth soccer team from Israel, Mr. Arinc said when asked by reporters that the government didn't plan to cut all ties with Israel.

—Margaret Coker in New York contributed to this article.

Israel faces fallout from action

BY CHIP CUMMINS
AND MARGARET COKER

The deadly boarding of a flotilla of activists off the coast of Gaza has plunged Israeli Prime Minister Benjamin Netanyahu into his worst diplomatic crisis since taking office early last year, and analysts say it could have far-reaching—and unintended—implications for Israeli security issues.

The sea battle follows a series of diplomatic setbacks for Israel, including the expulsion recently of Israeli diplomats from Britain and Australia after those governments accused Israel of forging passports used in the alleged murder of a Palestinian official in Dubai. (Israel has said there is no evidence linking Israel to the murder.)

Most recently, Israel failed last week to prevent a United Nations conference on nuclear weapons from singling it out for scrutiny as part of a pledge to work for a Middle East nuclear-free zone.

"Seemingly on the surface, the incident itself is not a strategic crisis for Israel, but Israel is already deep in trouble ... since [the Netan-

yahu] government came to power," says Yossi Melman, a security and defense expert, who writes for Israel's Haaretz newspaper.

The battle triggered harsh condemnation from Palestinian officials and Israel's Arab neighbors, including those few with relations with Israel. Jordan said the "horrible crime cannot be justified." Egyptian President Hosni Mubarak issued a statement condemning what he called "excessive use of force," according to Egypt's state news agency.

It also drew a tough response from several European allies, who challenged Israel on whether it used disproportionate force.

French Foreign Minister Bernard Kouchner said "nothing could justify the use of such violence." Britain, in a statement, said it would request information from Israel on British citizens thought to be aboard, and called on Israel to lift its blockade of Gaza.

Germany, too, was seeking information on six German citizens believed aboard the ships, and called for an immediate investigation. Although it was careful not to directly place blame.

The European Union also called for a full enquiry. A European parliament spokesman said late Monday that no EU lawmakers were aboard the flotilla.

The biggest risk from the incident could be a further, sharp deterioration in relations between Israel and Turkey, analysts said. The two regional powers enjoyed a once-close relationship, and often conduct joint military drills. But beginning with Turkey's harsh criticism of Israel's military offensive in the Gaza Strip from December 2008 to January 2009, that relationship has been under strain.

Some of the flotilla's ships, which Turkey alleges Israeli's navy seized in international waters, are Turkish-owned. Turkey recalled its ambassador to Israel and has said it will cancel a number of planned exercises with the country.

The incident also could have repercussions for U.S.-brokered peace talks between Israel and the Palestinians, a key Washington priority. Any disruption to talks could put more strain on the U.S.-Israel relationship, which has been chilled in recent months by Israel's insistence

Troubled waters

Israeli Prime Minister Benjamin Netanyahu's diplomatic woes heightened amid international criticism of the military's violent storming of a flotilla of activists Monday. Other recent headaches include:

Oct. 16, 2009: UN Human Rights council endorses a report by South African jurist Richard Goldstone, alleging possible war crimes by both Israel and Hamas during Israel's Dec.-Jan. military offensive in Gaza. Israel condemned the report.

Jan. 31, 2010: Dubai police say they think Israel's Mossad may have had a hand in an alleged murder of top Hamas leader in the city-state. Dubai later blames Israel outright. Israel says Dubai has no proof.

March 9: U.S. VP Joe Biden criticizes Israel's decision to build more East

Jerusalem homes on the first day of his visit to Israel. Israel apologies for the timing of the announcement.

March 23: Britain expels an Israeli diplomat after accusing Israel of forging UK passports related to the Dubai-Hamas murder.

May 24: Australia follows Britain, expelling an Israeli diplomat after implicating Israel in forging Australian passports used in the murder.

May 28: United Nations conference calls for a nuclear-free Mideast, singling out Israel and calling for inspection of its nuclear facilities.

on continuing West Bank and East Jerusalem settlement-building. Mr. Netanyahu, who was scheduled to visit the White House this week for a meeting that Israeli and U.S. officials hoped would help mend frayed ties, canceled his trip to fly back to Israel and deal with the crisis.

The action also threatens Israel's stated top strategic priority: keeping Iran from getting a nuclear weapon. Washington is pushing a fresh set of

sanctions against Iran at the U.N., but the uproar over the violent flotilla boarding could distract from that effort, draining support from some key, nonpermanent members of the Security Council, including Turkey.

"If we are getting on the nerves of the world, this will imperil the country and our real security goals," said Mr. Melman, the security expert.

EUROPE NEWS

Köhler suddenly steps down

German president cites lack of respect for office during backlash over Afghanistan remarks

BY MARCUS WALKER

BERLIN—German President Horst Köhler resigned unexpectedly Monday, throwing his country into political confusion, after saying criticism of his views on German military deployments abroad had shown a lack of respect for his office.

The resignation baffled government officials because there had been no sign of pressure on Mr. Köhler to resign.

Chancellor Angela Merkel's governing coalition and left-leaning opposition parties now have 30 days to elect a new federal president, a largely ceremonial role in Germany but one that can carry considerable moral authority.

Mr. Köhler said in a short resignation statement that he took exception to the backlash over an interview he gave to German state radio on May 22. In the interview, made after a visit to German troops in Afghanistan, Mr. Köhler said Germans were coming to understand that "a country of our size, with this foreign-trade orientation and thus trade dependence, must know that... in extremis military deployments are needed to uphold our interests, for example open trade routes."

Left-leaning opposition parties attacked Mr. Köhler for suggesting Germany should go to war to defend its business interests—a taboo in a country where the trauma of World War II has made even deployments under a United Nations mandate, such as Afghanistan, controversial.

The president's spokesman said he had been willfully misunderstood, and that his mention of upholding "open trade routes" referred to Germany's naval participation in anti-piracy operations off the Horn of Africa, not to the war in Afghanistan.

On Monday, Mr. Köhler said he regretted that his radio comments had been misunderstood, but that critics had gone too far by accusing him of advocating wars that would violate the German constitution. Such accusations "show a lack of respect for my office," he said.

The president of the Upper House of Parliament, Jens Böhrens, will temporarily take over as acting president. Mr. Böhrens is also governor of the city-state of Bremen and a member of the opposition Social Democratic Party.

Despite the upheaval created by

Horst Köhler

Career highlights

1982: Joins Germany's finance ministry.

1990: As state secretary, Köhler negotiates East-West German monetary union, the withdrawal of Soviet troops from the GDR and the Maastricht Treaty's framework for European monetary union.

1993: President of the German Savings Bank Association

2000: Appointed managing director of the International Monetary Fund

2004: Becomes Germany's president.

2009: Re-elected for a second term.

Source: The president's office

Mr. Köhler's resignation, it is unlikely to have an impact on major questions of German public policy, such as the war in Afghanistan or the European economic crisis, say analysts. Mr. Köhler's declining influence in the major national debates may have been the real driver behind his resignation, says Karl-Rudolf Korte, a professor at Duisburg-Essen university and one of Germany's leading political scientists.

The president's resignation "is very surprising, but his voice in the political realm has been waning," Prof. Korte said.

Mr. Köhler, a former head of the International Monetary Fund who became popular for his broad criticisms of the country's political class, was first elected president in 2004 and won a second five-year term in May 2009. Under Germany's constitution, an assembly comprising federal lawmakers and delegates from Germany's 16 states elects the country's president.

The resignation could add fuel to a debate about the weakness of political leadership in the European Union's most populous country and biggest economy. Ms. Merkel is under fire from German lawmakers and media for her hesitant handling of the euro zone's escalating financial crisis this spring, and analysts say the chancellor's risk-averse style of



Horst Köhler at the press conference where he announced his resignation

trying to sit out problems is wearing thin with German voters.

Only last week, Roland Koch, another leading figure from Ms. Merkel's conservative Christian Democratic Union, resigned as premier of the state of Hesse and retired from active politics. Mr. Koch, unlike Mr. Köhler, was a divisive figure because of his aggressive policies for dealing with immigrants in Germany, but his retirement prompted Germans to bemoan the growing blandness of their political class.

Mr. Köhler is only the second German federal president to resign, following Heinrich Lübke in 1969, who stepped down two months before his term ended amid failing health. The normally staid job of president includes making speeches on the state of the nation, its ethical values and its thorny history, but presidents also can intervene in practical politics on occasion, including by refusing to sign laws.

Mr. Köhler's most notable decision was to dissolve Germany's Parliament in 2005, triggering early elections, which the left-leaning then-chancellor Gerhard Schröder narrowly lost to Ms. Merkel.

Ms. Merkel said Monday she had tried to change Mr. Köhler's mind. "I regret this resignation to the utmost, but I have told him that I respect this resignation," she told reporters. "I have always worked very well with Horst Köhler as president. He was an important adviser, particularly during the economic and financial crisis, thanks to his great international experience."

German Vice-Chancellor Guido Westerwelle, who is also foreign minister, echoed Ms. Merkel's remarks. "I have tried change his mind," Mr. Westerwelle said. "But the president had made his decision. I wholeheartedly regret this decision."

—Andrea Thomas
contributed to this article.

New Treasury official in U.K. defends past expense claims

BY PAUL HANNON

LONDON—The second-in-command at the U.K. Treasury Monday said he hadn't avoided paying capital-gains tax on the sale of a London property in 2007.

Danny Alexander was appointed chief secretary of the treasury Saturday, after David Laws resigned over allegations that he had broken parliamentary rules in claiming as expenses £40,000 (\$57,848) he had paid his partner in rent and other housing costs.

That came as a major blow to the government, which has been in office for less than three weeks. The chief secretary will be responsible for identifying the spending cuts needed to cut the government's huge deficit, starting with an emergency budget due June 22.

But the day after Mr. Alexander's appointment, the Daily Telegraph reported that he had avoided paying capital-gains tax, or CGT, on the sale of his former London home by designating it as his first home for tax purposes, while claiming expenses from Parliament on the basis that it was his second home, his main residence being in Scotland.

In a statement, Mr. Alexander insisted that he had acted within the law, which allows home owners to avoid paying tax on a property if they sell it within 36 months of it ceasing to be their only or main home.

"I sold the Elspeth Road flat in 2007 and moved to another flat but was advised that CGT was not payable because of the operation of final period relief, which exempts homes from CGT for 36 months after they stop being the main home," Mr. Alexander said.

Capital-gains tax in general is a pressing issue for the coalition government, which has said it will raise the rate of taxation to bring it into line with income tax rates. Capital gains tax is currently charged at 18%, but the highest rate of income tax is 50%.

However, the issue appears to divide the two parties that make up the coalition, with the Liberal Democrats favoring the move as a step toward making the tax system fairer, while many in the Conservative Party oppose the move.

Pope sets up Irish abuse panel

BY STACY MEICHTRY

ROME—Pope Benedict XVI on Monday tapped a group of top Catholic officials, including the archbishops of New York and Boston, to lead a Vatican probe into alleged sex-abuse cover-ups that have ripped through the Catholic Church in Ireland.

The appointment of the investigators paves the way for the Vatican to take a more direct role in overhauling the Irish Church, which has been rocked by government reports that faulted local church officials for covering up decades of sexual abuse and rape within local dioceses and schools run by religious orders.

The move comes as Pope Benedict is under pressure to crack down

on Roman Catholic bishops across Europe who either failed to promptly report abuse or, in some cases, committed acts of abuse themselves.

Separately Monday, the Vatican said the pope had accepted the resignation of Irish-born Archbishop Richard Burke, 61, as head of the Diocese of Benin City in Nigeria. For more than a year, Archbishop Burke has faced allegations that he began a sexual relationship with a woman when she was 14 years old. The Vatican's one-line statement cited a section of canon law used to dismiss bishops deemed unfit for service without elaborating on the reasons behind the bishop's departure.

In a statement Monday, Archbishop Burke apologized for having

sexual relations with the woman, breaking his oath of celibacy. However, Archbishop Burke denied the relationship began when she was a minor. "She and I had a caring relationship that began in the latter part of 1989, when she was 21 and I was 40," Archbishop Burke said. "This was entirely inappropriate behavior and it is something for which I am truly sorry."

Pope Benedict has faced criticism that he hasn't moved fast enough to address the abuse crisis. Since his election in 2005, the pope has met with victims and stripped abusive priests of their ministries.

The pope first announced the Irish investigation, known as a "visitation," in a March letter of apology that he wrote to Ireland's Catholics.



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U.S. NEWS

BP begins third try to contain oil spill

Risky operation comes as anger in U.S. rises

By GUY CHAZAN

BP PLC, facing rising public anger in the U.S., began Monday its third attempt to contain oil from its leaking well in the Gulf of Mexico, but the risky operation could make the spill worse in the short term.

The latest procedure involves slicing off the leaking pipe at the top of the well's broken blow-out preventer, placing a cap over the leak and channeling the captured oil and gas to a vessel on the surface. BP officials said the procedure could take from four days to a week, and it already has two different caps on the ocean floor, ready to be deployed.

BP didn't try this approach sooner because it feared the kinks in the pipe still attached to the blow-out preventer were acting as a choke on the leak. Removing the pipe could lead to a more violent surge of oil.

Carol Browner, White House Energy and Climate Change Advisor, said Sunday on CBS's "Face the Nation" that the flow of oil could temporarily increase by 20% before the new device is put in place.

The Obama administration is stepping up pressure on BP as the company's successive efforts to control the spill—and the resulting political damage to President Barack Obama—have failed.

BP's Macondo well has been spewing crude into the Gulf ever since the rig that was drilling it for BP, the Deepwater Horizon, caught fire and exploded April 20, killing 11 workers.

The U.K. oil giant's palette of options for containing the spill before relief wells are completed is dwindling after the failure over the weekend of an operation it called a "top kill." That involved forcing heavy drilling mud into the well to stop the flow of oil and gas.

BP says in the latest procedure it will use robots to slice off the leaking riser pipe where it connects to the blow-out preventer, the huge stack of valves that sits on the seabed atop the ruptured well. A containment cap with a rubber seal will be placed over the cut riser and will

draw up the oil and gas through a pipe to a ship.

One early indicator of how well the new procedure is going will be whether the undersea robots are able to cut the riser pipe cleanly, so that the cap can be seated on a smooth surface and the seal works to prevent oil from leaking out.

Viewers of the live feed BP is streaming from the well site could see whether there's a reduction in the volume of oil and gas escaping around the seal. That would indicate that the cap is seated properly and is capturing oil.

William Abel, a veteran well-control expert, says one of the dangers is that the robots won't succeed in making a clean cut, and the cap won't seal properly. Also, once the pipe is sliced, oil could surge out, obscuring the view for engineers who rely on live images streamed from video cameras attached to the robots. There are also doubts among outside experts about how effective the cap will be.

"The big unknown is how much oil it will capture," said Greg McCormack, director of the Petroleum Extension Service of the University of Texas at Austin. One of BP's earlier containment efforts, which involved inserting a tube into the leak connected to a mile-long pipe to the surface, only managed to collect about 2,000 barrels a day on average—a small fraction of the total flow.

Another potential hazard: Hurricane season is about to start, and in rough storms the ship that's collecting oil from the leak—the Discoverer Enterprise—may have to temporarily disconnect from the cap system and move to safety. BP says it is building hurricane-related precautions into its plans for the containment system, which will be "continually refined."

BP says it is confident that cutting the riser pipe won't make the spill worse. It says its engineers have concluded from pressure readings taken during preparations for the top kill that obstructions inside the blow-out preventer are impeding the flow of oil, not bends in the riser pipe.

Two Fed officials upbeat on recovery prospects

By IN-SOO NAM
AND WILLIAM MALLARD

Two senior Federal Reserve officials were upbeat Monday about the U.S. economic recovery despite the worsening debt crisis in Europe.

"Right now, the prospects for continued growth in the U.S. remain relatively solid," Charles Plosser, the president of the Federal Reserve Bank of Philadelphia, told a news conference during a **Bank of Korea** seminar in Seoul. "I hope, I anticipate at this point that the U.S. won't have a double-dip recession." He added that the European crisis "raises some clouds on the horizon" and that the Fed would have to "be cautious" in response.

Charles Evans, president of the **Chicago Fed**, said the U.S. recovery

is "well under way" but still-low inflation means the central bank should keep rates very low "for an extended period," in line with its official policy statement.

"Inflation is severely under-running price stability, so it's still appropriate to keep an accommodative policy," Mr. Evans told a separate news conference at the Seoul event.

A few weeks ago, many analysts expected the Fed to begin raising interest rates by the end of 2010. As the situation in Europe worsened in May, those expectations have been put off and now many analysts don't expect the Fed to move until 2011.

Mr. Evans said the European crisis would likely damp U.S. exports to a small degree but that for now it wasn't likely to have a big impact or change the outlook for Fed policy.



Associated Press

A supply vessel passes through oil floating near the site of the Deepwater Horizon spill in the Gulf of Mexico Monday.

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