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THE WALL STREET JOURNAL.

VOL. XXVIII NO. 87 EUROPE Monday, June 7, 2010

DOWJONES A News Corporation Company europe.WSJ.com

£1.50
Bahrain BD 1.50 - Egypt $1.75 (C/V) Jordan JD 2 - Kuwait KD 1 - Oman OR 2 Qatar QR14 - Saudi Arabia SR 14

G-20 nears capital rules accord

By Michael M. Phillips And Charles Forelle

BUSAN, South Korea—The world's leading economic powers edged toward agreement on new rules to ensure that major banks keep enough money in reserve to insulate them against future crises.

Separately, European governments, under pressure to show progress in implementing their planned bailout for the continent's struggling governments, are on track to sign off on the final details of €440 billion ($530 billion) in loans intended to be a backstop if the continent's sovereign-debt troubles deepen, European officials said.

The G-20 finance officials agreed Saturday they would finish work on the tightened banking standards before their leaders meet for a summit in Seoul in November, ahead of their original year-end goal.

"It is critical that our banking regulators develop capital and liquidity rules of sufficient rigor to allow our financial firms to withstand future downturns in the global financial system," the finance ministers and central bankers said in a communique released at the end of the two-day meeting on the Korean coast.

The meeting showed that while the G-20 is reaching an accord on banking standards, it remains at odds over another central policy goal: imposing a global levy on financial institutions, either to recoup public expenditures on bailouts or to raise money that might be used to address the next crisis.

Under the new plan being hammered out by EU officials, if a euro-zone country had trouble paying its debts, it could apply for the bailout funding. Officials said a special purpose vehicle, set up to borrow money from capital markets and then dole it out to troubled nations, could be up and running this month.

Euro-zone leaders have already agreed on the basic structure of the package: A private vehicle chartered under Luxembourg law and owned by the 16 euro-zone countries would raise money with the guarantee of euro-

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European Pressphoto Agency

Hungarians get sinking feeling

Having spooked markets with renewed worries about its debt levels, Hungary suffered severe flooding over the weekend. Residents were evacuated from more than 100 houses in Boldva after the River Bodva burst its banks.

Meanwhile, the government tried to calm investors worried that Hungary would become the next Greece. After an emergency cabinet session, ministers pledged to keep the budget deficit goal for 2010, stressing that, despite a large deficit, Hungary isn't facing a sovereign credit default.

The government said it would formulate its action plan by Monday, when it is expected to brief visiting officials from the IMF and EU.

—Article on Page 4.

AT&T discusses buying sizable stake in Reliance

India's **Reliance Communications** Ltd. and U.S. telecom giant **AT&T** Inc. have sounded out each other's interest about a potential transaction in which AT&T would take a significant minority stake in the Indian cellphone company, according to people familiar with the matter.

By Amol Sharma, Anupreeta Das and Spencer Ante

The people characterized the informal discussions as very early, and cautioned that no deal is imminent, but said advisers and officials at the companies have been in touch in the past few weeks to explore the idea. Reliance, which is backed by billionaire Anil Ambani, said on Sunday its board has approved the sale of up to a 26% equity stake in the firm to raise cash for debt reduction and network upgrades.

Associated Press

Anil Ambani

The Indian company, the nation's second-largest wireless carrier with 105 million subscribers and a market capitalization around $7.4 billion, has been in stake-sale talks with Abu Dhabi-based **Etisalat Emirates Telecommunications** Corp. for about two months but is now courting other suitors including AT&T and other foreign telecom firms, one of the people said.

AT&T, the second largest U.S. cellphone company, with 87 million subscribers, is

Please turn to page 3

Unless two imbalances can be fixed, two new crises will follow this one

[Agenda]

BY IRWIN STELZER

Even the least among you can, well, cause a mess, we have learned as Greece's problems roll out around the world. First it was the euro zone that found Greece's problems couldn't be confined to that country's tiny economy. Then it was the entire European Union that caught the disease, as the banks in non-euro-zone countries found themselves holding a lot of sovereign debt that had once seemed risk-free. Even Hungary, which has been working with the IMF since 2008 and is "some 18 months ahead of Greece" in getting its house in order, according to Goldman Sachs analyst Magdalena Polan, finds the cost of insuring its debt rising, and its currency falling, as rumors of default are given credence by nervous markets.

America was next: so exposed are its banks to the problems created by Greece, Spain and other countries struggling to bring spending down to sustainable levels, so spooked are they by the prospect of Lehman Brothers Mark II, that President Barack Obama had to take time off denouncing BP to ring Spain's prime minister José Maria Zapatero and urge him to do what Mr. Obama has failed to do in America: reduce the deficit.

All of which might at least have the virtue of forcing policymakers to follow the advice of Rahm Emanuel, President Obama's chief of staff. Mr. Emanuel famously said "You never want a serious crisis to go to waste."

But to waste it will go. The threat to continued economic recovery created by a badly skewed world-trading system

Reuters

China's Vice Premier Wang Qishan, left, and Timothy Geithner need balance

won't be resolved when the G-20 summiteers convene in Toronto later this month, laying the ground for two new crises. China won't float its currency, and Germany won't stimulate domestic demand.

So long as America keeps shipping billions of dollars to China to pay for sneakers, T-shirts and (soon) cars, China will use those dollars to buy Treasury

China won't float its currency, and Germany won't stimulate domestic demand.

IOUs, keeping interest rates low and encouraging asset bubbles in America— bubbles, we now know, that, when pricked, burst with considerable force on economies around the world. We know, too, that so long as Germany lends money to Greece and its other EU partners to pay for Mercedes cars and other German manufactured goods, it will be diluting incentives in countries running persistent trade deficits to become more competitive.

"Imbalance" is the word, and it creates multiple threats to the stability of the world economy. There is little doubt that these "imbalances" were among the topics discussed at the meeting of G-20 finance ministers in Busan, South Korea, concluded this past weekend. And will be among the topics discussed at the G-20 summit in Toronto, once the ritual banker-bashing is concluded, probably at the private break-away meetings that are always the most important part of these gatherings—more important even than the photo-ops that permit the world's leaders to show solidarity by posing for a group photo, often in the dress of the host country.

It seems that almost every country intends to power its way out of recession by exporting more. Mr. Obama has promised to double U.S. exports in the next five years; Britain is hoping to revive its economy by "making things" and exporting them; the troubled countries of southern Europe are being urged to undertake structural reforms to become more competitive exporters; and the German economy continues to outperform other euro-zone countries in part because a falling euro is driving an increase in exports.

In a period of high unemployment, imports are seen as stealing domestic jobs, especially by politicians more concerned about the next election than the next decade.

The solution, both in the case of the imbalance between China and the U.S., and Germany and the rest of euroland, is for both exporting countries to stimulate demand at home so that they are less reliant on exports to create jobs, and expand markets for goods made in the US and in euroland countries.

Not an easy thing. China has to keep its export industries creating jobs for the millions who are moving from rural areas to its cities, or risk social unrest. Germany would have to adopt policies to discourage saving and encourage spending—a huge cultural change that successive governments have been unwilling to pursue. Which is why U.S. Treasury Secretary Tim Geithner's call in Busan on Saturday for "stronger domestic demand growth" in surplus countries did not meet with an enthusiastic reception in Beijing and Berlin.

Neither China nor Germany seems prepared to adopt these policies. One new crisis will be created as euroland members, unable to devalue to become more competitive with Germany, will retrench, aborting the area's nascent recovery. The other is rising protectionism as America's Democratic politicians, unable to persuade China to let its yuan rise, demand the erection of barriers to the flow of imports.

A crisis wasted, and two new ones created.

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

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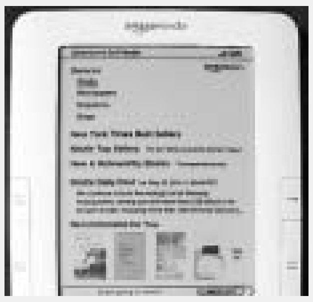

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'I think people are going to be using PCs in greater numbers for many years to come.'

Microsoft CEO, **Steve Ballmer**, on the company with the most to lose.

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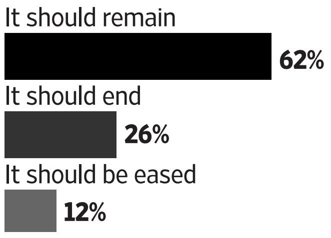


THE WALL STREET JOURNAL EUROPE
(ISSN 0921-99)
Commodity Quay, East Smithfield,
London, E1W 1AX

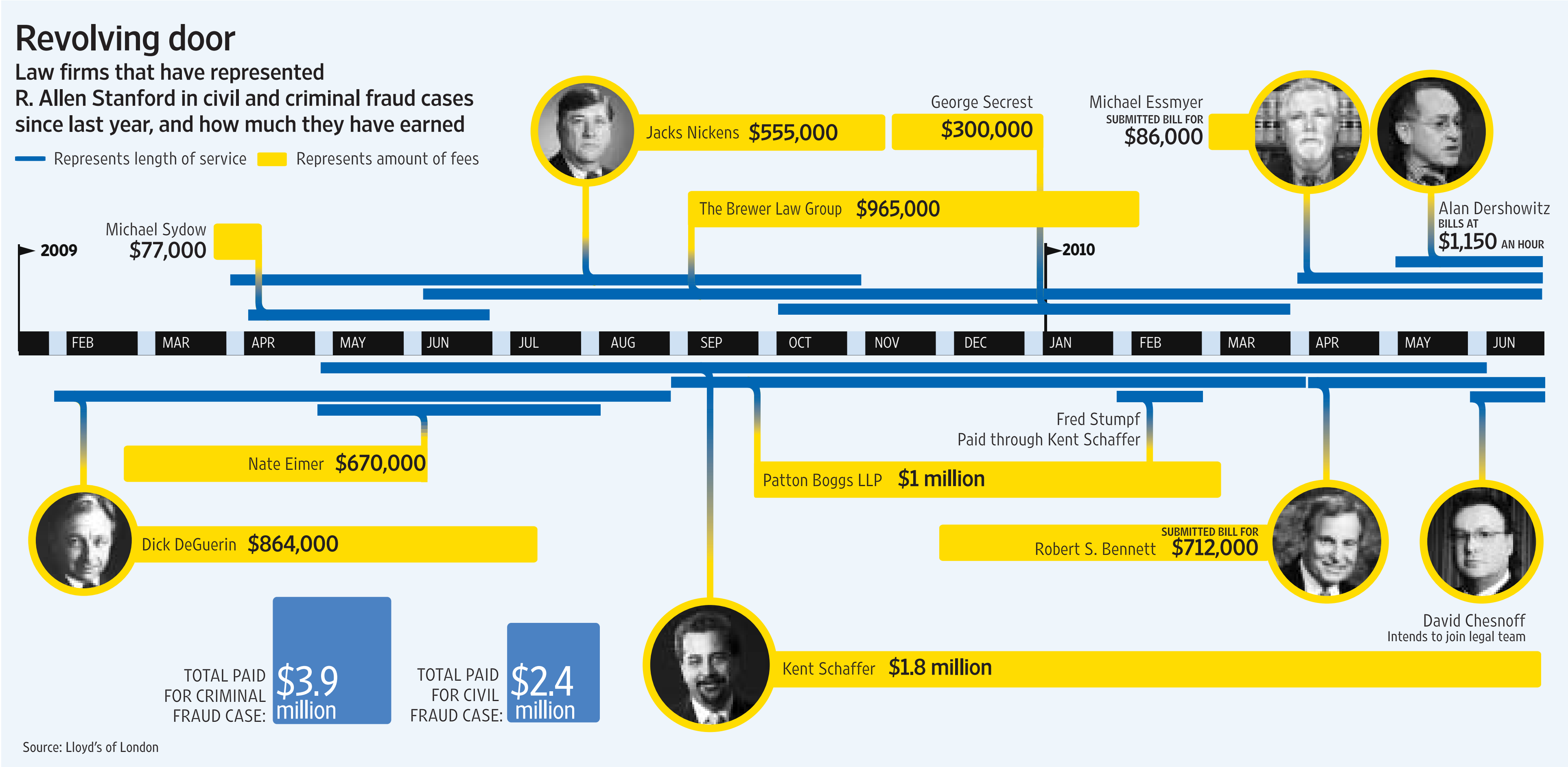
SUBSCRIPTIONS, inquiries and address changes to: Telephone: +44 (0) 20 3426 1234. Calling time from 8 a.m. to 5 p.m. GMT. E-mail: subs.wsje@dowjones.com. Website: www.services.wsje.com

ADVERTISING SALES worldwide through Dow Jones International. Frankfurt: 49 69 9714280;
London: 44 203 426 1111; Paris: 331 40 17 17 01.

Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya BasInevi.
Registered as a newspaper at the Post Office.

Editeur responsable: Patience Wheatcroft M-17936-2003.
Registered address: Boulevard Brand Whitlock, 87, 1200 Brussels, Belgium

NEWS



Stanford defense a legal quagmire

BY AMIR EFRATI

HOUSTON—Since his arrest last year, R. Allen Stanford has hired—and fired—a parade of blue-chip attorneys as he prepares for a January trial on charges of operating a multibillion-dollar Ponzi scheme.

It isn't uncommon for criminal defendants to go through one or two sets of defense lawyers during a long campaign, but the Stanford case is exceptional, legal experts said. A total of about 120 lawyers, paralegals and clerks from at least 10 law firms have come and gone after running into conflicts with Mr. Stanford, court records show.

Dick DeGuerin, Mr. Stanford's first criminal lawyer, was canned after about five months of defending the onetime Texas billionaire, who has pleaded not guilty to criminal and civil charges in federal court in Texas. "I wish I was still in it," said Mr. DeGuerin. He found out he was fired by reading another law firm's press release, he said.

"I was chagrined, I was sad," said Jacks C. Nickens, who worked on the civil case and was sacked last year after about four months. Michael Essmyer said he got his pink slip last month after just a few weeks on the job.

The revolving door of lawyers has not gone unnoticed by the federal judge in the criminal case, David Hittner, who criticized Mr. Stanford in April.

Now known as inmate #35017-183 in the Houston federal detention center, Mr. Stanford said in court at the time he had the right to replace his lawyers whenever he wanted. He has since claimed in filings that some of his former lawyers were in the case for fame or money.

"I am a man who has been treated like a piece of meat with attorneys who are more concerned with representing themselves to the public than representing me," Mr. Stanford wrote last week in a court filing. "Almost all my attorneys have effectively left me on my own to try to fight the biggest fight of my life," he wrote. Mr. Stanford declined to comment further.

Despite being rejected by Mr. Stanford, many of his ex-lawyers, in interviews, said he was innocent or had a "defensible" case. They said Mr. Stanford—who used to run a business empire— was accustomed to giving orders, not taking advice.

Kent Schaffer, who held on for six months before being fired earlier this year, said Mr. Stanford wanted the criminal trial to be moved to another city, in spite of being advised by Mr. Schaffer that the priority should be to prepare for trial, not to fight for a change of venue, among other "superfluous" issues.


Bloomberg News

Indicted financier R. Allen Stanford is escorted Thursday into the Bob Casey Federal Courthouse in Houston.

Despite the many changes in counsel, attorneys can't seem to stay away, not least because they want to be part of one of the most high-profile fraud cases in decades. Mr. Stanford was accused of misusing $7 billion in customer funds at a bank based in the Caribbean island nation of Antigua, an alleged fraud surpassed only by Bernard Madoff's decades-long Ponzi scheme.

Another draw: the deep pockets of insurer Lloyd's of London and another firm, which are picking up Mr. Stanford's legal tab. They have paid $6 million in fees so far. Lloyd's is trying to shut the spigot, and last week called the frequent lawyer changes an "abusive practice."

Several former lawyers suggested another reason for the decisions made by Mr. Stanford, who has been repeatedly denied bail. Since being detained last year, Mr. Stanford has been beaten by another inmate and has shed dozens of pounds, according to accounts by Mr. Stanford, his former lawyers and doctors.

Lee Shidlofsky, a lawyer who represented Mr. Stanford in the Lloyd's dispute, said he was "a different person than he was before this [incarceration] happened, and perhaps the lawyers bear the brunt of that." Mr. Shidlofsky said he stopped representing Mr. Stanford in May, citing an unspecified conflict with him.

Infighting among the lawyers themselves, including one physical altercation last year between two lawyers, has contributed to the legal team's messy situation.

In March, Mr. Stanford moved on to another attorney, Robert S. Bennett, who had pitched his legal services to Mr. Stanford's daughter, writing in an email that "none" of the previous attorneys had been in "a position to understand and advocate for your father."

With just seven months until a criminal trial in Houston, Mr. Stanford's current legal team is in disarray. This week, Judge Hittner ordered Mr. Essmyer, who had been "terminated" by Mr. Stanford, to stay in the case. Mr. Essmyer declined to comment. Meanwhile, David Chesnoff, a Las Vegas defense lawyer who has represented celebrities such as Britney Spears said he intends to join the team.

—Perry Stein contributed to this article.

AT&T discusses buying a sizable stake in Reliance

Continued from first page

looking at international expansion as the domestic market saturates, sapping future growth potential. India is a particularly attractive target, with over 600 million wireless customers already and carriers adding 17 million new ones per month.

Mobile-data services are expected to grow rapidly in India in coming years, especially since landline Internet penetration is low, with only about 52 million Web users out of a population of nearly 1.2 billion.

Still, there are significant hurdles for foreign telecom companies entering India, including complex tax and merger regulations. And a crowded cellphone market, with six players who have more than 10% market share, has led to margin-thinning price wars. Facing those challenges, the U.K.'s **Vodafone Group** PLC last month took a $3.4 billion impairment charge on its $11 billion purchase in 2007 of a controlling stake in the third-largest Indian wireless carrier.

As part of its interest in international expansion, AT&T has held informal discussions in the past year with telecom operators in several countries, including Reliance, the people familiar with the matter say.

In the past, one significant roadblock to a deal with Reliance was an Ambani family pact that made it difficult for Anil Ambani to sell equity in his company without a go-ahead from brother and rival Mukesh Ambani, who is India's richest man and controls industrial conglomerate **Reliance Industries** Ltd.

The two brothers dissolved that pact two weeks ago, however, opening the door for Reliance Communications to pursue a sale.

A deal with an Indian carrier would mean a return to the country for AT&T, which in 2005 sold its 33% stake in Idea Cellular, an Indian wireless operator.

The U.S. market is getting tougher for AT&T and other carriers, who are battling to steal each other's existing customers.

AT&T, which added 512,000 net contract customers in the first quarter, down from 897,000 a year earlier, must also deal with the possibility of eventually losing its exclusive contract to carry the **Apple** Inc. iPhone in the U.S., a key driver of the company's wireless business in recent years.

EUROPE NEWS

Hungary aims to calm fears

By Gordon Fairclough

Agence France-Presse/Getty Images

Hungarian Prime Minister Viktor Orbán, shown at a Brussels news conference Thursday.

BUDAPEST—Hungary's new cabinet huddled in an emergency session over the weekend to devise an economic plan aimed at restoring confidence in the nation's creditworthiness, as the government backtracked on officials' earlier comments that the country could default on its debts.

Mihály Varga, a senior official who acts as the prime minister's chief of staff, vowed Hungary would stick to strict spending limits set in the country's agreements with the International Monetary Fund and the European Union. He said Hungary wasn't at any risk of default.

"The government aspires to regain credibility," Mr. Varga said Saturday at a press conference called after remarks by other politicians about the state of Hungarian finances spooked investors, causing the Hungarian currency to plunge and dragging down the euro.

The government said it would formulate its action plan by Monday, when it is expected to brief visiting officials from the IMF and EU. It was unclear exactly when details would be announced to the public.

Friday's punishing market reaction—which showed how little tolerance investors have for any move away from budget austerity in the wake of the Greek crisis—was followed by phone calls from European officials warning that Hungary needed to get its fiscal house in order, people familiar with the situation said.

The combination appeared to have prompted a sharp reversal—in rhetoric, at least—by the government, which came to power after the right-leaning Fidesz party won a lopsided victory in April elections after a populist campaign calling, among other things, for tax cuts.

Prime Minister Viktor Orbán's press aide, whose comments that Hungary could miss its deficit-reduction targets and would need to work to avoid following in Greece's footsteps sent markets reeling Friday, made an about-face Sunday. He said the administration would cut bureaucracy and aim to stay within the IMF's budget restrictions.

"The government has created an artificial crisis," said Tibor Szanyi, a long-serving member of parliament from the opposition Socialists who represents a Budapest constituency. "They wanted to exaggerate the situation" for political ends, Mr. Szanyi said. "It is really dangerous to do that in the heart of Europe."

Politicians and analysts in Budapest said recent pessimistic comments by Fidesz party officials may have had a dual political objective: first, to test the waters and see if lenders would permit more relaxed fiscal policies. And, if not, to provide an excuse to back away from campaign promises and stick to tight budget limits.

In 2008, the government, burdened with heavy debt, was unable to borrow in capital markets amid the global credit crunch. It turned to the IMF and EU for a bailout, and agreed to stringent limits on government spending. Under the deal, this year's budget-deficit target was set at 3.8% of gross domestic product.

In April, after the Fidesz party victory, Mr. Orbán, who is now prime minister, said Hungary would take a tough stance in trying to negotiate new terms with the IMF and EU. "We won't listen to dictates but aim to have an economic program which wins them over as our partners," he said at the time.

In the months that followed, Mr. Orbán's Fidesz party has made repeated accusations that the previous government understated the likely size of this year's budget deficit and that undisclosed fiscal skeletons lurked in the closet. Some hinted the deficit could end up being as large as 7% or 7.5% of GDP.

One international official familiar with the government's budget situation and with its dealings with the IMF and EU said such figures are "completely misleading." The official said that if Mr. Orban doesn't take some steps to rein in costs, the deficit could be slightly above 3.8% of GDP, "but nothing dramatic."

"So far there is nothing to back the previous statements" about a ballooning deficit, the official said. The program with the IMF and EU "is so far on track."

Péter Oszkó, who served as finance minister until the end of May as part of a government of technocrats charged in large part with implementing austerity programs, dismissed the Fidesz deficit comments as a "planned political tactic" and said the previous government had been completely transparent about the budget situation.

When it handed power to Mr. Orbán's administration, the departing government predicted that the 2010 deficit could rise a bit over 4% unless cuts were made to unemployment programs that had grown faster than expected. The central bank independently forecast a deficit of 4.5% if the government makes no additional cuts. That is a far cry from the situation in Greece, where the government budget deficit was 13.6% of GDP last year.

Since 2008, Hungary has made considerable progress in curbing government spending. It has cut back on pensions, raised the retirement age, frozen wages for government employees and pared various subsidy programs. It hasn't needed to draw any funds from its IMF and EU credit facilities this year, despite being qualified to do so.

Mr. Oszkó said he called the government on Friday morning to warn them that talk of potential defaults and comparing Hungary to Greece was extremely dangerous. But he said officials remained confident. "They didn't realize that they were in trouble," he said. "They caused such a mess that they put the whole euro zone in trouble."

—Margit Feher and Veronika Gulyas contributed to this article.

Pressure on euro keeps growing

By Don Curren

TORONTO—The euro's decline gathered pace last week as investors worried about the euro zone's festering debt crisis spreading, drawing in Hungary as the next focal point and sending investors to the safety of the dollar, yen and Swiss franc.

CURRENCY MARKETS

With the pressure on the common currency set to persist, key levels are coming into sight, in particular the $1.1800 mark, regarded as significant because it is the level at which the euro exited its first day of trading on Jan. 4, 1999. It would also be a decisive move under $1.20, which is the 10-year average for the euro against the dollar.

The euro fell as low as $1.1955 on Friday, the weakest the common currency has been since March 2006, on a combination of European debt concerns and a disappointing U.S. jobs report.

On Thursday, Lajos Kosa, vice president of Hungary's Fidesz party, which won parliamentary control in April elections, said the country is in a Greece-like sovereign-credit crisis. The remarks brought a new dimension to Europe's debt crisis and raised worries that problems are spreading.

"These things have a way of spreading around the world, and we are seeing evidence of that," said Aaron Fennell, senior market strategist at futures broker Lind-Waldock in Toronto.

Over the weekend, Hungary's new government sought to calm markets, stressing that the country isn't facing any sovereign-credit default.

The new developments from Hungary came at a time when bond yields for Italy and Spain were moving back to the highs they set May 10, the day European officials announced a €750 billion ($897 billion) rescue plan for fiscally troubled member nations, said Camilla Sutton, currency strategist at Scotia Capital in Toronto.

"You add the developments in Hungary on top of that, and it just adds to the fear that's already there," she said. "We're in the midst of taking the next leg lower."

Late Friday, the euro traded at $1.1966, down from $1.2158 late Thursday. The dollar was at 91.69 yen, down from 92.63 yen. The euro weakened to 109.72 yen from 112.62 yen. The U.K. pound weakened to $1.4476 from $1.4616.

Analysts expect the euro to trade in a range between $1.1800 and $1.2300 this week.

The dollar is seen moving between 90.00 yen and 93.00 yen, with the greenback surrendering ground against the yen, a traditional safe haven, if uncertainty and aversion to risk remain paramount in markets.

While the euro dominates attention in currency markets, investors will also be watching for comments from Japan's incoming prime minister, Naoto Kan, to see if he signals any changes in the country's foreign-exchange policies. Mr. Kan, formerly finance minister, is widely believed to favor a weaker yen.

A weekend meeting of finance ministers and central bankers from the Group of 20 industrial and developing powers produced statements of concern about the euro-zone crisis, but there were no specific references to currencies in the G-20 communique.

Investors will be looking for guidance on the euro-zone debt crisis from Monday's meeting of European Union finance ministers and Thursday's policy meeting of the European Central Bank. The ECB isn't expected to adjust monetary policy, but market participants will look to the postmeeting news conference with ECB President Jean-Claude Trichet for any indication of how the central bank views the sovereign-debt problems and the euro's plight.

After the euro hit an all-time low against the Swiss franc Friday, the pronouncements and actions of the Swiss National Bank will also come under close scrutiny. The SNB is thought to have intervened on numerous occasions in the past 15 months to slow the franc's appreciation.

G-20 moves close to pact on banking standards

Continued from first page

zone members, then lend it out at a higher rate to the troubled country.

The complex structure is an effort to steer clear of EU prohibitions on direct purchases of member-state debt—a cornerstone of monetary union meant to keep countries from being responsible for one another's affairs. The bailout effort hasn't been without critics, especially in fiscally sound Germany, but the mechanism passed perhaps its highest hurdle last month when the German parliament gave approval for Germany's share of the credit guarantee.

The final details to be agreed upon include precisely how the special vehicle would market its bonds and whether the various countries' individual guarantees would apply to separate pieces of the debt, or fractionally to the whole thing.

The €440 billion chunk is separate from a €110 billion lifeline designated especially for Greece, the most troubled of the euro-zone nations. It would also only be called into action after a separate €60 billion facility, operated by the European Union itself, had been exhausted.

That facility, which is easier to set in motion, would be carried on the books of the union.

On the G-20 agenda was the related matter of how to solve Europe's dilemma of needing to cut government borrowing at the same time that economies there are reliant on state spending for growth and employment.

Spending cuts on pensions and public sector jobs could assuage financial markets in the near term, but could also cause growth to slow, compounding countries' abilities to pay down debt.

"The recent events highlight the importance of sustainable public finances and the need for our countries to put in place credible, growth-friendly measures, to deliver fiscal sustainability," said a communiqué delivered by the countries at the meeting's end.

Just a few months ago, talks dubbed Basel III, after the Swiss town where they take place, appeared in danger, with countries bickering over, among other issues, whether certain types of securities counted as a viable capital cushion.

U.S. officials said top-level talks this weekend gave more impetus than they had expected to the ground-level negotiations. Technical experts in the Basel Committee on Banking Supervision have the job of turning the general agreement into specific guidelines.

"Stronger capital and liquidity requirements and constraints on leverage are necessary to help ensure that global active financial institutions are better able to withstand future financial shocks and economic shocks," U.S. Treasury Secretary Timothy Geithner told reporters as the meetings were wrapping up.

The G-20 vowed to try to implement the new rules by the end of 2012, but there has been discussion recently of pushing back that target for countries nervous about exposing weakness in their banks.

EUROPE NEWS

Church beatifies slain Polish priest

Associated Press

WARSAW—Thousands of Poles filled a sunbathed square in Warsaw on Sunday for the beatification of Jerzy Popieluszko, a charismatic priest tortured and killed in 1984 by then-communist Poland's secret police for supporting Lech Walesa's Solidarity movement.

The head of the Vatican's saint-making office, Archbishop Angelo Amato, presided over the Mass at Pilsudski Square that was also celebrated by 120 bishops and 1,600 priests. The late priest's 90-year-old mother Marianna, his sister and brothers, were among some 140,000 attending, among them Mr. Walesa.

Archbishop Amato read out Pope Benedict XVI's declaration that made Popieluszko blessed for his martyrdom in giving his life to defend good. The crowd applauded when the priest's portrait was unveiled.

The pope, on a visit to Cyprus, said Popieluszko's "zealous service and his martyrdom are a special sign of the victory of good over evil." Beatification is a step toward possible sainthood, which, if sought in an official procedure, should be backed up by proven cases of miracles attributed to the candidate for sainthood.

The 2½-hour Mass in Warsaw was followed by a procession of his remains—referred to as relics—encased in a small silver reliquary, to a church in southern Warsaw.

Popieluszko's grave remains in the yard of St. Stanislas Church, where he used to give riveting sermons. Since his burial in 1984, it has been visited by many world leaders.

Popieluszko became an icon in Poland's struggle against communism thanks to the "Masses for the Homeland" he delivered in the 1980s, in which he preached freedom at a time of martial law.

On Oct. 19, 1984, three secret police officers kidnapped the 37-year-old priest and his driver. The priest was beaten, bound, gagged and stuffed in the trunk of an unmarked police car. He escaped when they pulled in at a secluded parking lot, but was captured again, beaten and stuffed in a sack weighed down with stones and thrown into the Vistula River.

Hundreds of thousands of people attended his funeral, which became a show of opposition to the communist regime. The authorities conducted a quick trial and convicted the three abductors and their immediate superior to prison terms of up to 25 years. All have since been released. Beatification procedures opened in 1997. Last December, Pope Benedict declared Popieluszko a martyr, opening the road to his beatification.

Reuters

A woman sings as she holds a rosary during the beatification mass for Father Jerzy Popieluszko in Warsaw on Sunday.

Juncker: Euro's fall isn't a big concern

BY WILLIAM HOROBIN

PARIS—Euro-zone Chairman Jean-Claude Juncker Sunday said the current level of the euro isn't a concern, but called for improved government across the euro area and greater cooperation between countries using the currency.

"I was surprised by the speed of the fall, but I'm not worried about its current level," Mr. Juncker said, noting he doesn't normally comment on exchange rates.

'Too many countries amongst the 16 members behave like national economies, but national economies no longer exist,' said the euro zone's chairman.

Speaking in an interview Sunday on television channel TV5MONDE and international radio station RFI, Mr. Juncker, who is also prime minister of Luxembourg, said euro-zone exporters will without doubt benefit from the "rebalancing" of the euro.

Mr. Juncker said the euro's recent volatility is due to a perceived weakness of the common European currency that makes it vulnerable to rumor and badly thought out statements from policymakers.

"There have been imprudent statements from some Hungarian officials that have made financial markets think that Hungary is the future domino," he said. He noted that he isn't worried about the situation in Hungary, which isn't part of the euro zone.

Mr. Juncker said that perceived weakness of the euro is wrong as fundamental data show that Europe's economy is doing better than Japan and the U.S. Still, he said that a lack of economic government in the euro zone is a source of concern for markets and steps must be taken to rectify this.

"We haven't learned enough about collective management of the common currency. Too many countries amongst the 16 members behave like national economies, but national economies no longer exist; we are in an economy crowned by the common currency," he said.

For Mr. Juncker, economic government of the euro zone would be a way of avoiding overspill from one national economy to another.

He said ministers preparing national budgets must consult with peers in euro-zone governments before passing the budgets through parliament.

Mr. Juncker also said that the euro has been suffering from undervaluation of the yuan.

"The yuan is significantly undervalued. Up until now the euro has been carrying on its shoulders the adjustment forced upon us by imbalances in the fundamental elements of global economy," Mr. Juncker said.

"China must be able to adopt a more flexible monetary policy."

THE DEFICIT DILEMMA

The U.S. has yet to agree on how to tackle its debt

[THE OUTLOOK]

By Deborah Solomon

WASHINGTON—Few here in Washington argue the U.S. budget deficit will cure itself. But there's no agreement on what to do about it. The debate divides into two camps.

On one side is the Obama administration—and Keynesian economists—who argue the U.S. needs to spend more, not less, to help gird the nascent economic recovery. They say it's too early to take the kinds of drastic measures being contemplated in some parts of Europe, and that strengthening the economy through spending will ultimately reduce our debt.

"Spurring growth, if we can achieve it, is by far the best way to improve our fiscal position," Lawrence Summers, who heads the president's National Economic Council, said in a speech last month.

Prescriptions for dealing with the budget range from immediate cuts in spending to a go-slow approach, such as enacted deficit reduction that takes effect later.

On the other side are lawmakers and economists who say the U.S. cannot afford to wait to cut spending. The deficit will grow by as much as $9 trillion over the next decade, according to the White House, in large part because of increased spending on benefit programs, such as Social Security and Medicare, as well as an explosion in interest costs on debt.

U.S. debt is expected to rise from 53% of gross domestic product in 2009 to 90% in 2020, according to a Congressional Budget Office projection. Net interest payments on that are expected to nearly quadruple over that period to $916 billion in 2020, says the CBO.

Prescriptions for dealing with the budget range from immediate cuts in spending to a go-slow approach, such as enacted deficit reduction that takes effect later. There is no consensus either on timing or on such big questions as whether to pare back the social safety net or raise taxes.

"No one will step up right now and suggest broad-based spending cuts or tax increases, but that is what we need both for the magnitude of the effect involved, but also the sense that there's going to be shared sacrifice," said William Gale, an economist with the Brookings Institution, a Washington think tank.

Unlike Europe, the U.S. is not facing market pressure to trim its budget deficit, making it possible for policy makers to avoid action. Indeed, Europe's turmoil has sparked a rush of money into the relative safety of the U.S.

But the situation in Europe is making it harder for the U.S. to ignore its fiscal woes. The turmoil across the pond has only exacerbated tensions in the U.S. over the proper role and size of government.

The issue is now a mainstay in the 2010 campaign, with Republicans seizing on increased stimulus spending as evidence Democrats are out of touch. "Instead of increasing spending, we should be cutting spending and quit throwing money into things that aren't working and aren't effective," said Oklahoma Republican Sen. Tom Coburn.

Tensions over the deficit are beginning to have an impact on legislation.

Last month, fiscally conservative Democrats forced House leaders to pare and partially pay for legislation extending long-term unemployment benefits and reviving several popular business tax breaks. The bill wound up with a 10-year, $115 billion price tag, about half the cost of a more-ambitious package unveiled days earlier. The Senate has yet to act.

In some ways, the situation in Europe has simply galvanized those urging immediate action. During a series of town-hall meetings last week, Rep. Paul Ryan (R., Wisc.) showed voters a PowerPoint presentation outlining the nation's fiscal woes, ending with slides entitled: "Europe & Greece: A Cautionary Tale" and "How Do We Avoid This Fate?"

"We are going to have to make a big choice in this country," Mr. Ryan said in an interview. "Do we want to create a welfare state that spends other peoples' money or do we want to change our trajectory?"

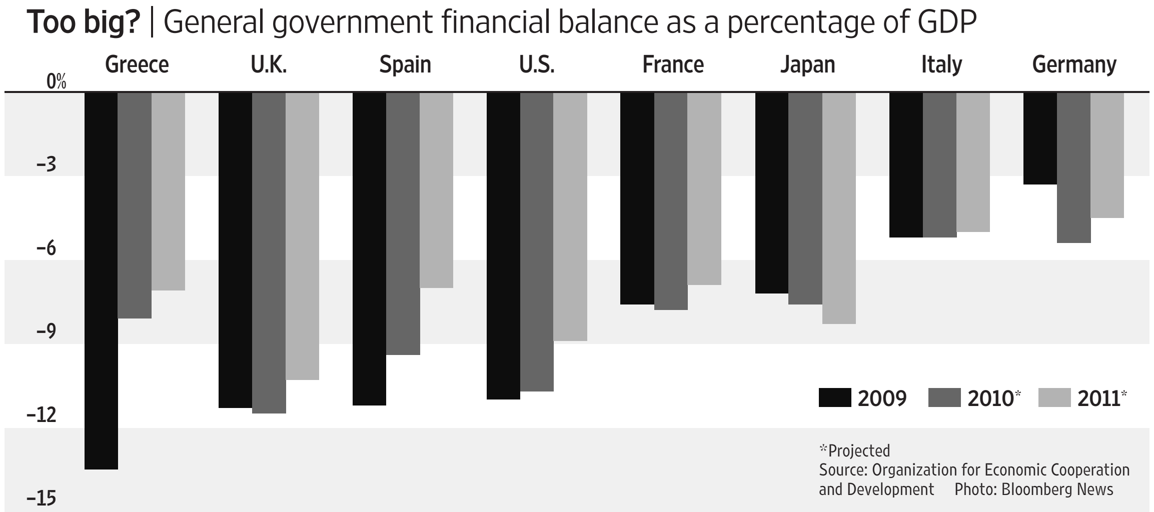
His proposal: Stop spending and start cutting.

For the Obama administration, that's not an easy choice to make. The President has proposed a series of steps to tame the deficit, including freezing annually appropriated spending (aside from defense) for three years, allowing Bush-era tax cuts to expire for the wealthiest Americans and creating a bipartisan fiscal commission to suggest ways to reduce the deficit to 3% of GDP from the current 10%.

But the priority remains stimulating economic growth through continued spending.

Ultimately, tough choices will have to be made, such as cuts to entitlement programs and tax increases. For now, that's not a debate Washington wants to have.

Geithner, left, speaks with G-20 officials including European Central Bank Chief Jean-Claude Trichet, Friday in Busan, South Korea.



In Europe, the threat to economic growth posed by austerity is exaggerated for now

By Marcus Walker

BERLIN—Reports that Europe is strangling its recovery with austerity are exaggerated.

Promises to cut budgets are de rigueur in Europe as governments scramble to reassure investors unnerved by Greece's debt crisis. The belt-tightening has raised worries in Washington that Europe's conversion to fiscal rectitude could derail the global recovery.

But the timing and depth of Europe's cutbacks vary greatly, and countries that aren't yet under severe pressure from bond markets are trying to steer a middle way between growth and fiscal rebalancing. EU countries fall into three basic categories:

One embattled group—Greece, Spain, Portugal and Ireland—has no choice but to cut budget deficits hard. These four account for only 18% of euro-zone gross domestic product, according to economists at Goldman Sachs.

The second includes the U.K. and Italy, where policy makers fear they could face similarly severe pressure from markets eventually. They are cutting their deficits immediately—but slowly—to begin with.

A third group, the core of euro-zone members around big economies Germany and France, is following St. Augustine's prayer for "chastity and continence, but not yet." Warnings of fiscal schmerz (pain) and rigueur (austerity) from Chancellor Angela Merkel and President Nicolas Sarkozy belie the fact that both countries, as well as a few smaller neighbors, are letting budget deficits rise this year.

Even the euro core will start to cut spending and raise taxes from 2011 onwards. That's too restrictive for Keynesian economists, the U.S. Treasury and the International Monetary Fund, all of whom have called on Europe's financially sounder countries to put off cuts to prop up growth.

The U.S. and IMF found themselves in a minority when finance ministers from the Group of 20 leading economies met in South Korea on Friday and Saturday. Most other participants pressed Europe to sort out its finances soon.

But austerity plans in core Europe are probably cautious enough to allow a fragile recovery to continue, many economists say.

"Germany is still easing, Spain is tightening, Italy is neutral—it looks about right," says Greg Fuzesi, economist at J.P. Morgan in London. "You can't rule out the risk that the recovery will fade because of fiscal tightening, but at the moment it looks like the cyclical dynamics will continue to give Europe a lift."

Even if Europe's fiscal repairs don't choke off the recovery, they could make it more reliant on business while weakening household spending. Consumers are expected to bear the brunt of measures such as indirect tax increases and public-sector pay freezes. Meanwhile the fast-falling euro is set to boost exports. A sustained 10% drop in the euro—as seen in the last six months—adds about half a percent to GDP in the single-currency zone, say economists.

As a whole, the euro zone is still in stimulus mode this year—just. But in 2011, budget cutbacks across the zone will subtract around 1.5% from GDP, according to Goldman estimates, meaning that the private sector will have to carry the recovery. Goldman expects the euro-zone economy to grow by around 2% next year despite the fiscal drag.

Keynesians still argue Europe has the balance wrong, and that Germany and some others are doing less than they could to support growth. Whatever the economic merits, the political argument was lost decisively in Europe in May, when Germany backed away from tax cuts, the euro zone agreed on a huge bailout fund, and the U.K. elected a Conservative-led government.

The euro zone's €750 billion bailout fund for countries that, like Greece, might lose access to capital markets presents Germany and other countries with potentially high costs. That turned Ms. Merkel's government decisively against cutting taxes—an election pledge that voters increasingly saw as irresponsible anyway. Surveys show ordinary Germans are worried about rising public debt, which they fear could undermine their cherished welfare state.

Across the euro zone, saving the single currency—and with it, European integration—by beefing up budget discipline now takes political priority over a faster economic recovery.

"It would have been preferable if core countries, particularly Germany, had delayed fiscal consolidation a year longer," says Jennifer McKeown, senior European economist at London consultancy Capital Economics. "But there might have been growing market concerns about the core countries' public finances, too, which would not have been good for the euro experiment," she says.

When to roll back public spending was a key issue in the U.K. election, with the then-Labour government arguing for cutting later, and Conservatives arguing for action now.

U.S. NEWS

Oil cleanup could extend into fall

Containment cap is making progress in funneling off 10,000 barrels a day; 'final fix' to well expected in August

BY KARA SCANNELL
AND TOM BARKLEY

U.S. Coast Guard Admiral Thad Allen, who is overseeing the federal response to the Gulf of Mexico oil spill, on Sunday said progress was being made to contain the oil, but predicted that the cleanup effort could extend into the fall.

"We're making the right progress," Mr. Allen told CNN. But "I don't think anybody should be pleased as long as there's oil in the water."

Earlier Sunday, **BP** PLC Chief Executive Tony Hayward said a containment cap was now funneling off more than 10,000 barrels of oil a day from the blown-out well, which has been gushing oil a mile beneath the ocean surface.

Mr. Allen said vents on the cap were slowly being turned off to keep additional oil from leaking. In a separate appearance on "Fox News Sunday," he said the "final fix" would be the drilling of a relief well, which was estimated to be completed by August.

Mr. Allen predicted that even if the latest effort to contain the leak works, "this will be well into the fall," citing the oil-remediation effort and long-term environmental impact. "There will be oil out there for months to come," he told CBS's "Face the Nation."

He declined to speculate on how much oil the containment cap has been capturing since Friday, saying more data are needed on the amount produced from the flow captured from the broken well.


Reuters

BP CEO Tony Hayward waits to appear on BBC television in London on Sunday. He said the oil-well cap was working.

Some scientists have predicted the oil could move up the East Coast and head toward Europe. Mr. Allen told Fox that "the probability exists but it's a low probability."

Mr. Allen made the rounds on major news talk shows on Sunday to discuss efforts by the U.S. government and BP to stem the oil spill. BP had previously tried several other approaches, which failed.

Mr. Allen said that while BP has been trying every step possible to try to stem the flow, it needed "to get better at the retail side," when dealing with those impacted by the spill and the general public.

With the cap allowing BP to siphon off only a portion of the oil at a time, Mr. Allen said, "nothing should be taken as good enough."

Mississippi Gov. Haley Barbour, a Republican, said on Fox News Sunday that the media's tendency to lump all of the Gulf coastlines and beaches together as victims of the spill was hurting the state's tourism industry. "We have had virtually no oil," he said.

Mr. Barbour echoed concerns expressed by Louisiana Gov. Bobby Jindal that temporarily shutting down offshore drilling, even for six months, could harm the economy. He also worries that a shutdown could drive oil companies to other resource-rich coastlines.

Democratic Sen. John Kerry of Massachusetts, appearing on ABC News's "This Week," said he thought the Obama administration was holding BP's "feet to the fire." But Republican Sen. John Cornyn of Texas said, "We need the president to step up and asset himself."

BP said Sunday that a containment cap placed on a ruptured well collected 10,500 barrels of oil Saturday. It said it hopes to increase the amount of oil it is able to funnel to the surface in the next few days.

"At the moment it is difficult to say, but we would expect it to be the majority, probably the vast majority of the oil," Mr. Hayward said earlier in an interview on BBC.

"We have a further containment system to implement in the course of this coming week which will be in place by next weekend. So when those two are in place we would very much hope to be containing the vast majority of the oil," Mr. Hayward said.

—Mark Long and Nicholas Winning contributed to this article.

Lawmakers eager to act

BY GREG HITT
AND STEPHEN POWER

WASHINGTON—Congressional Democrats plan an aggressive legislative response to the oil disaster in the Gulf of Mexico, led by proposals to raise liability limits for oil companies that cause spills and a renewed push to enact legislation to promote "clean energy."

BP PLC will face bipartisan wrath, but the debate over how the government should rework laws governing undersea oil exploration is likely to play out along party lines.

Democratic leaders are intensifying their calls for stricter regulation that would cover the entire offshore oil industry, as a half-dozen committees pursue investigations into the causes of the disaster as well as the response to it.

Senate Majority Leader Harry Reid (D., Nev.) on Thursday told several committee chairmen he wants a "comprehensive clean-energy bill" on the Senate floor by July, aimed at pushing the economy to "kick the oil habit." Mr. Reid's letter doesn't explicitly back climate legislation currently stalled in the Senate.

Mr. Reid also called for measures accelerating damage payments to individuals and communities suffering spill-related losses, and compelling oil companies operating in deep water to invest more in spill-response technologies and safety procedures.

Among other initiatives likely to be considered, beyond raising the cap on oil-spill liability to $10 billion or more: improvements in oil-worker safety; a toughening of environmental protections for offshore drilling; and a further revamping of the Minerals Management Service, the bureau in the Interior Department that manages oil resources. President Barack Obama has already ordered a wide-ranging overhaul of the MMS, dividing its current responsibilities across three agencies.

"The American public is riveted," said Rep. Edward Markey (D., Mass.), a senior member of the House Energy and Commerce Committee, which has been looking into the possible causes of disaster. "They are going to want reforms to be put in place to make sure it never happens again."

The debate over how to rework laws on undersea oil exploration is likely to play out along party lines.

Republicans plan to counter with legislation targeting BP rather than the oil industry as a whole. Legislation introduced by Sens. Lisa Murkowski (R., Alaska) and David Vitter (R., La.) would codify BP's promises to pay economic damages caused by the spill, and establish an Office of Deepwater Claims Compensation to expedite the processing of claims from individuals and state and local governments that have sustained losses.

Ms. Murkowski, whose state counts the oil-and-gas industry as a major employer, has said she supports raising the liability limits on companies drilling offshore above the current $75 million level. But she has said that raising the limit to $10 billion—as some Democrats have proposed—would exclude all but the biggest oil companies from operating offshore, and put U.S. firms at a disadvantage against large, foreign companies.

"This decision will have a major impact on our economic security, and Congress ought to take time to do it properly," said Robert Dillon, a spokesman for Ms. Murkowski. "We never make good legislation in the heat of the moment."

The political damage the spill is doing to Mr. Obama could be a factor in lawmakers' calculations. Congressional Democrats are eager to avoid becoming targets for the critics who are hitting the administration for not taking a tough enough stance toward BP.

"Senators and representatives have a real interest in getting ahead of the crisis, by taking actions to help those who have been harmed and to prevent the next disaster," said Daniel J. Weiss, director of climate strategy at the Center for American Progress, a left-leaning group close to the administration.

Action should ramp up next week, when Congress returns from its Memorial Day recess, and is expected to culminate before the end of June with debate in the House and Senate on a series of measures.

Lawmakers also will push to complete a handful of pending spill-related measures, including House-approved legislation that would increase an oil-spill tax on petroleum producers and raise $11.8 billion over 10 years. The Senate recently passed an emergency spending bill to provide $68 million to cover government costs tied to the spill.

—Jonathan Weisman contributed to this article.

U.S. NEWS

Associated Press

Steve Poizner, a foe of amnesty for illegal immigrants, is running for the Republican California gubernatorial nomination.

Hispanic voters drifted from GOP in last decade

Party's get-tough approach to illegal immigrants is taking a toll

By Miriam Jordan

LOS ANGELES—California Hispanics who registered to vote since the last midterm election are less likely to be Republican than those who registered just four years earlier, according to an analysis of party affiliation released Friday.

The report by the nonpartisan National Association of Latino Elected and Appointed Officials, or Naleo, also shows Hispanics—the fastest-growing voter bloc—are increasingly prone to register as independent, mirroring the trend among all voters.

Among California Latinos who registered between the 2002 and 2006 midterm elections, 23% were Republican, 50% were Democrats and 23% declined to state. More recently, GOP affiliation among Latinos has begun to slip. For those who registered since the 2006 midterm vote, only 16% are Republicans, 56% are Democrats and 24% declined to state an affiliation. For non-Latino voters, the figures are 24% Republican, 44% Democrat and 26% independent since 2006.

Naleo officials and political analysts said the shift could be accelerated by Republican campaign rhetoric championing a get-tougher approach toward illegal immigrants. The top two candidates in California's GOP gubernatorial primary, for example, have courted conservative voters by flooding the airwaves with ads calling for tighter borders and stricter laws.

"Even longtime Republican Latinos are unhappy with this emotional rhetoric," said Lionel Sosa, a media strategist on the Hispanic vote for seven GOP presidents. "Republicans feel they have to go way to the right on immigration to win the primaries. If they want to get elected, they'll need the Hispanic vote."

California insurance commissioner Steve Poizner, who has been losing ground in the GOP primary, has attacked front-runner Meg Whitman by claiming that—unlike him—she supports amnesty for millions of undocumented immigrants and opposes Arizona's new law to crack down on illegal immigration. Ms. Whitman, a former eBay chief executive, has countered by saying she is against any amnesty program and that she will send the National Guard to secure California's border with Mexico.

'If Republicans don't figure out how to do better among Hispanics...they are going to be talking about how not to lose Texas,' said Republican pollster Whit Ayres.

"We are confident that if Meg is successful on primary election day, next fall she will win over support in the Latino community because she is the only credible candidate to create jobs and fix our public schools, two key issues in the Latino community." Ms. Whitman's spokesman said.

Ron Nehring, chairman of the California Republican Party, said Democrats are using immigration to distract voters. "The way things are heading, this year's elections will be about taxes, spending, the economy, jobs and debt," he said, adding that "independent voters are strongly moving back to supporting Republicans, and that includes independent immigrants as well as voters who were born here."

Mr. Nehring also said the GOP recognizes the importance of attracting voters beyond its base. "In addition to offering solutions to the issues Americans are most concerned about, we're taking a different approach to building relationships long term into dozens of different ethnic, religious, and occupational backgrounds."

California Latinos' drift away from the GOP began in the 1990s, when Republican Gov. Pete Wilson embraced a ballot initiative that would prevent illegal immigrants and their children from accessing public services. Ultimately, the courts blocked the measure's implementation, but its approval by voters galvanized Hispanics to register to vote in record numbers. Since then, the only Republican to win a major California election was Gov. Arnold Schwarzenegger, who is considered pro-immigrant.

"This whole immigration thing is really angering me," said 28-year-old Elsa De La Rosa of Pasadena. "It motivates me to vote, and I know it's motivating other Latinos to vote." Ms. Rosa, who doesn't recall voting in the 2006 midterm elections, is a Democrat.

Republican candidates nationwide have been citing immigration to fire up voters, and polls indicate non-Hispanics back the Arizona law by 2-to-1. But the proportion of the U.S. electorate that is white non-Hispanic is declining rapidly: When Ronald Reagan was elected president in 1980, 88% of the national electorate was white. The figure was 74% when President Barack Obama was elected in 2008, and Latinos accounted for 7.5% of the electorate, twice their share two decades earlier.

"The numbers don't lie," said Republican pollster Whit Ayres. "If Republicans don't figure out how to do better among Hispanics, they are not going to be arguing about winning back Florida in the presidential race. They are going to be talking about how not to lose Texas."

Gay couples receive equal tax treatment

By Laura Meckler

The Internal Revenue Service has ruled that same-sex couples must be treated the same as heterosexual couples under a feature of California tax law. Advocates for the change say it is the first time the agency has acknowledged gay couples as a unit for tax purposes.

The change reverses a 2006 IRS ruling and opens a tax benefit to many same-sex couples that wasn't available before. It may affect couples in Nevada and Washington state, as well.

Specifically, the agency said nearly 58,000 couples who are registered as domestic partners in California must combine their income and each report half of it on their separate tax returns. Same-sex couples account for an estimated 95% of the state's domestic partnerships; partnership status is also available to heterosexual couples in which one partner is over age 62.

"For the first time ever, I'm able to file federal taxes that, in a small way, acknowledges what's going on in my relationship," said Eric Rey of Berkeley, Calif. Mr. Rey and his partner requested the IRS ruling, first during the Bush administration and again this year.

The pair wed during a brief window when same-sex marriage was legal in California, but the issue arises because the men are registered as domestic partners. Same-sex couples, even if they are legally married in their home states, may not file joint federal tax returns. The federal Defense of Marriage Act, passed in 1996, defines marriage as between one man and one woman and bars federal agencies from interpreting it otherwise.

But the tax issue is more complicated in California, one of nine states with community-property rules. Those rules require married couples to treat all income as joint property for a variety of purposes. If they are filing taxes separately, the Supreme Court has said they must combine their incomes and then divide the sum equally.

Beginning in 2005, California law directed that these same community property rules apply to registered domestic partners.

Applying this rule to federal taxes offers clear tax benefits for people such as Mr. Rey—an executive who said he earns much more than his partner does—because it brings him into a lower tax bracket. In 2007, he said, applying this standard would have cut his federal tax liability in half and more than doubled his partner's tax bill. Taken together, it would have saved them about $7,000, he said.

In 2005, the pair asked the IRS for clarification as to how they should file their taxes. The next year, the agency issued a memorandum stating that California domestic partners shouldn't apply the community-property standard to federal taxes because the relevant precedent didn't apply "outside the context of a husband and wife."

"The relationship between registered domestic partners under the California Act is not marriage under California law," the agency said.

In 2007, the IRS was less definitive. In a private ruling sought by Mr. Rey and his partner, it declined to offer guidance either way.

When President Barack Obama was elected, Mr. Rey's tax attorney, Donald Read, thought they should try again, citing the White House Web site's professed commitment to "equal federal rights" for gay and lesbian couples.

This time, the IRS said these couples not only may, but must, combine and then divide their income for federal tax purposes. It made that point in a new memo issued last month.

Mr. Read said it was the first time the IRS had given equal status to gay couples. IRS representatives wouldn't confirm his statement but couldn't point to any prior comparable decision.

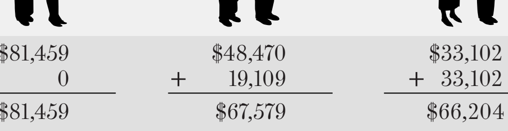
An IRS spokesman said the shift is due to a 2007 change in state law. That change dealt with the way the state calculates income for California taxes. Nevada and Washington state are also community-property states that recognize domestic partnerships, and so couples there may also be affected.

The IRS ruling has detractors. It doesn't appear to square with the Defense of Marriage Act, which bars federal agencies from recognizing same-sex couples, said David Herzig, an expert in tax law at Valparaiso University School of Law. That law, he said, means the IRS should not be recognizing these unions, even if state law directs otherwise.

"We shouldn't be picking and choosing where these rules apply," he said. In passing the federal law, he said, "You made your bed."

New math

Registered domestic partners in California will be required to combine their incomes and report half of it on their separate tax returns. How the change could affect the tax liability of three hypothetical same-sex couples with a combined income of $300,000:



ANNUAL INCOME FOR EACH PARTNER	$300k | $0	$200k | $100k	$150k | $150k
TAX LIABILITY	$81,459 + 0	$48,470 + 19,109	$33,102 + 33,102
OLD	$81,459	$67,579	$66,204
NEW Each couple's tax liablility is the same	$66,204	$66,204	$66,204
SAVINGS	$15,255	$1,375	$0

Note: Income figures are for wages only

Source: Pan Haskins, CPA, MS

WORLD NEWS

Israel weighs Gaza probe

Government debates U.N. proposal for an international commission

BY CHARLES LEVINSON AND JAY SOLOMON

JERUSALEM—Israel's government is struggling to respond to mounting calls for an international investigation into last week's deadly raid on a Gaza-bound aid flotilla.

U.N. Secretary-General Ban Ki-moon spoke with Israeli Prime Minister Benjamin Netanyahu by phone on Saturday evening, said a senior Israeli official.

During the call, Mr. Ban proposed an international commission to include Israeli, Turkish and American participants, and headed by former New Zealand Prime Minister Geoffrey Palmer, Israeli officials said. The U.N. declined to comment on Sunday.

The Obama administration, which is facing a growing policy dilemma, has also joined international calls for an investigation, but said it would accept an international presence on an Israel-led investigation. Israeli naval commandoes killed eight Turks and one Turkish American during the May 31 raid after activists aboard the Mavi Marmara ship, one of six ships in the aid flotilla, resisted the soldiers' efforts to board it.

Senior Israeli officials say they are uncomfortable with Mr. Ban's proposal.

"Nothing has been decided, but we have problems in Israel with U.N. investigations for obvious reasons," the official said.

The memory of the 500-page U.N. Goldstone Report, which accused Israel of war crimes during the Gaza War last year, is still fresh in the minds of Israelis as the government debates how to respond to current calls for an investigation.

Israel chose not to participate in the Goldstone investigation, believing participants had prejudged Israel's guilt. Some Israelis later came to believe that decision was a mistake that contributed to the one-sided nature of the report.

Israel's ambassador to Washington, Michael Oren, said Israel is "rejecting the idea of an international commission" in an interview with "Fox News Sunday."

Senior Israeli ministers are split. Defense Minister Ehud Barak opposes any international investigation, fearing it could undermine morale inside the military, said another senior Israeli official.

Foreign Minister Avigdor Lieberman has publicly voiced support for international involvement in an investigation. Senior cabinet ministers were due to meet late Sunday evening to debate the issue.

Israeli officials appear to be leaning toward accepting the presence of international observers or investigators on an Israel-led inquiry committee. Israel has a long history of conducting internal investigations into controversial military operations.

Some of those investigations, such as the 1982 Kahan Commission's investigation into the massacre of Palestinians in southern Lebanon by Christian militiamen, have been viewed as quite credible and led to the resignations of senior leaders.

Others, such as the Israeli military's recent investigation into allegations of misconduct during the Gaza War, have been received by outside observers with greater skepticism.

Still, it would be rare, if not totally unprecedented, for Israel to accept even a token international presence in an investigation of its armed forces' conduct.

"I don't know of any precedent for this. To a certain extent, this would mean ceding some of our sovereignty," a senior foreign-ministry official said.

The international fallout from last week's botched raid continued on Sunday, as the popular American rock band the Pixies canceled their concert in Tel Aviv scheduled for this week.

The band is the third international music act to cancel performances in Israel in the wake of the raid.

The Obama administration voiced appreciation Sunday that Israel's standoff with a seventh aid ship that was seized by Israeli soldiers on Saturday, the Rachel Corrie, was resolved peacefully. Israel towed the ship to a port in Ashdod on Saturday.

All 19 activists and crew members aboard that ship were deported on Sunday, mostly to Jordan, according to a spokeswoman for the Ministry of Interior.

U.S. officials said they have been working closely with Israeli and Palestinian officials to find new ways to deliver outside aid to the Gaza Strip while still respecting Israel's focus on preventing the smuggling of arms into Palestinian territories.

"We are grateful a confrontation was avoided," said a U.S. official. "We will continue to engage the Israelis on a daily basis to expand the scope and type of goods allowed into Gaza."

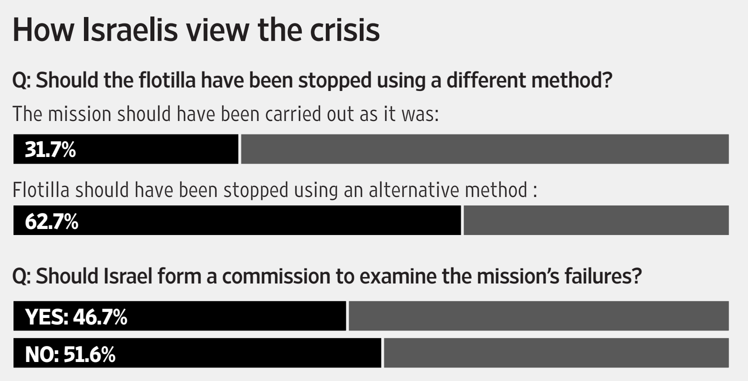
Secretary of State Hillary Clinton and other senior U.S. officials have stated publicly that they don't see Prime Minister Netanyahu's siege on the Palestinian territory as sustainable. But Washington hasn't moved yet to formally call for a lifting of the blockade. Senior U.S. officials have said Israel has legitimate concerns about the flow of arms to the militant Palestinian organization Hamas, which controls the Gaza strip and has launched thousands of missile strikes on Israel in recent years.

Pro-Palestinian activists are vowing to send more aid ships to Gaza in coming weeks. Activists in Lebanon said they hope to launch an aid boat toward Gaza within the next week. While former British lawmaker and antiwar activist George Galloway revealed on Sunday his plans for a September launch of two massive simultaneous aid convoys, one by land, and one by sea. He said his goal was for 60 aid ships and 500 aid trucks to descend on Gaza at the same time.

—Joe Lauria at the United Nations contributed to this article.

European Pressphoto Agency

Prime Minister Netanyahu, right, arrives at his Jerusalem offices on Sunday.



The poll questioned a representative sample of the Jewish population over age 18; no margin of error provided.
Source: Maariv, an Israeli newspaper

Japanese premier affirms ties with U.S.

BY YUKA HAYASHI

TOKYO—Japan's new prime minister, Naoto Kan, told President Barack Obama that the alliance with the U.S. will remain the linchpin of Tokyo's foreign policy in a call Sunday that took place while the premier was shaping his cabinet.

Two days after Yukio Hatoyama stepped down as leader following his botched effort to relocate a controversial U.S. base in Okinawa, Mr. Kan pledged to solve the issue in accordance with a recent bilateral agreement that led to his predecessor's departure.

In a call the U.S. requested, Messrs. Kan and Obama reaffirmed the importance of the security alliance between their nations and agreed to work in lockstep to solve issues facing both, such as the tensions in Iran and North Korea, the Japanese foreign ministry said. The White House said the two leaders "agreed to work very closely together."

After scoring an overwhelming win in a party election Friday to head the ruling Democratic Party of Japan, Mr. Kan plunged into the task of forming his cabinet. According to Japanese media, he intends to promote Yoshihiko Noda, senior vice finance minister, to finance minister, the position that Mr. Kan had held. Renho, a popular lawmaker who made her name in leading the DPJ's effort to cut waste in government spending, will be named consumer affairs minister.

For a smooth transition after the short tenure of the Hatoyama government, Mr. Kan intends to reappoint a majority of its ministers. They include Foreign Minister Katsuya Okada and Shizuka Kamei, the financial services minister.

In a show of surprising unity at Friday's election, Mr. Kan got support from 70% of the DPJ's 422 lawmakers, beating Shinji Tarutoko, a relatively unknown member of the lower house of parliament. Several powerful and much younger DPJ members viewed as Mr. Kan's rivals, including Mr. Okada and Transport Minister Seiji Maehara, pledged their support. As the DPJ controls the parliament, the party vote sealed Mr. Kan's ascent to premier.

Mr. Kan, a DPJ founder who has served as deputy prime minister, is Japan's fifth prime minister in fewer than three years. The short terms of the predecessors delayed efforts to solve chronic problems such as spiraling government debt, slow economic growth and rising joblessness among young people. In addition to sticking to the Okinawa deal, Mr. Kan had said at a news conference Friday that he aims to push through his plan to scale back the privatization of state-run Japan Post Holdings, which includes huge banking and insurance arms, a policy that some view as unfriendly to business.

He will also likely continue with the economic policy stance that he took as finance minister. The new prime minister prefers a weaker yen, which would bolster exporters' profits and help to fight deflation. Mr. Kan has been one of the leading voices warning of the dangers of deflation and has pushed the Bank of Japan to take more aggressive measures against falling prices. He has also hinted that Japan needs to raise its consumption tax from the current 5% rate, an idea that goes against the DPJ's campaign pledge last year but has earned praise from economists.

Mr. Kan said he would try to break the stagnation that has ailed Japan for more than two decades. "We can achieve a strong economy, a strong fiscal condition and strong social security at the same time," he said while accepting his party's stewardship.

He inherits a DPJ that took power in September amid a wave of popularity, ending a half-century rule by the conservative Liberal Democratic Party. Since then, the party's support has plummeted amid Mr. Hatoyama's inability to deliver his Okinawa promise and a fund-raising scandal that embroiled top party strategist Ichiro Ozawa, who stepped down as secretary general earlier last week.

Mr. Kan's appointment, combined with the resignation of Messrs. Hatoyama and Ozawa, improved the popular support for the party immediately. According to a poll released Saturday by the Asahi Shimbun Daily, the percentage of respondents who said they would vote for the DPJ in the July elections for parliament's upper house rose to 33% from 28% previously. In addition, 59% said they had positive expectations for Mr. Kan.

The new leader's staying power will depend to a large degree on his ability to capitalize on his reputation as a strong orator and party unifier in Japan's divisive political landscape. Mr. Kan—who lives in a 680-square-foot apartment in a Tokyo suburb and reported $45,000 in financial assets earlier this year—also enjoys a reputation as a clean, egalitarian politician.

His first test comes next month with the upper-house elections. The DPJ has a huge majority in the more powerful lower house, but a big loss in the upper house voting would force the party to rely on coalition partners with different policy views.

—Andrew Monahan and Kenneth McCallum contributed to this article.

WORLD NEWS

Lee sharpens rhetoric at Pyongyang

South Korea's president tries to balance anger over the incident with voters' fears over the possibility of war

BY EVAN RAMSTAD

Bloomberg News

Lee Myung-bak, South Korea's president, delivers the keynote address at the Shangri-La Dialogue in Singapore, on Friday.

SINGAPORE—South Korean President Lee Myung-bak over the weekend sharpened his criticism of North Korea for the alleged sinking of one the South's warships, but acknowledged his country can't go to war over it.

Mr. Lee's statements to different audiences during a Singapore stay made plain the difficulty of balancing the desire to penalize North Korea with the worries that many South Koreans feel—and some expressed in an election of local officeholders last week—about what North Korea will do if antagonized.

During his visit, Mr. Lee didn't acknowledge the losses his political party took in the local elections, which some analysts attribute to voters being upset by him reacting too strongly against North Korea. And that apparent setback didn't stop his government from formally complaining to the United Nations Security Council about North Korea on Friday.

On Sunday, Pyongyang called Seoul's request for the U.N. to punish it "yet another intolerable provocation," the Associated Press reported. The North's Committee for the Peaceful Reunification said Pyongyang will launch "stern punishment" if the South doesn't stop anti-North steps.

In Singapore, Mr. Lee pushed forward with a public-relations campaign to persuade other nations to stop North Korea's ability to act violently with relative impunity, while also assuring them that South Korea doesn't want a war.

In an address Friday night to the Asia security summit called the IISS Shangri-La Dialogue, Mr. Lee reminded the audience of military leaders that North Korea has a long history of bad behavior—including killing South Korean civilians and building nuclear weapons—for which it has received few penalties.

"We must not just forget something like this happened," Mr. Lee said. "We must not repeat the behavior that we took whenever North Korea engaged in such actions in the past."

U.S. Defense Secretary Robert Gates took up the message at the same conference. "The question people have to contemplate is, what are the consequences for a North Korea of an unprovoked attack on a neighbor? For nothing to happen would be a very bad precedent here in Asia," he said.

But on Saturday, Mr. Lee made plain the constraints on South Korea in a meeting with Singapore business leaders, saying the country won't have an "all-out war" with the North.

Even so, South Korea is trying to go further than last year, when, after Pyongyang tested a nuclear weapon for a second time, Mr. Lee and other political leaders spoke about ending the North's extortion cycle, in which it would take a provocative step, then call for diplomatic meetings and request a financial reward not to do something bad again.

Kim Tae-hyo, South Korea's deputy national security adviser, said in an interview that Seoul wants to break the less-visible "vicious cycle" in which North Korea taunts and attacks the South nearly at will.

"We want to make this a first case for international society to seriously look at North Korea's past history and join together and give a serious message and serious diplomatic and economic pressure so the North Korean leaders fundamentally change their strategic metrics and calculations," Mr. Kim said.

To do that, Mr. Lee said little for weeks about the March 26 sinking, in an effort to calm emotions in South Korea and exhibit restraint on the international stage. Despite suspicions by others in the government and many in the South Korean public, he said nothing about North Korea until after a 74-person investigation committee on May 20 announced its findings, including remnants of a North Korea-made torpedo.

And when North Korea and skeptics in South Korea criticized Mr. Lee's government's formal accusation, it invited critics to view the recovered ship themselves. Over the weekend, military officials took about two dozen South Korean bloggers to see the ship and examine investigators' findings. More will visit this week.

Mr. Lee has also parried North Korea's own PR campaign, refusing its request to send its own investigators to look over the ship, for instance. And Mr. Lee, unusually for a South Korean president, personally thrust back at some of the invective North Korea has hurled over the incident. He told the military audience in Singapore that the North's rhetoric is "laughable" and part of the bigger pattern of bad behavior.

But amid the noise, South Korea scaled back some of the unilateral penalties, most significantly a plan to blast propaganda messages at North Korean soldiers across the inter-Korean border, and delayed a planned joint antisubmarine exercise with the U.S.

Some South Koreans are unnerved by the tit-for-tat between the two capitals, particularly after experiencing 10 years of presidents whose economic outreach to the North was accompanied by mild criticism of Pyongyang at most, including when its authoritarian regime tested nuclear weapons and killed six South Korean sailors in a 2002 sea skirmish.

"The government's stance on North Korea is too strong," says Shin Chang-hyun, a 35-year-old office worker in Gwangju, South Korea. "The last two governments' policy was, you might say, just giving money away, but the Lee government is too hardline. This is too radical a change."

That kind of sentiment, analysts say, contributed to a stronger-than-expected showing by opposition parties in local and provincial elections last Wednesday. Mr. Lee's Grand National Party had expected Mr. Lee's response to the Cheonan ship sinking to help it break a pattern in which ruling parties fare poorly in elections at the midpoint of a presidential term. Instead, opposition parties prevailed in 10 of 16 key races.

Asked how the election setback affects Mr. Lee's strategy, Mr. Kim said that there's no serious doubt among South Koreans about the North's responsibility for the ship attack, which killed 46 sailors.

"There is only a minority view that, in order to preserve short-term peace and stability, why not just grab North Korea again and give them money so they will be quiet," Mr. Kim said. "But many people in South Korea realize this piecemeal and partial approach cannot fundamentally resolve the dilemma of the inter-Korean relationship."

For now, the biggest constraint in the South's hopes of penalizing North Korea is China, which is Pyongyang's chief economic and political ally, and Russia, both of which have veto power at the U.N. Security Council.

Mr. Kim said Seoul hasn't decided precisely what form of penalty it will seek at the council, but it is working with Beijing and Moscow to decide the "basic important elements of the message we want to deliver."

—Jaeyeon Woo in Gwangju, South Korea, contributed to this article.

Sri Lanka sees faster GDP growth

BY ERIC BELLMAN

COLOMBO—Fresh investments and consumer optimism spurred by the end of the war in Sri Lanka are helping the economy here more than expected, said the country's central bank governor.

The Central Bank of Sri Lanka likely will raise its projection for gross-domestic-product expansion this year to 7% from an earlier estimate of 6%, said its governor, Ajith Nivard Cabraal. The revision could happen as early as this week, he told The Wall Street Journal.

"We have already started to enjoy economic activity taking a very quick march upwards," he said in an interview from his Colombo office overlooking the Indian Ocean. "The stock market is doing much better, bank lending is coming back and local investors are getting upbeat about what they should be doing."

Mr. Cabraal said the central bank is waiting to confirm whether the numbers for the first quarter were in line with initial estimates. If they are as strong as he expects, then the bank will raise its forecast, he said.

Expatriate Sri Lankans are sending more money home, foreign investors are expanding their operations here, the government is in the middle of an infrastructure push and local consumers and companies are spending more than before, confident that their spending plans won't be spoiled by war.

Last year, the government won its three-decade-long war against the Tamil Tiger separatists, opening the north and east of the country to more development and ,so far, ending regular terrorist attacks in Colombo, the capital.

"We are emerging out of the conflict and it is important for us to convey the message that Sri Lanka is open for business," said Mr. Cabraal.