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As South Africa exits World Cup, what lies ahead for the nation?
NEWS 3

Latest model keeps Apple top of smartphone class
BUSINESS & FINANCE 19

THE WALL STREET JOURNAL.

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Osborne sets harsh budget against the U.K.'s deficit

U.K. Chancellor of the Exchequer George Osborne delivered a harsh budget with new spending cuts and tax increases of £40 billion ($59 billion), an emphatic salvo in the debate over when the major economies can afford to pull back their stimulus measures without falling back into recession.

In an emergency budget packed with deep spending cuts and significant tax increases, Mr. Osborne said the government's formal fiscal targets will be to eliminate the structural current deficit by the 2015-16 financial year and to have the ratio of debt to gross domestic product falling by that year.

But Mr. Osborne said that to increase the credibility of the fiscal plan, he is setting out plans to reach these targets a year early—by the end of the current parliamentary term in the 2014-15 financial year. Mr. Osborne said 77% of the fiscal consolidation will come through spending cuts with the rest delivered through tax increases. Tax rises include an increase in value added tax to 20% from 17.5%. Some government departments face budget cuts of 25% in real teams over the next few years.

Most of the world's largest economies agree that fiscal consolidation is now the top priority, French Finance Minister Christine Lagarde said Friday, shrugging off concerns that a fresh round of austerity measures in Europe could kill off the nascent global recovery.

That wasn't the only area in which Mr. Osborne and Ms. Lagarde acted in tandem. In a joint statement, Germany, France and the U.K. said Tuesday they will introduce a bank levy to offset the cost of future bailouts and will urge counterparts from the Group of 20 industrial and developing nations to do the same at a summit this week in Toronto.

For his part, U.S. President Barack Obama plans to urge his counterparts at the G-20 meeting to continue some level of stimulative spending.

The U.S. has been pushing the G-20 to focus on stimulus at least since a London summit in April 2009, while Germany, France and other European countries wanted to focus more on financial regulation. The U.S. won that fight. The G-20 as a whole increased fiscal spending in 2009 and 2010 by at least 2% of gross domestic product to fight the recession—a jolt that's likely to be cut back sharply in 2011, the IMF figures. Financial regulation was put on a slower track.

Bloomberg News

George Osborne struck probably the last traditional pose with the budget box William Gladstone first used in 1860. The box's fragility has consigned it to a display in the Cabinet War Rooms

General's jokes fall flat; job in doubt

U.S. Gen. Stanley McChrystal faced a barrage of criticism from President Barack Obama and other senior administration official—and little public support—for reportedly mocking Vice President Joe Biden and others in a magazine article, casting doubt over future of the top commander in the Afghan war.

Mr. Obama summoned Gen. McChrystal to the White House from Kabul because of the article, an eight-page profile in Rolling Stone magazine titled "The Runaway General." It portrays Gen. McChrystal, the commander of NATO forces in Afghanistan, and his staff as rogues with little regard for Washington officials, including Mr. Obama.

White House spokesman Robert Gibbs didn't rule out the possibility that Gen. McChrystal will be asked to resign.

High-level disputes over major foreign-policy decisions are nothing new in Washington. The put-downs of senior Obama administration officials made in jest by Gen. McChrystal and his aides may have, under normal circumstances, caused just a few ripples.

But the comments' impact have been magnified by a series of public setbacks for the war effort, including ongoing violence in Marjah, site of a highly-touted offensive earlier this year.

—Full article on page 11

Judge blocks U.S. oil-drilling ban

By Stephen Power And Angel Gonzalez

A U.S. federal judge Tuesday overturned the Obama administration's six-month moratorium on new deepwater oil and gas drilling, handing a major victory to the oil industry and delivering a stinging rebuke to the White House.

White House spokesman Robert Gibbs said the administration would immediately appeal the decision. "Continuing drilling at these depths without knowing what happened" in the April 20 explosion that triggered the spill "does not make sense."

U.S. District Judge Martin L.C. Feldman, in siding with the industry, said the administration had trivialized the economic impact of the moratorium. He added that the plaintiffs "have established a likelihood of successfully showing that the Administration acted arbitrarily and capriciously in issuing the moratorium."

"An invalid agency decision to suspend drilling of wells in depths of over 500 feet simply cannot justify the immeasurable effect on the plaintiffs, the local economy, the Gulf region, and the critical present-day aspect of the availability of domestic energy in this country," Judge Feldman wrote.

In his ruling, Judge Feldman said the moratorium "does not seem to be fact-specific" and did not account for the safety records of the many companies that operate in the Gulf.

"Are all airplanes a danger because one was?" the judge wrote. "All oil tankers like Exxon Valdez? All trains? All mines? That sort of thinking seems heavy-handed, and rather overbearing."

The Obama administration last month ordered a six-month halt to new offshore drilling in water deeper than 150 meters following the April 20 explosion of a **BP** PLC deepwater well that killed 11 people, sank the Deepwater Horizon oil rig and touched off the sprawling Gulf oil spill.

President Barack Obama and other administration officials have said the halt was necessary to give the government time to investigate the causes of the BP spill, and consider what new safety measures the industry and regulators should take to prevent a similar accident.

The oil industry has protested that the moratorium was putting thousands of jobs at risk. Tuesday's ruling came in a legal challenge to the moratorium filed by an oil-field-service company affected by the ban, **Hornbeck Offshore Services** LLC.

Hornbeck Offshore was soon joined by other small oilfield-service companies, and got support from the state of Louisiana, underscoring the growing rebellion against the moratorium in the Gulf.

Please turn to page 9

The Quirk

It's not a stuffed animal, it's a $6,000 medical device.
Page 33

Editorial & Opinion

George Osborne's anti-Keynesian budget. Page 13

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THE WALL STREET JOURNAL.

PAGE TWO

Osborne takes first step in program to dismantle the Brown legacy

[Agenda]

By Iain Martin

Was Gordon Brown watching the U.K. budget yesterday? The former prime minister and "Iron" chancellor of the exchequer didn't seem to be in the chamber of the House of Commons, making it the first time in 27 years he has been absent for such an occasion. If he did see the denunciation of his government's record that was delivered by George Osborne, it was probably on television from his constituency home in Scotland, where he has been skulking since the election.

He has visited parliament once since leaving office. His family is understood to be in London—the school term necessitates it—but we are told that Mr. Brown has been reflecting back in Fife and bashing out several thousand words a day.

Mr. Osborne certainly gave Mr. Brown plenty more food for thought, unveiling a package of measures predicated on the assumption that he, Mr. Brown, had left behind the most awful mess since the Visigoths sacked Rome in 410 AD.

It is not just that the new chancellor is determined to pin the blame for his inheritance on the chancellor before him; that is standard political operating procedure.

Mr. Osborne clearly wants to destroy the foundations of the Brownite settlement, alter public perceptions of how growth is encouraged and limit the reach of the state. He is seeking to arrange a once-in-a-generation change in the terms of trade.

Mr. Osborne doesn't have a radical reputation—his record suggests that he is overly focused on short-term tactics at the expense of a longer-term strategy. But in a well-received and cleverly presented budget, he chose to be rather bold. At the center was the argument that private-sector activity will drive recovery and that an over-large state will crowd it out.

Associated Press

George Osborne's predecessor, Gordon Brown, delivers his first budget in 1997.

This might sound uncontroversial, but not in contemporary Britain, where the state is almost 50% of the economy. Throughout the Brown years, ever-higher public spending was fetishized as being an undeniable good. To question such assumptions was heretical.

> His gamble is that he will not be upended by a double-dip recession if demand drops sharply.

So, alongside Mr. Osborne's many austerity measures were some serious attempts at encouraging enterprise: lower small-companies tax, a drop in the corporation tax by one pence a year for the next four years, and a range of other re-educations and simplifications. It had the feel of a downpayment, with the promise of more to come.

First, Mr. Osborne wants to eviscerate every inch of Mr. Brown's legacy. The chancellor has sought relentlessly to contrast his approach to Mr. Brown's style of budget presentation. Mr. Brown was secretive, resenting having to tell Tony Blair what was in his budgets and typically leaving it as late as possible. So, Mr. Osborne consulted widely, metaphorically handcuffing himself to the senior Liberal Democrats in the coalition and binding in his colleagues to tax rises and spending cuts.

The emphasis is on a return to simplicity and the supposed abandonment of smoke and mirrors. In this the small details matter. The Treasury "Red Book," the publication that accompanies each budget, had grown under Labour into a government public-relations brochure, with pictures of happy children, contented citizens and various beneficiaries of government munificence featuring on the front. Tuesday it had a plain red cover again and was half the size.

The message is supposed to be that the new team avoids tricksy tactics and wouldn't dream of burying bad news. Call me a cynic, but let's see. If hidden horrors emerge in the days to come, such claims will look silly.

For now this budget will be seen mainly in terms of the severe pain it imposes—with an increase of 2.5 percentage points in VAT to 20%, other tax rises and cuts in welfare benefits.

There is a bigger crunch to come this autumn, when the government unveils its Comprehensive Spending Review. In real terms, spending is actually projected to carry on going up—from £637 billion ($939.83 billion) in 2010-11 to £711 billion in 2015-16—but that still represents the biggest squeeze since World War II. Government departments that are unprotected (all bar the giant health budget and the minuscule amount spent on overseas aid) can expect dramatic cuts in the region of 25% over the next four years.

That means job losses in the public sector. And the coalition's projections on unemployment look too modest. Next year—with cuts and rising joblessness—promises to be bloody.

But beyond that, one can start to see the outline of where the coalition is trying to get to. Through the gloom Mr. Osborne thinks there are better times ahead. In austerity he sees opportunity to dismantle the superstructure of the Brownite state—and to simplify the tax system. In accelerating deficit reduction he will get credit from the markets.

His gamble is that he will not be upended by a double-dip recession if demand drops sharply at home and in Europe. Instead, he has put his money on the private sector powering a recovery a good deal stronger than is now expected.

If he's right, he'll be able to cut taxes and be garlanded in time for the next election. Get it badly wrong and he'll be like Gordon Brown, sitting at home watching the television as his successor delivers an austerity budget.

What's News

■ **Europe moved to back** a new tax on banks, led by the U.K., which included the levy in its emergency budget. Germany and France pledged to follow suit in coming months, and the three nations will ask other countries to join them at a weekend G-20 summit. 6

■ **France's Crédit Agricole** warned that it faces more than $1 billion in new losses from its Greek business, as Europe's financial crisis threatens to infect even relatively healthy countries. 19

■ **Eurocontrol is preparing** for a more prominent role in efforts to unify the EU's air-management systems. 7

■ **Dutch life-insurance** and pensions giant Aegon said it will further restructure its U.K. unit, denying reports it wants to sell the business. 21

■ **London police** are investigating a privacy group's complaint that Google broke the law by collecting data from wireless networks. 25

Inside

Peppers and poppers: Fresh concerns on diet and medicines. **31**

The most fateful few days in football's history. **32**

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'The iceberg is looming and these delicate adjustments won't be enough to avoid a collision.'

Allen Mattich on the impact of the yuan revaluation on China's economy

Continuing coverage

Decision day for Groups C and D. Follow the action at **wsj.com/worldcup**

Question of the day

Vote and discuss: Does the emergency budget unveiled by the British government do enough?

Vote online and discuss with others readers at **wsj.com/polls**

Previous results

Q: Do you think China's yuan move will have a lasting impact in global financial markets?

Yes	61%
No	39%

NEWS

European Pressphoto Agency

South Africans in Cape Town watch a live broadcast of their national team's 2-1 defeat of France on Tuesday. Despite the victory, South Africa failed to advance in the World Cup.

Problems trump South African goals

By Peter Wonacott
And Robb M. Stewart

JOHANNESBURG—Even before South Africa became the first host nation ever to be eliminated in the opening round of the World Cup, its citizens debated what awaits a volatile nation deprived of its football distraction.

Millions of South Africans have cheered the national underdogs—the team is ranked 83rd in the world, ahead of only North Korea in the 32-team field. But despite Tuesday's 2-1 victory over 2006 runner-up France, South Africa, which got an automatic bid as host nation, failed to win by a big enough margin to move into the next round, crushing hopes of those who saw a deep run by the team as a sort of national panacea.

"I'm proud of the boys," said South Africa's coach, Carlos Alberto Parreira, following Tuesday's win.

The South African government has used the World Cup as a catalyst for development, and to address social ills of crime and race tensions. It has claimed success on all fronts.

The government estimates that more than 200,000 jobs were created for stadium construction and nearly 400,000 tourists are expected to visit during the World Cup. Heavy police presence on streets appears to have reduced rampant crime. And politicians pointed to how South Africans of all colors became football fans, a sign of how the nation has grown together since the 1994 elections ended white minority rule.

"For the first time ever in the 16 years of freedom and democracy, we see black and white South Africans celebrating together in the stadiums and fan parks," President Jacob Zuma said. "This unity and explosion of national pride will go down in our history as one of the most defining moments of the history of our young nation."

Yet in a country where 40% of the population lives below the poverty line—and 25% of working-age people are unemployed—social and economic discontent can't stay bottled up for long, say analysts.

"We have to go back to reality," said Prince Mashele, executive director for the Centre for Politics and Research, a think tank in Pretoria. "All the problems that bedevil this country will resurface."

Ahead of the World Cup, antigovernment protests plagued townships, with residents railing on the government for spending billions on new stadiums while they lacked electricity, clean water and decent housing.

In recent months, worries have surfaced too that anti-immigrant attacks will erupt once the World Cup security blanket is lifted after the July 11 final. Many foreign nationals have left cities and townships, say activists and area residents.

Associated Press

South African fans in Soweto celebrate a goal in Tuesday's match.

Two years ago, a wave of anti-immigrant violence swept South Africa's black townships, leaving dozens dead and forcing thousands to flee their homes. Anger is rising again over perceptions that black-owned businesses are handing coveted jobs to immigrants from elsewhere in Africa, said Mncedisi Twalo, a social activist in Guguletu township outside Cape Town.

"They are the ones hiring cheap labor who are not from this country and who are employed at the expense of the poor communities," he said.

The numbers of those coming to the Central Methodist Church in Johannesburg—a sanctuary for immigrants—have declined due to fears of violence, says Wellington Masaiti, a security guard at the church.

"Everyone at the church was told about these threats and it's a matter of making [a] personal decision to go or stay, he said. "But I assure you violence is coming soon."

Police and politicians have played down these threats. "The issue of xenophobic attacks after the World Cup has no foundation except to influence the vulnerable within our society to commit crime," said Deputy Minister of Police Fikile Mbalula. "We have confidence in both the police and our people," he said.

Other political observers say rumors of violence don't jibe with the current jubilation over hosting the world's biggest sporting event. Since it won the right to host the World Cup in 2004, the first for a country on the continent, South Africa has sought to prove wrong those who predicted logistical chaos. Success so far should give a boost to the national psyche despite the team's exit, says Jakkie Cilliers, executive director for the Institute for Security Studies in Pretoria.

"I think the glow of the World Cup will linger a while longer," he said.

But even as the World Cup has been played, labor unrest has simmered. Public servants and utility workers have threatened to walk off the job to press demands for higher pay. Emotions have run high in recent disputes, with picketers clashing with police during recent strikes by transport workers and stadium security guards.

Members of the Congress of South African Trade Unions, a labor umbrella body, are prepared to strike, World Cup or no World Cup, said the group's spokesman, Patrick Craven.

He added: "I don't think that anyone in South Africa thought that the World Cup was going to solve the fundamental economic and social problems facing the country."

—Ntando Ncube contributed to this article.

Cup ends for Les Bleus, Bafana Bafana

By Darren Everson

BLOEMFONTEIN, South Africa—For a moment, it looked like they might actually do it. South Africa had all the momentum. And it had the perfect opponent.

France's showing at this World Cup will go down among the most infamous in sports history. The French did, however, show just enough life to deny the host country a trip to the second round.

South Africa beat France, 2-1, at Free State Stadium Tuesday—but it needed to win by three more. The result, combined with Uruguay's 1-0 victory over Mexico, meant that the Mexicans had advanced to the Round of 16 over Bafana Bafana by tiebreaker. The South Africans are thus the first host team in World Cup history to fail to advance.

But South Africa, which appeared to have virtually no shot coming into the game, made a go of it, taking an early 2-0 lead. It was an effort to be proud of for the hosts, and something less than that for the visitors.

Winners of the 1998 World Cup and runners-up in 2006, France's performance and behavior at this World Cup drew world-wide scorn. The French scored one goal, allowed four, had a player (Nicolas Anelka) sent home for allegedly insulting his coach and then protested that expulsion by refusing to train.

Ordinarily, French people on strike isn't a big deal, but this was.

France's woes might just be this simple: no Zinedane Zidane. Les Bleus haven't been nearly the same without the retired legend, who helped them to the 1998 World Cup title and the 2006 final. Since 2002, France has played nine matches at major championships without Mr. Zidane. They've won one and been held scoreless six times.

Before the game, the French players stood arm-in-arm during the French national anthem. Then they returned to their old ways.

In the 20th minute, South Africa scored the game's first goal—Bongani Khumalo heading in a corner kick from Siphiwe Tshabalala, who spent all afternoon launching lethal curls into the box.

Just five minutes later came the moment that gave all of South Africa hope: a French red card. Yoann Gourcuff got sent off for elbowing MacBeth Sibaya, while the two went for a header in the South African box. The card was justifiable; Mr. Gourcuff led with his elbow.

With France now a man down, this match and the Mexico-Uruguay one suddenly got a lot more interesting.

South Africa's Katiego Mphela stretched the lead to 2-0 in the 37th minute. Uruguay went up, 1-0, on Mexico in their 43rd. The South Africans had come into the day needing not only to win but also to make up five goals of goal differential on Mexico to advance. Before halftime, they'd already cut it to two.

But hope for the host faded midway through the second half. In the 25th minute, after numerous South African near-misses—including one shot off the post—France star Franck Ribery got in behind the Bafana defense on the right side and centered to Florent Malouda, who netted the easy tap-in.

Although South Africa went on to win, the goal ended any realistic hope of doing enough to overcome Mexico for the second-round spot.

EUROPE NEWS

U.K. proposes sweeping budget cuts

Government says its 'unavoidable' plan increases VAT and taxes banks; critics say the program will limit growth

By Alistair MacDonald

Britain's new government laid out what it dubbed an "unavoidable budget," seeking to tame a massive deficit with billions of pounds in spending cuts and tax increases that hit public-sector workers, banks, welfare recipients and others.

In his first budget, Treasury chief George Osborne judged that the long-term risk of avoiding tough action is greater than the short-term risk of undercutting the economic recovery. That debate could dominate the Group of 20 meeting of large economies this week, with mainly European nations calling for austerity measures while other countries, led by the U.S., say stimulus is still necessary.

Mr. Osborne told Parliament the budget "pays for the past, and it plans for the future."

The Treasury chief announced a fiscal tightening that by the end of the five-year parliament term will see new spending cuts and tax increases of £40 billion ($59.33 billion), adding to the more than £73 billion of cuts already set by the previous government.

The moves are designed to eliminate the so-called structural deficit—the gap in the government's finances that won't be erased by an uptick in growth—by the fiscal year ending March 2015, one year earlier than expected.

The moves will add up to about 8% of the U.K.'s gross domestic product by 2015-16, representing the deepest cuts since Margaret Thatcher three decades ago.

"This is a harsh budget, harsher than had been expected and so should placate the markets," said Jamie Dannhauser, senior economist at Lombard Street Research in London.

Agence France-Presse/Getty Images

Housing advocates in masks depicting, left to right, Clegg, Osborne and Cameron, protest the budget in London Tuesday.,

U.K. markets have been buffeted by fears the country could lose its triple A rating. On Tuesday Fitch Ratings called the U.K. plan a "strong statement of intent." Market reaction was muted, with the pound and U.K. government debt only edging higher.

The budget represents an attack on the size of the state in a country where public spending represents almost 50% of the economy, one of the largest shares in the developed world. Mr. Osborne said 77% of the debt reduction will come through spending cuts, with the rest delivered through tax increases.

Among the sweeping cuts, some departmental budgets will fall by 25% in real terms over the next four years. There is a two-year public-sector pay freeze, and a £11 billion cut in welfare spending. Tax rises include an increase in value-added tax to 20% from 17.5%.

The government said the pain will be evenly dispersed across all parts of society. The Queen's annual state wage will be frozen at £7.9 million next year.

There is also an increase of capital-gains taxes from 18% to 28% for the highest tax payers and a tax on banks' balance sheets that the government expects will raise £2 billion a year. Still, many analysts said they thought both were less than expected, muting criticism from business and bank lobbies.

At the other end of the scale, Mr. Osborne announced a tax change that means almost 1 million of the lowest paid will escape income tax.

The Conservatives, who lead the coalition, aim to stem accusations that their retrenchments are particularly harsh on the poor; some measures were also part of the coalition agreement with the Liberal Democrats.

Cuts and boosts

- Government-department spending will be cut by 25% — excludes health and international aid
- Welfare benefits will be linked to the consumer-price index rather than the retail price index — expected to save £6 billion a year
- Value Added Tax to rise to 20% on Jan. 4, 2011 from current 17.5%
- Bank levy on balance sheets to be introduced in Jan. 2011

The opposition Labour Party and unions said the budget would hit growth and increase unemployment.

The new Office for Budget Responsibility said the increased cuts will curb growth by 0.4 percentage points over the next two years, but increase it over the next three.

But their latest predictions that the economy would grow 1.2% in 2010, 2.3% in 2011 up to 2.7% in 2014 and 2015, were criticized as being too optimistic by many economists, which risks making it more difficult for Mr. Osborne to hit his accelerated target of eliminating the structural deficit by 2014/15.

Tuesday's budget could prove a defining moment for the U.K.'s first coalition government in some 60 years. Prime Minister David Cameron took office May 11 at the head of a Conservative-Liberal Democrats coalition after a close election campaign that centered around tackling the budget deficit.

—Laurence Norman, Neil Shah and Paul Hannon contributed to this article.

U.K. budget measures point to loose policy

By Natasha Brereton

LONDON—The U.K. government set out Tuesday the strictest fiscal plans in decades, underscoring the possibility of further Bank of England policy loosening and the necessity for interest rates to remain at their all-time lows for a very long time.

In an emergency budget that responded to rating agencies' demands for aggressive measures to pare a £155 billion deficit, Chancellor of the Exchequer George Osborne outlined steps that would produce a modest structural surplus within five years.

Government spending took the brunt, with 77% of the tightening coming through cuts to a raft of welfare benefits and a public-sector pay freeze.

But tax hikes were also striking, with a delayed increase in the sales tax and an immediate rise in capital gains tax.

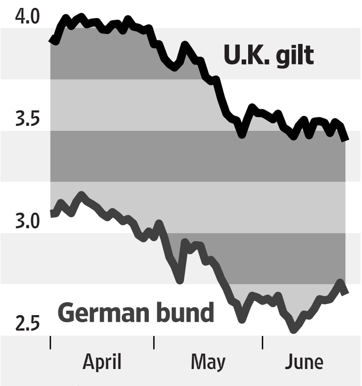
Announcing the measures, Mr. Osborne pointed out that tighter fiscal policy would allow rates to stay lower for longer.

He quoted BOE Governor Mervyn King saying that weaker growth would probably also mean softer inflation, allowing the central bank to respond.

Lending credence

In a sign of rising confidence, the gap in yields between U.K. and German sovereign bonds has been narrowing over the past month

10-year bond yields, in pct. points



Source: Thomson Reuters

"The budget underlines the need for continued very strong support from monetary policy," said Jonathan Loynes, U.K. economist at Capital Economics. "We still think interest rates are going nowhere for a long time."

Investor concerns about sovereign creditworthiness elsewhere in Europe had increased pressure on the U.K. government to take drastic action to tighten its fiscal belt.

International ratings agencies had threatened to remove the U.K.'s triple-A credit rating if the new government didn't set out aggressive steps to put its finances on a sustainable path.

But their initial response to the package of measures was positive on Tuesday, with Fitch Ratings saying it provided a "strong statement of intent."

Economists noted that the delay in the sales tax rise to the start of 2011, by which time the BOE expects annual inflation to have eased back to its 2.0% target from 3.4% in May, should limit the concerns of the Monetary Policy Committee's more hawkish members.

Some analysts warned that since the increase would result in inflation rising back above its target and staying there for an extended period, that risked pushing up inflation expectations, which have already gained in response to recently elevated inflation readings.

But though that could provide a hurdle to further policy easing, the BOE is highly unlikely to raise interest rates any time soon.

Fresh economic forecasts produced Tuesday by new independent fiscal council, the Office for Budget Responsibility, show the U.K. economy growing 1.2% in 2010, 2.3% in 2011, 2.8% in 2012, 2.9% in 2013 and 2.7% in 2014 and 2015.

Alan Clarke, U.K. economist at BNP Paribas, voiced skepticism about the optimism of the forecasts, which imply that £113 billion of fiscal tightening by 2015 will slow growth in 2010 and 2011 but raise it from 2013.

"This is screaming no rate hikes any time soon," Mr. Clarke said.

He added that Mr. King's willingness to respond if the fiscal tightening damped growth and inflation to a great enough degree suggested the possibility of additional policy stimulus.

He tipped the BOE to announce £25 billion of extra bond purchases in August, and a further £25 billion in November.

The BOE launched its £200 billion quantitative-easing program—through which it has bought mostly U.K. government bonds with freshly created central bank money—in March 2009, having slashed its key interest rate to an all-time low of 0.5%.

It suspended the program in February but has kept the door open to easing conditions further if the government's tax and spending plans weaken growth to a greater degree than was foreseen, or if there are new shocks to the economy.

While aggressive fiscal tightening had been widely expected, the central bank by convention bases its forecasts on the latest available official projections for tax and spending—up until now, the previous Labour government's May Budget Report, which contained more gradual consolidation plans.

The emergency plan responds to rating agencies' demands for aggressive action to pare a £155 billion deficit and aims to create a modest structural surplus within five years.

The BOE has incorporated an estimate of the impact on consumer demand due to expectations of fiscal tightening into its forecasts, but Tuesday's report provides them with quite a bit more to factor in, BNP Paribas's Mr. Clarke said.

Further clarity on exactly where the cuts will fall will emerge after the comprehensive spending review over the summer and at the Pre-Budget Report in the autumn.

EUROPE NEWS

Short-term pain to yield gains later?

[Commentariat]

"The specific measures announced today are substantial and enhance confidence in the U.K. public finances...Securing the reductions in 'unprotected' departmental and welfare spending will be very challenging and the Spending Review announced for [Oct. 20] will be important in detailing and enhancing the credibility of today's Budget announcements."
—Fitch Ratings

"It is doubtful that the similar measures announced in Germany and France will affect their location choices as those countries would not be natural alternative jurisdictions to the U.K. Moving to Asia becomes more attractive when the combined effects of the levy and corporate and personal tax regimes are taken into account."
— Nigel Harman, U.K. head of banking at KPMG

"Throwing tens of thousands of public sector workers on the dole [unemployment benefit] will cost the country billions in lost tax revenue as well as piling billions onto the benefits bill."
— Dave Prentis, the general secretary of UNISON, the U.K.'s largest public-sector union

"Although VAT will rise as expected, the delay until January next year—by when inflation should have fallen back a long way—should limit the concerns of the inflation hawks on the [Bank of England's monetary policy committee]. We still think interest rates are going nowhere for a long time."
—Jonathan Loynes, chief European economist at Capital Economics

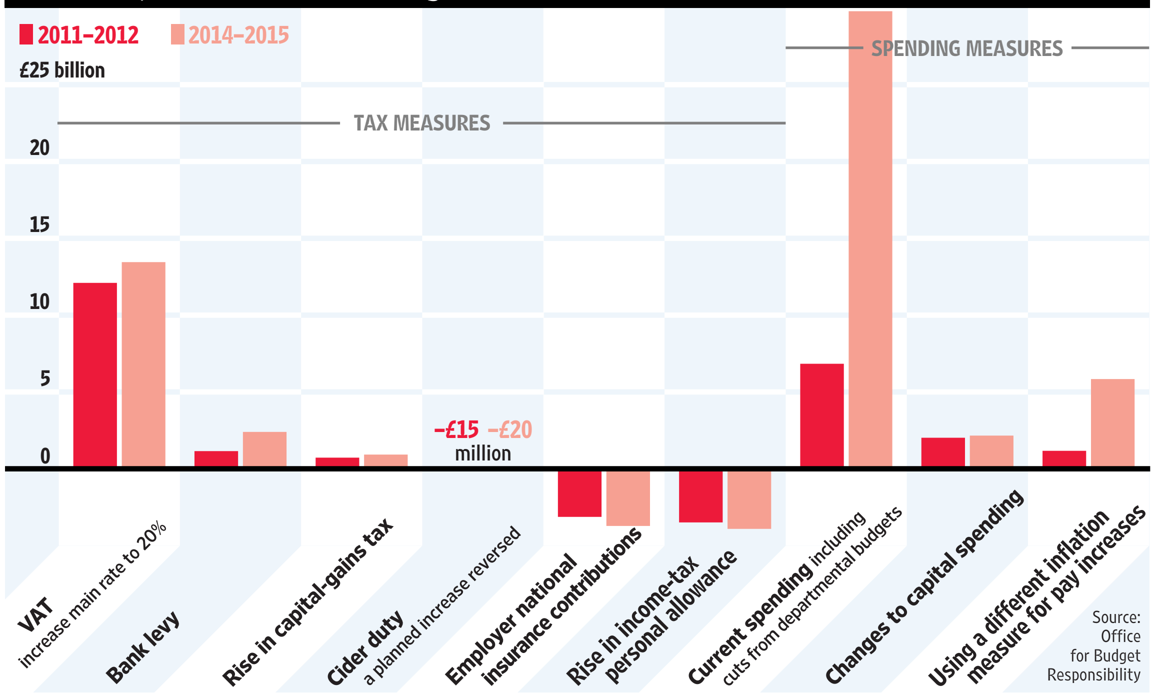
"[The decision to freeze alcohol duty] is a welcome relief for struggling pubs .... [The VAT] increase is not welcome, but is understandable... We hope this will be short-term pain for long-term gain."
— British Beer & Pub Association

"Although there was some uncertainty at times, the wholly expected VAT increase saw the retail sector jump by up to 4% — the news certainly could have been worse — and it was a similar story with the banks where the [planned levy] could have been somewhat more aggressive."
— IG Index

"This budget is not driven by economics, it's driven by ideology: their commitment to a smaller state."
— Harriet Harman, the interim leader of the Labour Party

"[The rise in capital-gains tax to 28%is] a big increase but it could have been a lot worse — many were expecting a hike to 40% or even 50%."
— Caspar Noble, a partner in the tax group at Ernst & Young

The hits | How far the U.K. budget's measures reduce the deficit



Source: Office for Budget Responsibility

Agence France-Presse/Getty Images

Lagarde hints that austerity may continue

By David Gauthier-Villars

PARIS—France might take new austerity measures this summer if the country's economy fails to meet growth targets, Finance Minister Christine Lagarde said Tuesday.

"Balancing our public finances is a priority," Ms. Lagarde said in an interview. "The road is arduous, but our political determination is complete."

The statement came against the background of weakening economic growth prospects in France, which could mean the French state gets less tax revenue than it was expecting. After gross domestic product for the second quarter is announced in August, France might have to cut its 2011 growth forecast, said Ms. Lagarde. The forecast currently stands at 2.5%, which she said was "audacious."

France's resolve to square its finances comes before a meeting of the Group of 20 leading and developing nations, where heads of government will debate the fundamental direction of their economies. Broadly, the U.S. wants governments world-wide to maintain consumer demand in order to not choke growth. But the Europeans have pledged to focus on rigorous budgets in order to avoid Greece-style crises over their sovereign debts.

Germany, has said it will shave €80 billion ($98.5 billion) off its deficit between 2011 and 2014.

France has said it aims to slash its budget deficit, which swelled during last year's recession, to below 3% of GDP in 2013 from an expected level of about 8% this year.

Ms. Lagarde said on Tuesday that the 3% target was "immutable" and that she would conduct a review in mid-August, based on second-quarter GDP data, to see whether more cuts are needed.

The government has already announced €45 billion in spending cuts and €5 billion in tax increases.

Ms. Lagarde said France would use G-20 meetings in Canada to promote a French, German and U.K. initiative for a new bank tax designed to help insure financial institutions against future, widespread crisis.

If implemented, the tax could yield €1 billion in France alone, Ms. Lagarde said. "It's quite something," she added. Later Tuesday, France's Finance Ministry said Ms. Lagarde misspoke and that the tax could yield a few hundred million euros.

Reuters

French Finance Minister Christine Lagarde listened during a conference last Wednesday at the Economy Ministry in Paris.

Europe champions levies on bank balance sheets

By Sara Shaefer Muñoz
And Alistair MacDonald

Europe on Tuesday moved to back a new tax on banks, with the U.K. including the levy in its new emergency budget and Germany and France pledging to follow suit in coming months.

The three nations will now urge other countries to join them at the weekend summit of the Group of 20 leading nations to be held in Toronto. "The French, U.K. and German governments are committed to the full implementation of the ambitious G-20 financial-sector reform agenda and look forward to discussing these proposals further," the three governments said in a joint statement.

Broadly, these governments are pursuing levies that would tax banks' balance sheets in a way that would encourage institutions to seek more stability in funding—setting higher rates on short-term financing, such as overnight interbank borrowing, and levying little or no tax on their longer-term debt and customer deposits. It remains to be determined how the taxes would be used—returned to national treasuries, or deployed to a bank-relief fund.

Sweden has already started its own bank levy. The Obama administration remains committed to a levy, said a senior U.S. official, and is looking for vehicles outside the financial regulation bill to pass the tax.

The subject of bank levies will be on the agenda at the G-20's summit, but countries are likely to agree to disagree, say people close to the matter. The countries that have had to pay for bailouts of their financial sectors—including the U.K., U.S., Germany and France—are backing bank levies of one sort or another. Countries such as Canada and Australia don't want to punish their banks, which were left relatively unscathed by the credit crisis.

European Union leaders—except for the Czech Republic—agreed last week to back a bank tax as a way "to ensure fair burden-sharing and to set incentives to contain systemic risk." But they haven't agreed on what the funds raised should be used for.

Britain and France both favor the money going into national treasuries as part of general tax revenue. Germany, supported by the European Commission, the EU's executive arm, has proposed that the money raised should be directed toward a bank-resolution fund. Sweden's levy follows this model.

The Obama administration has pushed for a bank tax to recoup government payments for the recent crisis, which it dubs a "financial crisis responsibility fee," on the short-term liabilities of banks with assets of more than $50 billion. But it hasn't been able to win Congressional approval thus far; the tax isn't part of the financial regulation bill nearing completion in Congress.

The German-Swedish approach has been criticized as creating "moral hazard," an incentive for banks to indulge in reckless behavior in the knowledge that they would be rescued. Chantal Hughes, a spokesperson for the European Commission, says: "You can't have a moral-hazard situation worse than it is at present."

With different bank-levy approaches emerging, leaders are expected to focus on preventing banks from arbitraging different tax regimes. A senior U.S. official said Monday that uniformity beyond the U.S. and Europe wasn't critical given that these markets represent such a large percentage of the global financial system.

But an Indian adviser said he was concerned with such an outcome because developing-nation banks are becoming a larger part of the global system and the G-20's goal should be a uniform position on bank levies.

German Chancellor Angela Merkel on Tuesday said her cabinet would finish a draft bill for a bank levy this summer. France said it would present details of its bank levy in its 2011 budget this fall. Germany's planned levy would be an annual tax on banks' balance sheets, excluding customers' deposits, which could generate as much as €1.2 billion annually.

In the U.K., British Finance Minister George Osborne announced the levy as part of the new government's budget Tuesday. The tax, based on banks' balance sheets and starting next year, aims to encourage banks to move to less-risky funding profiles by taxing short-term funding more heavily than long-term funding and leaving retail deposits and other top-rated capital out of the tax altogether. Final details of the levy will be published later this year, the U.K. Treasury said, following a consultation with the banking sector and other interested parties.

A statement from the British Bankers' Association said banks "are committed to working with the government to ensure new bank levies balance tax-raising objectives with the need to keep the recovery moving." But it added that these efforts need to be coordinated internationally.

—Stephen Fidler, Bob Davis and Patrick McGroarty contributed to this article.

Spending fight likely at G-20

By Bob Davis
And Marcus Walker

The U.S., worried about producing a "Hoover moment," may be headed for a showdown with its major economic partners over the speed at which they withdraw fiscal support for their economies.

European leaders are more cautious about spending, chastened by the example of Greece, where investor confidence was shattered by mounting debt and the possibility of a default, prompting a nearly $1 trillion rescue fund.

In China, officials worry that continued stimulus could create unsustainable asset bubbles. Indeed, one reason China may have pledged Saturday to allow the value of its currency some flexibility is to resist inflation by making imports less costly, economists speculate.

China's plan to loosen the tether between its yuan and the dollar removed what would have been a sore point from the G-20 agenda, paving the way for tensions over fiscal policy to become a bigger theme at the meeting, to be held in Toronto. Other issues include large trade surpluses in Germany and Japan, and big deficits in the U.S.

Canada, whose weight in the G-20 is magnified this year because it hosts the summit, is pressing for deficit reduction, urging its peers to halve their deficits by 2013. Finance Minister Jim Flaherty says he will be push for concrete debt and deficit reduction targets.

A tilt toward austerity is under way in Japan too, which has run up giant debts over two decades to shake the country out of its economic doldrums. Prime Minister Naoto Kan, who took office June 8, wants to double the country's broad sales tax from the current 5% within several years and cap next year's national budget at this year's level.

"Fiscal policy which relies excessively on deficit bond issuance is no longer sustainable," he said in his inaugural speech, citing the example of Greece.

The pace of government spending is vital for the global economy, which is recovering modestly from the deep downturn.

The debate expected this weekend: What is the biggest threat to growth, diminished demand or escalating debt?

"The No. 1 topic of conversation [at the G-20] will be how quickly should fiscal stimulus be withdrawn," said Harvard economist Kenneth Rogoff. a former chief economist of the International Monetary Fund. "The U.S. is at one extreme [pushing growth] while the rest of the world is much more anxious."

The U.S. isn't arguing for an increase in spending but rather that countries not act too precipitously. "Should confidence in the strength of our recoveries diminish," Mr. Obama wrote the other leaders last week, "we should be prepared to respond as quickly and forcefully as needed to avert a slowdown in economic activity."

The U.S. has been pushing the G-20 to focus on stimulus at least since a London summit in April 2009, while Germany, France and other European countries wanted to focus more on financial regulation. The U.S. won that fight.

The G-20 as a whole increased fiscal spending in 2009 and 2010 by at least 2% of gross domestic product to fight the recession—a jolt that's likely to be cut back sharply in 2011, the IMF figures.

EUROPE NEWS

Eurocontrol prepares for 'Single Sky'

European Union's plans to unify national air-traffic systems bring obscure umbrella control agency into the spotlight

By Daniel Michaels

Associated Press

Passengers at Portela Airport in Lisbon in May faced long delays as a cloud of volcanic ash disrupted flight schedules.

BRUSSELS—Eurocontrol operated in obscurity for 50 years before an Icelandic volcano thrust the air-traffic agency into public view. Soon it will play an even more prominent role in efforts to clear Europe's perennially snarled skies.

The European Union is finalizing plans to unify the 27-country bloc's patchwork of national air-management systems under a project dubbed the Single European Sky. Eurocontrol, the umbrella organization for air-traffic controllers in 38 countries, isn't part of the EU, but is set to be a cornerstone of the EU's new structure.

At a meeting Thursday, EU transport ministers are expected to back plans to designate Eurocontrol as the Continent's new performance-review body overseeing air-traffic controllers, with authority for the first time to judge their efficiency under one standard. Later this year, the EU is likely to appoint Eurocontrol to manage Europe's first unified network of international air lanes.

Plans for the Single Sky, which had dragged for years, took on new urgency when Iceland's Eyjafjallajokull volcano erupted in April, prompting the closure of almost 80% of European airspace. The EU's disorganized reaction persuaded officials that greater coordination is vital.

The Single Sky "would not have solved the problem, but would have enabled a more nimble response," said EU Transport Commissioner Siim Kallas in late April, when he announced a push to fast-track the plan.

Eurocontrol, which is funded by member nations and airline fees, leveraged its Continent-wide view to play a big role in getting airspace reopened. The EU has since established a crisis center at Eurocontrol's headquarters so the next aviation emergency won't be handled on an ad hoc basis.

Director General David McMillan says that experience shows the potential benefits of Eurocontrol for airlines and passengers. "The big win, if we can get it, is a single air-traffic management process on the Continent," he said in an interview.

Mr. McMillan, who came to Eurocontrol in January 2008 from the British Civil Aviation Authority with the mission of reshaping the 38-country organization, said his goal is to create "a much more straightforward process" than the national fiefdoms that now exist.

For decades, European countries have managed airways as if they had only national roads and no international expressways. The EU until recently had little say over aviation, and national regulators jealously guarded their skies to protect both military airspace and jobs for civilian air-traffic controllers.

The U.S., in contrast, handles airspace roughly comparable in size and traffic to the EU's with one traffic network.

As European air travel soared over the past two decades, its spider's web of routes has become overloaded. EU officials have tried fruitlessly since the 1990s to improve aviation integration, which they say would reduce delays and cut both fuel consumption and carbon emissions by more than 10%. The stalemate has been typical of many tussles in the bloc: EU functionaries fighting to wrest power from their counterparts in national capitals.

Eurocontrol, founded in 1960 under an international treaty, on paper looks like the ideal body to handle the Single Sky. The agency now acts as a clearinghouse for flight plans of planes flying anywhere between Ireland and Armenia, covering an area much larger than the EU.

But industry officials say that because of turf battles among Eurocontrol, the EU and European national governments, the agency hasn't lived up to its potential. Denied real authority over flights, Eurocontrol staff—many on lucrative long-term contracts—busied themselves with projects that rarely translated to action.

"In the past, one had the sense Eurocontrol was out of control," said Ulrich Schulte-Strathaus, secretary-general of the Association of European Airlines.

Mr. McMillan acknowledged that Eurocontrol "had become a bit sleepy and disengaged." Since beginning his five-year term, Mr. McMillan said, he has focused on meeting the needs of airlines, national controllers and others outside his agency.

A key part of Eurocontrol's reorientation is Mr. McMillan's current effort to simplify its structure along three separate lines that fit with the EU's plans. One unit will handle regulation as part of the Single Sky. Another is being prepared to manage operations across Europe's entire air-traffic network. The third will handle research, particularly for new satellite-based air navigation systems that the EU plans as part of the Single Sky.

Industry officials say they like the agency's reforms but await more results. "We want to see Eurocontrol fulfilling the needs of the industry, and not building their empire," says Günter Martis, director of European affairs at the Civil Air Navigation Services Organization, a trade group for national air-traffic managers. "They have fantastic expertise, but they need to use it in the right place, and not invent activities for themselves."

Mr. McMillan said he wants Eurocontrol's technical knowhow to be used according to the industry's needs. As Eurocontrol moves to link more closely with the EU, he faces a political challenge of balancing growing momentum for integration against lingering resistance from the national authorities that fund Eurocontrol.

"It's a very, very difficult task for David," said Mr. Schulte-Strathaus at the Association of European Airlines. "He's dependent on member states as his lords and masters, and on the European Union for Eurocontrol's future."

Mr. Schulte-Strathaus says Mr. McMillan has maneuvered skillfully so far. But airlines impatient for greater efficiency will only applaud once they can fly through seamless skies.

Unifying Europe's skies

The EU aims to start implementing its 'Single Sky' plan in 2012. Here are some of the key improvements planned:

Today	Single Sky
Governments handle air-control independently.	EU plans to oversee one network.
Flights zigzag along routes based on national borders.	Planes will fly more directly, cutting flight time and fuel consumption.
Countries are divided into inefficiently small air-control regions.	Large 'functional airspace blocks' will span borders.
Air-controllers work to different standards and charge varying fees.	Peformance rules and fees will be standardized across EU.
Eurocontrol organizes flight plans using national air lanes.	Eurocontrol likely to act as 'network manager' with greater authority.
Military airspace usually closed to commercial aircraft.	Military and civilian controllers will cooperate on airspace use.
Controllers in frequent radio contact with aircraft.	Aircraft will navigate by satellites, letting controllers handle other tasks.

Sources: European Union, Eurocontrol

Why Lithuania still wants to adopt the euro

Agence France-Presse/Getty Images

Lithuanian Premier Andrius Kubilius

By Paul Hannon

The euro zone may be in crisis, but it is a club that continues to attract new members.

Estonia will become the 17th nation to adopt the euro in January, and the other Baltic states want to follow as soon as they can bring their budget deficits into line with the entry criteria.

Speaking ahead of a pitch to potential investors in London Tuesday, Lithuanian Prime Minister Andrius Kubilius said his government intends to make further big budget-deficit cuts to join the currency area in 2014.

Little more than a decade after its foundation, the euro zone faces a major test of its coherence. The failure of its systems for monitoring and controlling buildups in government debt has forced member governments to provide €10 billion ($12.3 billion) in loans to Greece, helped by the International Monetary Fund.

On top of that, euro-zone policy makers acknowledge that the existence of a common currency has led to big divergences in competitiveness, with Greece, Spain, Portugal and other countries losing ground against Germany, largely because wages in those countries have grown more rapidly than productivity.

Yet for Mr. Kubilius there isn't an alternative to joining the euro zone. In his view, Lithuania doesn't have the freedom of choice open to larger countries around the Baltic Sea—such as Sweden and Denmark—which have chosen to stay out of the currency area.

"It's an instrument that will allow us to feel a little more safe in the global financial system," he said.

Lithuania has long pegged its currency to the euro, so in Mr. Kubilius's view, Lithuania "almost has the euro, without the benefits," such as a say in forming euro-zone policy and less-expensive access to bond-market financing.

Outside the currency area, Lithuania has suffered greatly form the financial crisis and the global economic recession.

Its economy contracted 15% last year, partly the result of the bursting of a property bubble, while the unemployment rate hit 13%. The economy continued to shrink in the first quarter of this year, and the European Commission doesn't expect growth to resume until next year.

With tax revenues collapsing, the budget deficit soared to 8.9% of gross domestic product last year. Mr. Kubilius's center-right government responded by slashing public-sector wages, cutting social-welfare benefits and raising the sales tax.

Mr. Kubilius estimates that without those measures, the deficit would be 12% of GDP or higher. But further measures are required to bring the deficit below 3% of GDP in 2012, meeting that criterion for joining the euro zone.

It is Mr. Kubilius's second term as prime minister, his first having been in 1999, when Lithuania was suffering from the fallout from Russia's financial crisis. He says he is confident his government can achieve its fiscal aims.

"I don't see any major problems to achieve this goal, if nothing very bad will happen in Europe," he said.

Obama's budget chief steps down

Orszag to leave post in July as administration wrestles to tame burgeoning U.S. deficit

By Jonathan Weisman

Reuters

Peter Orszag, in Washington in April, plans to step down as White House budget director in July.

WASHINGTON—The White House said budget director Peter Orszag, one of the most visible members of U.S. President Barack Obama's economic team, will be leaving his post this summer.

Mr. Orszag, the most senior official to leave the Obama administration, will step down in July, two administration officials said.

Officials close to Mr. Orszag noted that he had served nearly four stressful years in similar posts, first as director of the Congressional Budget Office, then as Mr. Obama's first director of the Office of Management and Budget.

Mr. Orszag helped steer through Congress a $797 billion economic-stimulus bill in his first weeks at the White House job, before becoming one of the driving forces in shaping the health-care law.

He told the Associated Press on Tuesday that he viewed the passage of last year's economic-stimulus bill as his most significant accomplishment.

The president had wanted a decision from Mr. Orszag before the fall, when the administration will begin putting together the fiscal 2011 budget amid some of the greatest budget pressures in modern U.S. history.

Mr. Orszag will also be marrying Bianna Golodryga, an ABC News business reporter, in September, and "restarting his life," a person close to the budget director said.

"Peter has served alongside and within a valuable economic team that has faced the greatest economic crisis any president has faced since the Great Depression. It is an enormous task," White House Press Secretary Robert Gibbs said Tuesday.

Already, administration officials have begun vetting possible successors. One, Gene Sperling, a director of President Bill Clinton's National Economic Council and a top aide to Treasury Secretary Timothy Geithner, has been cleared to take the position of deputy budget director, but uncertainty about Mr. Orszag's departure date had frozen Mr. Sperling's move.

Along with Mr. Sperling, White House officials are considering names including Laura Tyson, a top economist in the Clinton administration and dean of the University of California's Haas School of Business; Robert Greenstein, the director of the liberal Center on Budget and Policy Priorities; and Rep. Artur Davis, an Alabama Democrat and early supporter of Mr. Obama's White House bid who recently lost the Democratic nomination for Alabama governor.

According to a person familiar with the deliberations, Ms. Tyson's name has surfaced because she is seen as a confident, credible spokeswoman for White House economic policy as the record budget deficit moves to perhaps the most prominent spot in the president's domestic agenda.

Mr. Orszag will leave with major legislative accomplishments under his belt. But a man who made his name as a budget hawk, first at the Brookings Institution, then at the Congressional Budget Office, also failed to make a dent in a deficit swollen by spending during the economic downturn that stayed high as Mr. Obama pushed through spending and tax cuts to restore economic growth.

A bipartisan White House commission is considering ways to tame the deficit, and will report back after the November midterm elections.

If the ideologically diverse panel can agree on recommendations, the president must then turn his attention to implementing them.

If the group cannot agree, officials said, Mr. Obama will have no choice but to push his own budget solutions.

The deficit is lingering at nearly 10% of the gross domestic product. Even under the president's assumptions on declining health-care spending and a freeze on nonsecurity domestic spending, the deficit wouldn't drop to what Mr. Orszag has called sustainable levels over the next decade without a sharper policy response.

The commission is looking at cuts to discretionary spending and entitlements such as Social Security and Medicare, as well as an overhaul of the tax code that would simplify taxation and bring in more revenue.

If, as expected, Republicans grab more seats in the U.S. Congress in November—or even control of the House of Representatives—the president plans to push them to make good on their own promises to tackle the budget deficit.

—Jared A. Favole and the Associated Press contributed to this article.

Pressure is on to finish bank rules

By Damian Paletta

WASHINGTON—House and Senate Democrats are under pressure to complete their overhaul of financial regulations before President Barack Obama meets with world leaders this weekend, setting up a scramble to iron out differences on a range of complicated provisions.

The discussions cover issues from bank regulation to consumer protection. They seek to find a balance that may appease the few centrist Republicans willing to support the bill, while also keeping liberal Democrats happy.

If lawmakers don't complete their work this week, not only will Mr. Obama go to the Group of 20 summit this weekend without a final bill to tout, but also Congress might not be able to pass a law before the July 4 recess.

Lawmakers on Monday neared a deal on a key part of the bill, people familiar with the matter said, which would limit the amount of capital a bank can place in risky investments.

This provision, known as the Volcker Rule, had originally proposed a strict ban on banks making bets with their own money, a practice known as proprietary trading. Lawmakers were in advanced talks to allow large banks to invest a small amount of their capital—perhaps 2%—into certain privately managed funds, several people familiar with the matter said.

The precise level is still being discussed, and aides said the number could change. To appease critics of big banks, the agreement could remove part of the Senate bill that gave the Treasury secretary discretion to discard the limits on proprietary trading altogether.

Former Federal Reserve Chairman Paul Volcker, the idea's originator, had expressed opposition toward allowing banks to invest even small amounts. President Obama and Mr. Volcker discussed the issue over the weekend, people familiar with the matter said.

"Mr. Volcker wants and expects a really strong bill," said the former Fed chairman's assistant, Tony Dowd. "He doesn't want it to look like Swiss cheese."

Lawmakers are also close to a deal that would place a new consumer-financial protection bureau within the Federal Reserve, scrapping an original White House proposal to create a stand-alone agency.

The change, which closely follows language adopted by the Senate in May, would likely not appease business groups, which oppose the creation of any new consumer-protection regulator with broad powers. Lawmakers are divided over whether it would have power over auto dealerships.

Congressional aides said lawmakers remained divided on whether banks should be allowed to keep their derivatives-trading operations.

A requirement that banks spin off such operations was inserted into the Senate-passed bill by Blanche Lincoln, an Arkansas Democrat.

Lawmakers were also divided about how to set up stricter capital rules for banks with more than $10 billion of assets, as required by an amendment Sen. Susan Collins (R., Maine) attached to the Senate bill last month. Banks say the rules would restrict their ability to lend.

Lawmakers on Monday did reach a deal that would limit the amount of fees banks are allowed to charge retailers for processing debit cards.

The conference committee of congressional negotiators seeking to resolve differences between the House and Senate versions of the bill plans to work through the consumer-protection issues on Tuesday, the Volcker Rule on Wednesday, and derivatives regulation on Thursday. The timing could slip if lawmakers need more time to resolve disputes.

Democrats and administration officials still expect almost all Republicans to vote against the final bill.

Big cities grow as recession reduces moves to the suburbs

By Conor Dougherty

Several of the biggest U.S. cities grew at a faster pace last year than at any time in the 2000s, as the recession and housing bust kept people from moving out of state or to the suburbs, the Census Bureau said.

Chicago saw its population increase 0.8% between July 2008 and July 2009, the fastest pace of the decade, according to Census data released Tuesday.

Denver, Seattle and Dallas also posted their highest annual growth rates of the decade for the same period. Of the 34 U.S. cities with more than 500,000 people, 19 grew faster last year than the year before, according to an analysis of Census data by William Frey, a demographer at the Brookings Institution.

New York, the largest U.S. city with about 8.4 million people, continued to grow steadily. The city's population expanded 0.5% in 2009, compared with 0.4% a year earlier, but still down from 0.7% in 2007.

"This has been a topsy-turvy decade for America's cities, where housing bubbles, credit crunches and a prolonged recession have cooled down many suburban hot spots and permitted more traditional areas to recoup earlier losses," said Mr. Frey.

Chicago saw its population increase 0.8% between July 2008 and July 2009, the fastest pace of the decade.

Earlier in the decade, several big cities, especially colder ones in the Midwest and Northeast, lost many residents to warmer cities in the South and West. But a years-long decline in home prices, combined with the worst recession in a generation, has prompted would-be movers to stay in place, helping many cities hang on to their residents.

The housing bust has also kept younger couples from moving to the suburbs, said Kenneth Johnson, senior demographer at the University of New Hampshire's Carsey Institute.

The reverse trend is playing out in once-hot housing markets. In Florida, an epicenter of the housing bust, two of the state's 19 cities with more than 100,000 people lost population in 2008-2009. Cape Coral saw its population decline 0.4% last year, a steeper tumble than Akron, Ohio, the rust-belt city that has long been losing population, including a 0.3% drop last year.

Other big cities in once-hot housing markets, such as Phoenix and Las Vegas, have seen population growth slow. Phoenix grew 1.5% from July 2008 to July 2009, the slowest pace of the decade. The city gained 24,000 people between 2008 and 2009, compared with nearly 41,000 between 2005 and 2006.

In Texas, where a milder housing bust and an economy buoyed by the oil industry shielded the state from the worst of the recession, population growth continues to outpace most of the rest of the U.S. Four of the nation's 10 fastest-growing cities over 100,000 were in the state, including Frisco, the fastest-growing city in the U.S.

U.S. NEWS

Feinberg ramps up Gulf victims fund

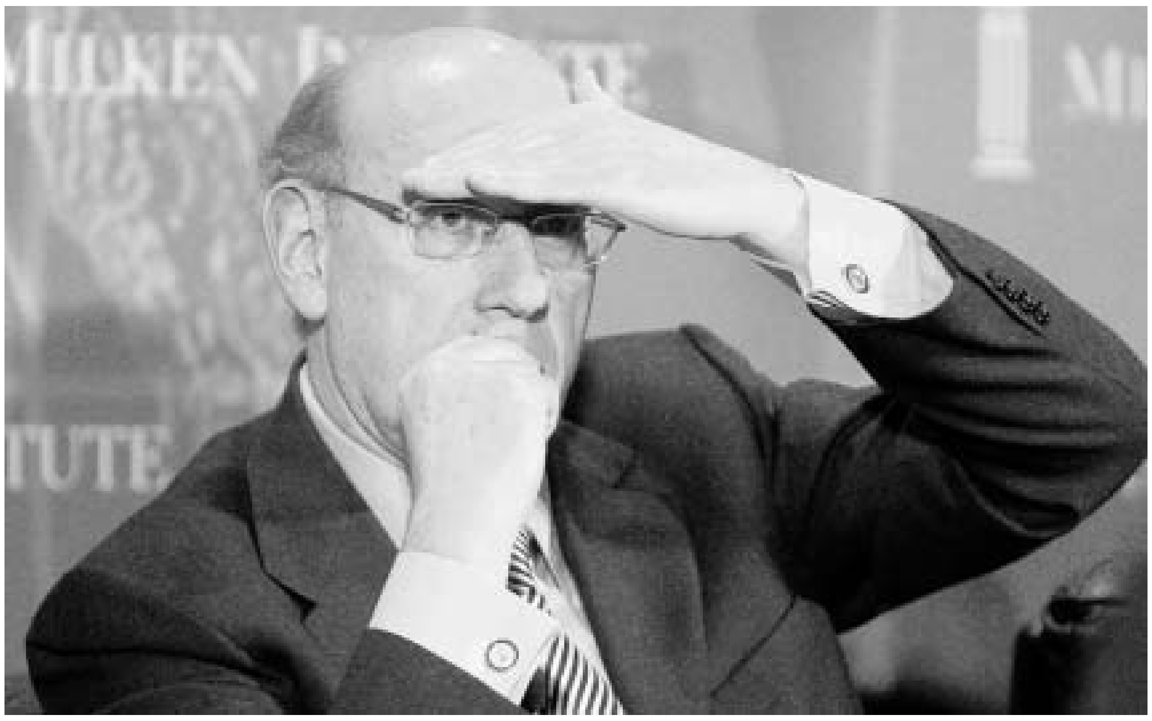
Administrator aims to speed up compensation system set up by BP; Mimosa Dancing Girls puts in a claim

By Neil King Jr.

Calamities and Kenneth Feinberg have a way of finding each other.

As soon as the Deepwater Horizon drilling rig sank and triggered a huge oil spill in the Gulf of Mexico in April, Mr. Feinberg started mulling how an avalanche of claims by economic victims could be handled. Less than two weeks ago, **BP** PLC called to offer him a job doing just that. Last week, BP and President Barack Obama jointly chose him as administrator of an unprecedented $20 billion compensation fund.

The Washington lawyer and arbitration guru is now racing to speed up the system that BP initially put in place to compensate tens of thousands of Gulf residents and businesses for their financial injuries. It's a task he predicts will outstrip in complexity all the other victims' funds he has run, from the Agent Orange liability litigation in the 1980s to the $7 billion for victims of the September 2001 terror attacks.



Reuters

Kenneth Feinberg, shown in California in April, was named administrator of an unprecedented $20 billion compensation fund.

What makes this case all the harder to handle is that it remains an unfolding disaster. "Until the oil stops, this is an ongoing tort. We just can't say what the final size of claims will be," Mr. Feinberg said in an interview. "The sheer scope of this is something we haven't seen before."

Two days after BP and the White House agreed on June 16 to set up an independent claims fund, Mr. Feinberg flew to the region, first to Mississippi and then Louisiana. Mr. Feinberg met Monday with BP executives in Houston to work out details for taking over the claims process. He is set to travel next to Alabama and Florida.

The fund he is set to administer has a number of oddities. It was created as a voluntary compact between the U.S. government and BP, but without any act of Congress, executive order or other legal anchor. Mr. Feinberg will have complete latitude to determine the fund's operations, including all key decisions as to who gets money and in what amounts.

Since his appointment, Mr. Feinberg has said repeatedly that he would neither take orders from the White House nor BP. But he said that Mr. Obama did give him one instruction: to get payments out quickly.

After meeting with Mississippi Gov. Haley Barbour on Friday, the 64-year-old Mr. Feinberg warned of the high potential for fraudulent claims in the same breath as he urged anyone who thinks they may be eligible to step forward. Getting people to apply in the first place is his first big hurdle.

"You'd be amazed how many people don't come forward," he said. "They procrastinate, they worry, they doubt they will qualify, they don't trust the process, whatever."

BP has faced heavy criticism for lapses leading up to the disaster and for failing to prepare for a spill of this size. But Mr. Feinberg praised the company for its work in getting a claims process running swiftly. For at least another month, Mr. Feinberg will be advising BP on ways to speed up payments and make the process more transparent. He said he hoped to assume all responsibilities by August.

In seven weeks, BP has written 31,000 checks worth $104 million to Gulf Coast fishermen, shrimpers and others whose work has been cut short by the spill. A team of nearly 1,000 clerks and adjusters are processing claims in 33 field offices from Louisiana to Florida.

"BP deserves a fair amount of credit here," Mr. Feinberg says. "This is the first time I know of where a company has implemented a whole process like this in the midst of an ongoing crisis."

The son of a tire salesman and a bookkeeper from Brockton, Mass., Mr. Feinberg makes his case in the heavy twang of south Boston. A former chief of staff to the late Sen. Ted Kennedy, he went on to become one of the country's most prominent arbitrators. After a rough start, he earned wide respect for how he handled the survivors and families of those killed on 9/11. The Treasury Department appointed him last year to monitor executive pay at companies that had received federal bailout money during the financial crisis.

"Ken is accustomed to handling these sort of issues without emotion," said former Attorney General John Ashcroft, who appointed Mr. Feinberg to run the 9/11 fund. "He was very good at distinguishing the deserving from the undeserving."

Doing the same along the Gulf Coast could be his biggest challenge. Can a motel 100 miles from the coast file for diminished revenues? What about a restaurant in Atlanta now having to pay more for shrimp?

And what about a New Orleans strip bar called the Mimosa Dancing Girls, which has put in a claim for a slump in sales? Asked about that one Monday on "Good Morning America," Mr. Feinberg said he was "very dubious about that claim," but didn't want to prejudge it.

As a rule, Mr. Feinberg said, he will turn to state law for guidance on which types of claims to honor and which to dismiss.

In the end, one aim of the fund—and a prime reason BP agreed to it—will be to minimize lawsuits against the company. To do that, Mr. Feinberg will offer big lump-sum payments to workers and businesses as an enticement to stay out of court.

"At some point, I will have to make an offer—'You take this amount in full satisfaction of your claim, but only if you waive your right to future litigation,'" Mr. Feinberg said. "And if I package it right, people will see that it makes no sense to fight it out in court."

For Planet BP, a silver lining

At least one institution can find the silver lining in the oil spill. In Planet **BP**—a BP online, in-house magazine—a "BP reporter" dispatched to Louisiana managed to paint an even rosier picture of the disaster. "There is no reason to hate BP," one local seafood entrepreneur is quoted as saying.

Indeed, the April 20 spill on the Deepwater Horizon came across in Planet BP as a stroke of luck. "Much of the region's [nonfishing boat businesses—particularly the hotels—have been prospering because so many people have come here from BP and other oil emergency response teams," another report says.

Planet BP did mention consumers being "afraid all seafood might be contaminated" and the uncertainty over the region's economic future.

—Benoit Faucon

Judge overturns U.S. ban on offshore drilling

Continued from first page

U.S. Gulf Coast, where the energy industry plays a significant role.

On Friday, drilling contractor **Diamond Offshore** Inc. filed a similar lawsuit in Houston.

Shares of companies with significant operations jumped immediately after news of the judge's ruling, although they quickly came off those highs.

Royal Dutch Shell, one of the big oil companies affected by the moratorium, praised Judge Feldman's decision, and said "Shell remains confident in its expertise and procedures to safely drill and complete deepwater wells."

The judge's ruling represents a stunning defeat for the Obama administration and Interior Secretary Ken Salazar. The administration had said that a six-month pause in drilling at depths greater than 150 meters was needed to allow the U.S. government and industry time to implement new safety rules and procedures to prevent another accident like the explosion on the Deepwater Horizon oil rig.

Bloomberg News

Ships in the Gulf of Mexico last week burn off oil and gas collected at the site of BP's out-of-control undersea well.

But the moratorium encountered vociferous resistance from the oil and gas industry, and from many elected officials in oil-producing Gulf states, including Louisiana Gov. Bobby Jindal. Industry groups said the ban would cost $330 million a month in direct wages.

The administration was also embarrassed when some petroleum engineers who were consulted by Mr. Salazar for advice on how to respond to the spill said their views had been misrepresented in an Interior Department report that called for a moratorium on deepwater drilling. The experts said they had never signed off on the moratorium, and echoed industry arguments that a broad ban on deepwater drilling was an overreaction that would unfairly punish workers and companies who had nothing to do with the Deepwater Horizon accident.

In a filing with the court, the Department of Interior had said that it instituted the moratorium with a view "for the long-term future," to reduce the likelihood of another disaster. "The public's interest weighs heavily in favor of making sure that a tragedy like this does not occur again," the filing said.

As the oil slick in the Gulf has grown, BP has faced withering criticism and deepwater drilling has come under scrutiny.

On Monday, BP collected a total of 25,830 barrels, the company said Tuesday. BP flared 10,270 barrels of oil and captured 15,560 barrels of oil. These figures beat BP's previous record achieved on Thursday, when the company collected a total of 25,290 barrels of oil.

In total, BP has recovered 298,600 barrels of oil since it put in place a containment cap and the flaring system.

At full optimization, the current operation could capture up to 28,000 barrels a day, Admiral Thad Allen of the U.S. Coast Guard, the federal commander for the response, has said. Scientists estimate the well is spitting out about 35,000 to 60,000 barrels of oil a day.

—Isabel Ordonez and Susan Daker contributed to this article.

Haley is tested on cultural links

Hopeful stresses loyalty to South Carolina

By Peter Wallsten
And Valerie Bauerlein

She was born in small-town South Carolina, attended South Carolina schools and won election three times to the state legislature.

But in her surging campaign for governor, Nikki Haley has been tested far more than other candidates on her cultural connections to the state.

Mrs. Haley, 38 years old, is an Indian-American, born into the Sikh faith, who converted to Christianity as an adult.

Her background has prompted some voters to seek assurances that she is committed to her Christian faith and understands the feelings among some voters about the state's Civil War history.

Mrs. Haley appears to have overcome these tests. She was heavily favored to win a GOP primary runoff Tuesday and is leading in general election polls—an ascent that began with an endorsement by Sarah Palin and, many GOP leaders believe, accelerated as voters rejected grumblings about Mrs. Haley's background and unproven allegations of marital infidelity. She would be the first woman to hold the state's top political job.

"As ugly and as tough as it has been," said Katon Dawson, former state GOP chairman, "I think South Carolina Republicans are pretty proud of what's going on right now."

Like her three GOP rivals for the governor's office, Mrs. Haley sat this spring for a videotaped interview with the Palmetto Patriots, a local activist group that aims to "fight attacks against Southern Culture" and talks with candidates "to ensure compliance with conservative values."

But Mrs. Haley was the only one to be asked the freighted question of what she thought had caused the Civil War.

Members of the group were curious about Mrs. Haley's views because of her heritage, said Robert Slimp, a Columbia, S.C., pastor who participated in the questioning. The group didn't ask her rivals about the war, he said, because "all of them are Southerners whose families go back to beyond the war between the states, back to antebellum times, and they would have a deeper appreciation of Southern thinking and mentality."

Mrs. Haley has also found herself questioned, in media appearances and personal conversations, about her Christian faith. As recently as Friday, Phillip Bowers, the GOP chairman in Pickens County and a co-chairman of the campaign of Mrs. Haley's rival in today's run-off, circulated an email to party activists suggesting that Mrs. Haley had been dishonest about her religious conversion.

The note charged that Mrs. Haley "can't seem to make up her mind about her faith." The campaign of Mrs. Haley's opponent in the Tuesday GOP run-off, Gresham Barrett, said it was "absolutely not" connected to the email.

Conservative radio show host Bob McLain said callers to his program have asked about Mrs. Haley's faith, and that questions about her religion had recently reached a "ludicrous point."

Mr. McLain said he had asked Mrs. Haley personally about her religion and came away convinced of the firmness of her Christian faith.

Mrs. Haley's campaign said persistent questions about religion had prompted it to revise its website. It now features a page designed to shoot down rumors, with the headline "Question: Is Nikki a Christian?"

The answer: "My faith in Christ has a profound impact on my daily life and I look to Him for guidance with every decision I make." That response was sharpened from the site's previous answer, which did not mention Christ but referred instead to "Almighty God."

When Mrs. Haley first ran for the legislature in 2004, one of her campaign brochures said she was "proudly raised with her Indian traditions." Still, her campaign has been sensitive to questions of race, and has chastised reporters for using the candidate's full name, Nimrata Nikki Randhawa Haley.

Jerry Young, a Haley supporter who leads a social-services charity in Charleston, said he believed Mrs. Haley's personal history was an advantage for her, politically.

"With people being sick of politics-as-usual, I think that opened up a door that probably wouldn't have been there before" he said. This year, Mrs. Haley's biography gives her "a better chance than somebody that may look like a South Carolina politician."

But even Mr. Young, who heads the Charleston Leadership Foundation, said he had felt the need to ask Mrs. Haley about rumors that she was a Buddhist.

He invited Mrs. Haley to his home, and his wife asked over dinner: " 'Is it true?' " Mr. Young recalled. "She said, 'Absolutely not. I'm a Christian.' "

Mrs. Haley's half-hour meeting with the Palmetto Patriots illustrated how she has sought to assure potential skeptics while also embracing her ethnicity.

She pledged to retain a political compromise that gave the Confederate flag a place of prominence in front of the State House, a position that puts her within the mainstream among GOP leaders in the state. Further, Mrs. Haley noted that "as a minority female" she was ideally suited to counteract an ongoing boycott led by civil rights groups.

Mrs. Haley chose her words carefully in talking about the causes of the Civil War.

"You had one side of the Civil War that was fighting for tradition, and I think you had another side of the Civil War that was fighting for change," she said. She did not use the word "slavery" but hinted at it, saying that "everyone is supposed to be free."

Mrs. Haley is the daughter of Indian immigrants. She was born in Bamberg, S.C., population 3,400, at a time when her family members were the only Indians in town, according to Jamie Brabham, whose children played with Mrs. Haley and her siblings.

Mrs. Brabham said the whispers about race and religion were disgusting and only elevated Mrs. Haley in many voters' minds.

"This child was born in this town," Mrs. Brabham said. "She grew up here. ... Come on! I thought we had climbed this mountain."

Nikki Haley

Born: Bamberg, S.C., daughter of Indian immigrants

Graduated: Clemson University in accounting

Work Experience: Family's clothing business, among other employers

Religion: Born Sikh; converted to Christianity

Political experience: Elected to state House in 2004. Re-elected twice

Policy positions: Favors term limits, eliminating state's small business income tax. Opposes federal stimulus package.

Husband: Michael; two children, ages 12 and 8

Associated Press

From left, former Massachusetts Gov. Mitt Romney, former South Carolina first lady Jenny Sanford, Nikki Haley and state attorney general Henry McMaster in Charleston, S.C., on Friday.

WSJ.com

For results from the elections and analysis visit **WSJ.com/US.**

Newcomer upends GOP race for governor in Florida

By John D. McKinnon

GULF BREEZE, Fla.—Many Republicans in this state thought their party's nomination for governor was all but settled. Bill McCollum, Florida's buttoned-down attorney general, had statewide name recognition and newly burnished conservative credentials, thanks to his leadership of a 20-state effort to overturn President Barack Obama's health law in court.

But in the course of a few weeks, a political newcomer has upended the race, launching a well-funded challenge to Mr. McCollum and taking the lead in two recent polls.

The challenger, Rick Scott, is surging even while carrying political baggage. Beginning in the late 1990s, the federal government investigated Mr. Scott's hospital chain, **Columbia/HCA**, over its Medicare and Medicaid billing practices, and eventually reached settlements with the company totaling $1.7 billion. Mr. Scott wasn't accused of wrongdoing in the matter.

Now, Mr. McCollum is fighting to avoid becoming the latest victim of the anti-establishment mood that has marked this election season. The primary is Aug. 24.

"Clearly it's a time when people are fed up with career politicians, so I think that's helping," Mr. Scott said in a recent interview.

In many of his TV ads, Mr. Scott talks directly to viewers and draws an implicit contrast with Mr. McCollum's 25-year political career. "Florida needs an outsider who's not part of the political establishment," Mr. Scott says in one ad. "Taxpayers need a businessman who knows how to create jobs, cut costs and balance budgets."

Mr. Scott has spent at least $15 million, much of it his own money, to air his advertisements in the past seven weeks.

"He's obviously struck a chord," said Peter Brown, who directed a Quinnipiac University poll in early June that found Mr. Scott up 13 points over Mr. McCollum, 44% to 31%. A more recent poll, by the Florida Chamber of Commerce Political Institute, showed Mr. Scott with a five-point lead.

Mr. McCollum and his supporters highlight the fraud settlements in 2000 and 2002 between the government and Mr. Scott's former hospital company. Mr. Scott left Columbia/HCA in 1997, in the midst of the federal investigation.

Mr. McCollum told a conservative group in Washington last week that as attorney general, he "undoubtedly" would sue and prosecute Mr. Scott if the Columbia/HCA investigation were under way today.

A spokeswoman for Mr. Scott noted that at the time of the Columbia/HCA investigation, Mr. McCollum was a key congressional defender of the company and other hospitals caught up in fraud investigations that were due in part to changes in the government's rules.

Mr. McCollum also points to Mr. Scott's lack of political experience. "I have a lot of knowledge of the state of Florida and the way state government works," he said. Mr. Scott "is just not knowledgeable in any depth about Florida."

Associated Press

Republican gubernatorial candidate Rick Scott introduces himself to Ruth Mayes while campaigning this month in DeFuniak Springs, Fla.