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THE WALL STREET JOURNAL.

VOL. XXVIII NO. 88 EUROPE Tuesday, June 8, 2010

DOWJONES A News Corporation Company europe.WSJ.com

THE WALL STREET JOURNAL.

£1.50

Bahrain BD 150 - Egypt $1.75 (C/V)
Jordan JD 2 - Kuwait KD 1 - Oman OR 2
Qatar QR14 - Saudi Arabia SR 14

Prudential's CEO defends strategy, apologizes for AIA bid's failure

Agence France-Presse/Getty Images

Prudential CEO Tidjane Thiam told the company's shareholders he regretted the 'strain' that its attempted transformational bid for AIA had put on Prudential's relationship with them. At a meeting Monday, shareholders exhibited signs of those strains, with one calling the insurer's board 'a disgrace.' Article on page 19

BP stems oil flow into Gulf; costs rise

By Jeffrey Sparshott And Mark Long

LONDON—**BP** PLC on Monday said it has continued to increase the amount of oil it is collecting from the Gulf of Mexico spill as its costs connected to the leak reached $1.25 billion.

The White House, meanwhile, indicated that the British oil company likely will face billions of dollars in penalties, and U.S. President Barack Obama said the spill's economic effects on the Gulf Coast will be significant.

"What is clear is that the economic impact of this disaster is going to be substantial and ongoing," Mr. Obama said.

White House Press Secretary Robert Gibbs said the costs associated with the spill will greatly exceed the amount BP could recoup by selling the captured oil on the market. In addition to response and recovery costs, there will be "penalties that will be involved in this in the many billions of dollars," he

Please turn to page 4

Euro zone finalizes loan terms

By Charles Forelle

BRUSSELS—Euro-zone finance ministers meeting in Luxembourg on Monday signed off on the final details of €440 billion ($527 billion) in loans intended to be a backstop if the Continent's sovereign-debt troubles deepen, European officials said.

The package is the largest piece of a €750 billion bailout assembled by European Union countries and the International Monetary Fund.

On Monday, the IMF called on the Continent to clean up its banking sector and to go beyond current proposals for joint management of national budgets.

If a euro-zone country were to have trouble paying its debts, it could apply for the 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 earlier 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-zone members, then lend it out at a higher rate to the troubled country. The finance ministers said the vehicle would aim to have the "highest possible rating" from credit-rating agencies.

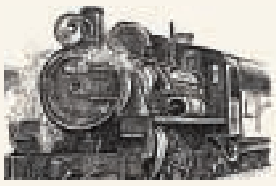
The structure is a bid to steer clear of EU prohibitions on direct purchases of member-state debt—a cornerstone meant to keep countries from being responsible for one another's affairs. The effort hasn't been without critics, especially in fiscally sound Germany, but the mechanism passed perhaps its 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 how the special vehicle would market its bonds and whether the 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 for Greece, the most troubled of the euro-zone nations. It would be called into action only after a separate €60 billion facility, operated by the EU itself, had been exhausted.

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

The Quirk



Editorial & Opinion

PAGE TWO

Svanberg could be the BP sacrifice

[Agenda]

By Patience Wheatcroft

Falling out with the president of the United States is not an advisable strategy for a global business. Whatever the circumstances that precipitated such an unhappy state, repairing the relationship would be a very high priority. So the question that should now be occupying the **BP** board is whether Carl-Henric Svanberg is someone with the ability to tread the wretchedly difficult diplomatic path that now lies ahead for the company.

The news from the Macondo well is slightly better, although oil is still pouring from the seabed and the crisis is far from over. But for BP, the damage from this disaster goes far beyond the cost of the clean-up. If it is to have any future in the world's heaviest energy-consuming economy, then it needs to be able to rehabilitate its relationship with the US government.

The oil industry is as much about geopolitics as it is about geology. Tony Hayward, BP's chief executive, is an oil man who has demonstrated that a silver tongue wasn't part of his tool-bag. This is in stark contrast to his predecessor, Lord Browne, who was adept at charming an assortment of presidents and potentates who had interesting oil assets. That his successor should be inwardly focused is not necessarily a bad thing: There is clearly more than enough to keep a chief executive fully occupied in righting some of the wrongs within BP. It is essential, though, that he should have a chairman with the complementary skills and schmoozing ability the industry requires.

Blood-lust-fueled demands for a human sacrifice from BP miss the point. The tragedy currently playing out in the Gulf of Mexico has many causes and blame will, in reality, be widespread. It can always be argued that, since it happened on his watch, the chief executive should resign, but Mr. Hayward is probably as well-qualified as anyone to steer BP operationally through this mess and certainly has the motivation to do so.

Stella Pictures/ABACAUSA.COM

Carl-Henric Svanberg, the Swedish chairman of the board of BP.

Mr Svanberg, a director of the company since last September who only became chairman in January, would be more easily sacrificed. Such has been his impact in his short term in office that it could be said that his departure would barely be noticed.

As images of oil-covered pelicans are plastered over the Internet, BP faces a decision over its dividend.

Such a low-key approach might have been understandable in his early days in his office as he got to know the business. It has been harder to understand in recent weeks, as BP has found itself the subject of opprobrium from all sides. If this was a deliberate strategy, then it is hard to understand. But Mr Svanberg has now emerged, blinking, into public view and it may be that he is about to demonstrate why it was that the King of Sweden saw fit to honor him with his medal for services to industry.

Yet his career in Swedish business, culminating in six years as president and chief executive officer of **Ericsson**, may not have made him ideally qualified for the role he now holds. The last thing BP requires at this crucial time is a boardroom upheaval for the sake of appeasing its critics. What it desperately needs, though, is the right team to lead it through a truly precarious period.

As images of oil-covered pelicans are plastered over the media and the Internet is awash with comments branding the business a pariah, it faces an imminent decision over the future of its dividend. Whichever way it moves on that, it will face criticism. President Obama has already set the tone for those who would see it as a scandal were the company to pay its shareholders a cent until all the damage from Macondo had been repaired and the compensation bill fully paid.

That dividend payment, however, is vital to many pension funds and pensioners. If BP believes that it can afford to honor its obligations to its owners as well as the victims of the oil spill, then it should do so. The company needs to retain as much of the goodwill of its investors as it can in these difficult times. Maintaining the dividend would be an important step in that direction. Dividend policy should not be dictated by the White House. Yet keeping shareholders on its side will only exacerbate BP's diplomatic challenge in the US, which is why it is imperative that the chairman should be something of a statesman, able to talk to politicians in language they understand and to make it easier for them to see a way of gradually rehabilitating the company.

Carl-Henric Svanberg may be that man.

If the non-executive directors have any doubts on that, though, they shouldn't hesitate to act. It would be a brave man to take on the chairmanship of BP at this stage, but without the right person at the top, the company's tragedy could be even greater than it currently looks.

A prudent apology

Calls for resignations from **Prudential PLC** have been as loud as those at BP. Monday, the chairman and chief executive seemed to make a little progress in quelling the ire of investors, although the heavy costs of the abandoned deal still rankle.

Chief Executive Officer Tidhane Thiam continues to maintain that taking over AIA would have been the right strategic move for Prudential, and he is probably right. Yet he and his chairman failed to persuade enough investors to share their enthusiasm for the deal.

They were wrong-footed from the start, when news of the proposed deal leaked and they had to go public with the plan ahead of schedule.

The issue for companies plotting big strategic moves is at what stage they should risk talking to their investors. An early approach to sound out attitudes appears sensible but investors are often ambivalent about the attractiveness of this tactic. Some don't like the idea of being made insiders, preferring to retain the right to trade the stock.

Major shareholders, however, should be prepared to sacrifice that right for the benefit of being involved in strategic decisions.

What's News

■ **Germany announced** $95.6 billion in budget cuts in the next four years, while the U.K. sought to prepare public opinion for similar austerity measures as concerns about public debt began to spread to larger economies. **7**

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Previous results

Q: Do you think Hungary is likely to follow in the footsteps of Greece?

Yes
14%
No
86%

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 Basînevi.

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

Texas movie subsidy stirs big-screen uproar

By Stephanie Simon

Texans are bombarding the governor's office with calls and letters to try to stop tax dollars from subsidizing a satirical film about a vengeful illegal immigrant.

The coming film, a bloody action movie with a star-studded cast titled "Machete," could be eligible for more than $1.5 million of taxpayer subsidies under a program designed to encourage directors to shoot in Texas.

The state Film Commission may deny subsidies to any production that includes "inappropriate content or content that portrays Texas or Texans in a negative fashion." But the commission, eager to woo as many movie, advertising and video-game shoots as possible, has never exercised that clause. "You have to understand that we want to create jobs," said Bob Hudgins, the commission's director. "That is our focus."

"Machete" may put that focus to the test. Directed by Robert Rodriguez and produced by Quentin Tarantino, the film stars Robert De Niro, Lindsay Lohan, Cheech Marin, Jessica Alba and, in the title role, Danny Trejo. Mr. Trejo plays a renegade Mexican cop who flees to Texas and is hired to assassinate a sleazy state lawmaker who has made his name by urging crackdowns on illegal immigrants. Mayhem ensues.

The movie grew out of a mock trailer Mr. Rodriguez made for a schlocky 2007 film called "Grindhouse," whose satirical, over-the-top style "Machete" is meant to embrace. Mr. Rodriguez called it a "hard-hitting, white-knuckled, good time."

But last month, he swerved into political controversy when he released what he later described as a "fake trailer" for "Machete" on a fan website. It opened with the star, Mr. Trejo, growling that he had a message for Arizona, which had just passed its controversial law aimed at identifying and deporting illegal immigrants. The footage that followed spliced scenes to make it seem as though Mr. Trejo was assembling an army of illegal immigrants bent on gory revenge.

Outraged, nationally syndicated radio host Alex Jones, who works out of a studio in Austin, Texas, accused the film's director of fomenting a race war and demanded that Texas deny the project subsidies. Mr. Jones has since changed his mind, saying that "the state shouldn't be able to pick and choose which type of film gets funding."

But his initial stridency sparked a broader outcry. In two weeks, more than 400 calls and emails poured into Republican Gov. Rick Perry's office, virtually all urging the state not to give tax dollars to "Machete," said Allison Castle, a spokeswoman for the governor.

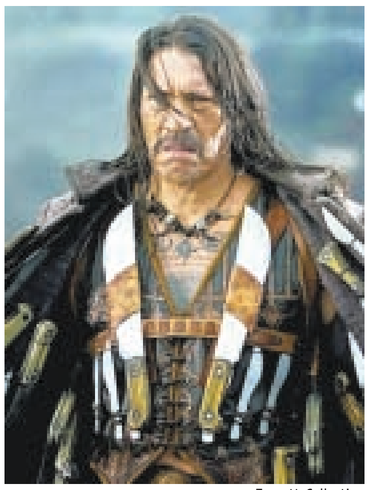
Peter Morrison, a real-estate developer in the small town of Lumberton, in southeast Texas, was among the protesters. "Machete, to put it mildly, is not only viciously anti-American, it's also incendiary," he wrote in a weekly newsletter he said he sends to thousands of online subscribers. "This isn't entertainment; it's propaganda of the worst kind."

In Texas, the incentives for producing films in-state are delivered after the shooting has wrapped, in the form of cash rebates. Big-budget films like "Machete" get back 15% of what they have spent in the state, plus a bit more if they shoot in economically depressed areas.

Mr. Hudgins, the film-commission director, said he won't decide whether "Machete" is eligible for the subsidy until he sees a final cut this summer. (The film is set for release Sept. 3 by 20th Century Fox, which, like The Wall Street Journal, is owned by News Corp.)


Zuma Press

Director Robert Rodriguez's coming film 'Machete' was shot in Texas and thus is eligible for a rebate of up to 15% of what was spent in the state.


Everett Collection

Danny Trejo in the title role in 'Machete,' appearing in a trailer.

GULF OIL SPILL

BP steps up effort to improve image

Oil company prepares to air series of TV commercials designed to diminish criticism over Gulf of Mexico spill

By Suzanne Vranica

Undeterred by criticism of a new television commercial featuring its leader, BP PLC is pressing ahead with a major ad campaign—in an effort to rescue its badly damaged image—as oil continues to spew into the Gulf of Mexico.

"We are preparing a series of ads to air over the next days and weeks," said Andrew Gowers, a spokesman for the oil company.

President Barack Obama blasted the British company Friday for reportedly spending $50 million on TV advertising as BP scrambles to fix its leaking well.

BP rolled out a new TV ad late last week featuring a personal apology from Chief Executive Tony Hayward. In the spot, he promises U.S. taxpayers won't be footing the bill for the cleanup. As images of the cleanup effort appear on screen, he says: "To those affected and their families, I am deeply sorry."

Early indications suggest the ad isn't hitting the mark with consumers and crisis experts. "The ad failed to resonate in a meaningful way," said Ju Young Lee, co-founder and chief scientist of Ace Metrix, a Los Angeles research firm that polled consumers on their reaction. "What consumers are saying is that they have been waiting for BP to say something and, after hearing it, they say they didn't learn anything new," she added.

In its poll of 560 consumers ages 21 to 54, Ace Metrix found that about 75% disagreed that Mr. Hayward was the right person to lead BP out of its image disaster. Ms. Lee said one in five respondents said they had a hard time believing Mr. Hayward's sincerity in the ad.

"It's very unfortunate that Tony Hayward is the face of this crisis," said James S. O'Rourke, a professor of management at the University of Notre Dame. BP has spent too much time "cleaning up" after Mr. Hayward's public missteps, he added, referring to recent gaffes such as a comment by Mr. Hayward that he "wanted [his] life back." Mr. Hayward later apologized for the remark.

Mr. Gowers said BP is tracking the reaction to its ads and is "happy with how they are performing." He wouldn't say whether Mr. Hayward will appear in the new ads.

The company declined to say how much it is spending on the marketing effort. It has suspended all of its regular advertising, and is using its ad budget to address the oil spill. Last year, BP shelled out almost $100 million on ad time and space in the U.S., according to an ad-tracking unit of WPP PLC.

BP bypassed its longtime ad agency, WPP's Ogilvy & Mather, to create the new TV ads, enlisting Purple Strategies, a Washington public-affairs firm that is owned by Republican strategist Alex Castellanos and Democratic consultant Steve McMahon, according to a person familiar with the matter.

BP recently hired a new head of U.S. media relations, Anne Womack Kolton, a former Energy Department official and aide to former Vice President Dick Cheney. U.K. public- and government-relations firm Brunswick Group is also among those working to repair BP's image.

European Pressphoto Agency

BP Chief Executive Tony Hayward spoke to reporters last month in Fourchon, La., about the Gulf of Mexico oil spill. He has apologized for saying that he "wanted [his] life back."

More leaking oil collected

Continued from first page

said.

BP said it brought 11,100 barrels of crude to a ship on Sunday after having collected 10,500 barrels Saturday, up from slightly more than 6,000 barrels the previous day.

U.S. Coast Guard Adm. Thad Allen, the U.S. government's point man on recovery efforts, said at a White House news conference Monday that BP was approaching the collection of 15,000 barrels a day.

The company last week placed a containment cap on the ruptured well and on Monday said a second containment system would be available for deployment in mid-June, potentially increasing the amount of oil and gas that can be captured.

The relative success of the capping procedure follows a string of failures to reduce the amount of oil that has been gushing into the Gulf for more than six weeks.

Scientists led by the U.S. Geological Surve+y have estimated at least 12,000 to 19,000 barrels of oil a day have been leaking into the water.

The cap is the latest BP attempt to contain the leak sprung by the explosion and sinking of the **Transocean** Ltd. drilling rig Deepwater Horizon, which BP was leasing. The April accident killed 11 workers.

BP hopes to enhance the system lowered over the well last week by using equipment initially developed for the failed "top kill" effort to plug the well.

Two relief wells currently being drilled are considered the best bet to plug the leak. Those wells are expected to be completed in August at the earliest.

Meanwhile, costs to stem the leak are mounting, though BP said it was too early to quantify total expenses and liabilities associated with the incident.

The $1.25 billion figure excludes $360 million for a Louisiana barrier-islands construction project, BP said.

—Jared Favole contributed to this article.

European Pressphoto Agency

Helicopters carried sandbags Monday as part of an effort to check the oil flow.

Florida's anglers get sidelined by spill

By Mike Esterl
And Jennifer Levitz

PENSACOLA, Fla.—Rebecca Yates hoped to reel in a $2,000 prize last weekend for catching a whopper of a king mackerel in the Gulf of Mexico.

Instead, Ms. Yates and a crowd of other would-be anglers hung up their rods and drowned their sorrows at the Paradise Bar & Grill on Pensacola Beach, as oil from the Deepwater Horizon spill gathered along Florida's northwestern shoreline. "I say we all just need to get drunk," she said, taking a swig of "firefly," a concoction of vodka, lemonade and sweet tea.

With about a third of federal waters in the Gulf closed to fishing as of the weekend, scores of local angler tournaments are being nixed, bait shops are empty and charter boats are idle, illustrating the extent to which the slick is hurting not only commercial fishermen but the Gulf's deep tradition of recreational fishing.

Ms. Yates, a 40-year-old paralegal, was one of about 50 female mackerel enthusiasts gearing up for the weekend's ladies-only Queen of Kings "rodeo"—essentially a fishing tournament—which was canceled as the oil approached the Panhandle, with a sheen just south of Pensacola Beach's fishing pier on Sunday.

The spill's northeast drift means Florida's anglers now are hurting along with fishermen from Louisiana, Mississippi and Alabama. Florida has the largest number of sport fishermen in the U.S., with 2.7 million, the highest "angler expenditures," with an average of $4.4 billion annually, and the largest number of "angler-supported jobs," with 75,068, according to the American Sportfishing Association.

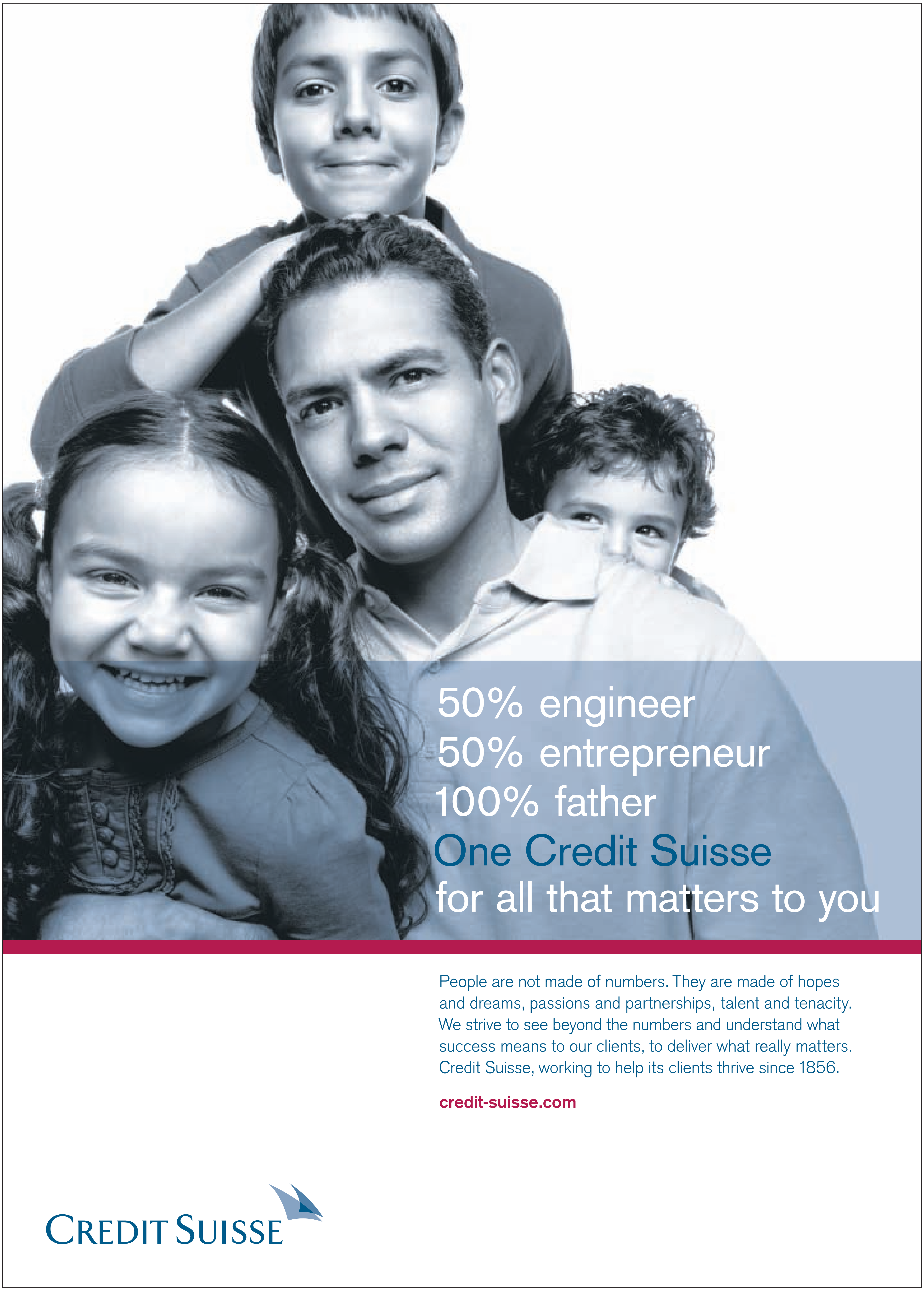
The Panhandle's saltwater-fishing season typically starts in March, when enthusiasts troll for cobia. Spanish mackerel and king mackerel start arriving in April and May; wahoo and mahi-mahi are popular catches beginning around late May. Snapper, grouper, amberjack and many other fish join the list before the season winds down in the fall.

Some in Pensacola refuse to let the oil stop them. Sean McLemore, a local scuba diver and fisherman, had signed up for four rodeos. All have been canceled, but he went spear fishing off the coast of Pensacola last week and caught a large red snapper. First, though, he had to dive through a patch of murky, water-oil mixture.

"It was like a chocolate milkshake," said the 30-year-old Mr. McLemore, who helps manage an electrical-contracting firm.

Joe Zwierzchowski, who organized the Queen of Kings rodeo, was still hoping to squeeze it in before the oil arrived. But after he arose at 5 a.m. Friday and saw news and weather reports, he pulled the plug. Mr. Zwierzchowski is holding off on canceling a bigger rodeo open to men, the Miller Lite Mack Attack, which is planned for August with a $10,000 prize. "But I'm not very hopeful," he said.

Fishermen here have a complex relationship with oil rigs. Some locals swear the rigs make for better fishing. Shrimp and other bait like to congregate around structures, and that draws larger fish, said John Booker, a sales clerk at Hot Spots Bait & Tackle in Gulf Breeze.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EUROPE'S DEBT CRISIS

Reuters

The ratings of Guido Westerwelle, left, are the lowest of any major German politician and have made him a liability to the coalition government headed by Angela Merkel

Partner's gaffes hurt Merkel's reach

By Patrick McGroarty and Matthew Karnitschnig

BERLIN—Guido Westerwelle, the youthful head of Germany's pro-business Free Democratic Party, led his party into government in September on a promise to lower taxes, spend more on education and cut red tape. Eight months on, Mr. Westerwelle is fighting for political survival.

Recent polls suggest the FDP, the junior coalition partner to Chancellor Angela Merkel's Christian Democratic Union, has fallen into a downward spiral, with the party recently scoring less than half the record 14.6% of the popular vote it garnered in September. Approval ratings for Mr. Westerwelle, who is also the country's foreign minister, have slumped to 24% from 43% in September.

Political miscalculations, weak leadership and a series of gaffes by the 48-year-old Mr. Westerwelle have upended the party's agenda, critics say. As a result, the FDP has been sidelined, pushing Germany closer to a constellation voters wanted to avoid—the "grand coalition," an awkward power-sharing arrangement between the country's two mainstream parties, the CDU and the left-of-center Social Democratic Party, or SPD.

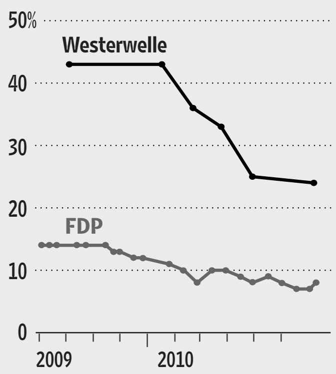
The turning point came last month when the government lost control of North Rhine-Westphalia, Germany's biggest state. The election defeat, due in large part to the FDP's poor showing, cost the coalition its majority in Germany's upper house of parliament. Now the government needs the support of the Social Democrats to pass major legislation.

"I don't want to sugarcoat things. The FDP is not doing well," Sabine Leutheusser-Schnarrenberger, a veteran FDP member and current justice minister, told Germany's Der Spiegel magazine in an interview.

The SPD's newly gained power in the upper house also gives Ms. Merkel less leeway than before in pushing through unpopular measures involving the European Union. When parliament approved a law last month allowing Germany to contribute to the emergency bailout package for the EU, the SPD abstained, allowing the measure to pass but showing disapproval.

Falling out of favor

Support for Guido Westerwelle and his FDP party has slumped since elections last September.



Source: Infratest Dimap polls of at least 1,000 adults

Supporters of the FDP had expected the party to prod the more centrist CDU into action on reform. Voters frustrated by years of inertia under the grand coalition government elected in 2005 embraced Mr. Westerwelle's message of renewal and flocked to the FDP, returning the party to government for the first time in more than a decade.

For many Germans, the biggest disappointment has been the FDP's shifting position on its signature issue—taxes. After pledging a major overhaul of Germany's complicated tax regime, including cuts, the FDP has backed away from the promise.

Now, the government is poised to end tax breaks for many Germans in order to meet deficit targets. Hope for tax relief all but evaporated last month as Germany made clear that it wants European governments to make tough budget cuts in exchange for aid guarantees—and that Berlin plans to lead by example.

After the election last month in North Rhine-Westphalia, government tax revenue estimates confirmed there was little room for tax cuts without putting additional stress on the federal budget. Ms. Merkel declared that the cuts were off the table. Mr. Westerwelle didn't protest.

For the FDP, it "was a mistake to tie their agenda so tightly to these tax cuts, because it was abundantly clear that there would be relatively little room for error," says Tim Spier, a political researcher at Heinrich Heine University in Düsseldorf.

Mr. Westerwelle's missteps haven't helped the party's cause. German foreign ministers often score strong poll ratings because representing Germany's interests across the globe often allows them to rise above the domestic political fray. But Mr. Westerwelle's ratings are the lowest of any major German politician. The 24% he received in a poll released by broadcaster ARD recently is just half the 48% Ms. Merkel scored.

Several gaffes have also helped push those numbers down. Mr. Westerwelle created a popular Youtube video last fall by snapping at a reporter for asking him a question in English. In another instance, he compared Germany's jobless benefits to "late Roman decadence."

The Free Democrats enjoyed a long reign as political kingmakers. That ended in 1998, and many of the party's current leaders adopted the brash style of politicians in perpetual opposition. The Free Democrats shifted from a party eager to compromise in exchange for power, to one committed mainly to pro-business ideals, Mr. Spier says. That rigidity has hurt the FDP since it returned to government last fall.

Nervous banks park record funds at ECB

By Terence Roth

The euro-currency system opened the week under fresh strain after concerns about bank liquidity and Hungarian finances heightened investor aversion to risk.

The open lack of official concern about the plunging euro, Hungarian debt warnings, fear of bank defaults and uncertainty about economic recovery have added to the level of toxicity.

In a clear sign of shaken nerves in the euro-zone banking system, the European Central Bank said early Monday that banks parked a record €350.9 billion ($419.9 billion) in cash at the ECB's low-yielding but safe overnight deposit facility.

If markets are functioning properly, banks use the ECB facility to the tune of only a few hundred million euros. Despite massive injections of ECB funding into the banking system, banks appear increasingly unwilling to lend to each other in money markets, where banks lend to each other at higher rates.

"The environment remains rather tense, with banks extremely keen on staying liquid," say analysts at UniCredit Bank. Not helping was last week's ECB financial stability report that banks face around €200 billion in loan losses this year and next, they observed.

Although not a member of the 16-nation euro zone, the new Hungarian government's warnings about the state of the country's finances raised fear of default risk for euro-zone banks. Budapest's attempts to downplay the warnings didn't fully reassure markets.

The Hungarian default talk weakened government bond markets along Europe's fiscally weak periphery. On Monday, the cost of insuring most European government debt against default continued rising, with Portugal and Belgium showing the largest gains.

Market analysts at Danske Bank detected that the ECB had to step up use of its controversial bond-purchasing program as a result. The ECB tried letting the government bond markets of Spain, Portugal, Italy, Greece and Ireland stand on their own two feet last week by scaling back is purchases. "However, markets did not function well and the ECB began buying once more Friday," Danske said. The ECB remains the only bidder in many of these markets, they added.

There also is a lot of competition for bunds. Belgium, the Netherlands, Austria, Germany, Portugal, Spain and Italy will issue up to €26 billion of bonds this week. The absorption of this amount will be cushioned by around €16 billion of German redemption and coupon payments.

Markets could face another liquidity crunch at the end of this month, when the ECB's mammoth €442 billion tender of 12-month funds expires. That total equates to almost half of the liquidity provided by the ECB and the 16 national central banks that currently provide around €846 billion in temporary funds to banks in the region.

Investors also have remarked on the apparent unconcern among euro-zone officials with the euro's precipitous decline against the dollar. Trading under $1.2000 early Monday, the shared European currency is down 21% from a December peak.

The ECB has made no sign of intervening, verbally or materially with actual euro purchases. Nor are senior EU officials likely to push for it, with the weak currency offering an edge for an export-led economic recovery. Euro Group Chairman Jean-Claude Juncker said Sunday the current level of the euro isn't a concern, but called for improved government cooperation between countries using the currency.

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 . "There have been imprudent statements from some Hungarian officials that have made financial markets think that Hungary is the future domino," he said.

EUROPE'S DEBT CRISIS

Fresh cuts in Germany and the U.K.

Europe's largest economies are beginning to feel the financial-market pressures that have hit Spain and Greece

Germany's government announced around €80 billion ($95.6 billion) in budget cuts in the next four years, while the U.K. government sought to prepare public opinion for similar austerity measures.

*By **Andrea Thomas** in Berlin and **Paul Hannon** in London*

The two countries' moves to rein in budget deficits show how financial-market nervousness over growing public debt in Europe is leading even the region's largest economies to focus on fiscal discipline, despite warnings from some economists that early spending cuts could hurt a fragile economic recovery.

German Chancellor Angela Merkel unveiled plans to slash the budget deficit in Europe's biggest economy by 2014 in order to comply with debt limits in Germany's constitution and with European Union rules.

The austerity policy will begin in 2011, when the government aims to save €11.2 billion, equivalent to just under 0.5% of gross domestic product, mainly by cutting spending but also with some extra taxes.

"Around €80 billion must be saved until 2014 in order to put our financial future on a solid footing," Ms. Merkel told reporters, adding that Germany faces "serious, difficult times" and that the measures "are necessary for the future of our country."

Germany's quest for budget discipline is partly aimed at setting an example for more profligate countries in the euro zone, which has been rocked by a crisis of financial-market confidence in recent months due to runaway public debt in Greece and other struggling members of the bloc.

The euro zone's fiscal crisis has made it even more urgent that the U.K. should take its fast-rising public debt, British Prime Minister David Cameron said Monday. The new U.K. government's examination of public finances showed that "the scale of the problem is even worse than we thought," he said.

Although the U.K. has a much stronger economy than Greece, the struggling euro-zone country's debt crisis "serves as a warning" that developed economies can suffer a sudden loss of investor confidence and a sharp rise in interest rates, said Mr. Cameron. "Investors don't have to put their money in Britain," he said.

Mr. Cameron warned that the U.K. government will have to pay £70 billion ($101.12 billion) in interest on its debt by 2015 if it doesn't take urgent action to reduce its borrowing.

That would make interest payments in 2015 bigger than the combined education, transport and climate-change budgets, and almost twice the annual revenues from taxes on company profits, Mr. Cameron said in a speech at the Open University in Milton Keynes. "That is how serious this problem is. This is how far we've been living beyond our means," he said.

Getty Images

David Cameron said Monday that the U.K.'s situation was worse than thought.

"We must go about the urgent task of cutting our deficit in way that is open and fair," Mr. Cameron said, adding: "The effects of these decisions will stay with us for years, if not decades to come."

Germany's targeted savings rise to €19.1 billion in 2012, €23.7 billion in 2013 and €27.6 billion in 2014.

Germany's Vice Chancellor and Foreign Minister Guido Westerwelle said the measures consist mainly of spending cuts and don't include any increases in income tax or the main rate of value-added tax.

The ax will fall on social-welfare and unemployment benefits, and the government plans to review its military spending.

Potential measures to raise extra tax revenues include a levy on nuclear-power companies, along with a tax on air passengers.

Germany's U-turn from a fiscally expansive stance to one of strict austerity comes as the government attempts to comply with a constitutional amendment, passed last year, that requires Germany to reduce its budget deficit, when adjusted for cyclical effects, to no more than 0.35% of GDP from 2016 onward. That requires narrowing the deficit by about €10 billion a year from 2011.

The government said it aims to reach the EU's permitted deficit limit of 3% of GDP by 2013 at the latest.

Germany's budget deficit reached 3.1% of GDP in 2009 and the government forecasts a deficit of around 5% this year. The so-called structural deficit, adjusting for economic swings, is currently around 3% of GDP, the government estimates.

Economists say Germany's austerity measures are likely to weaken but not undermine the country's economic recovery.

German manufacturing orders rose by a stronger-than-expected 2.8% in April compared with the previous month as demand grew at home and abroad, government data showed.

The data indicate that Germany's recovery is well under way following last year's 5% contraction in GDP, which was the worst performance in more than 60 years. The outlook is also brightening because the weaker euro is set to boost German exports further, economists said.

Hungary garners support

BY GORDON FAIRCLOUGH AND VERONIKA GULYAS

BUDAPEST—The European Union and International Monetary Fund sought Monday to bolster global confidence in Hungary's ability to manage its finances, after the government in Budapest pledged to trim its budget deficit and adhere to agreements with lenders.

Fears of a ballooning deficit in Hungary, touched off by comments from local politicians that have since been disavowed by government officials, unsettled global markets Friday, prompting steep drops not just in the Hungarian currency, the forint, but also in the euro and other European currencies.

"The Hungarian crisis is shadow boxing. It's not a real crisis," said Olli Rehn, the European commissioner for economic and monetary affairs, at a meeting of European finance ministers in Luxembourg. "Hungary has taken substantial measures of fiscal consolidation in the last couple of years."

Hungary turned to the EU and IMF for help in 2008, when it was unable to raise money in capital markets to fund its government-spending overruns.

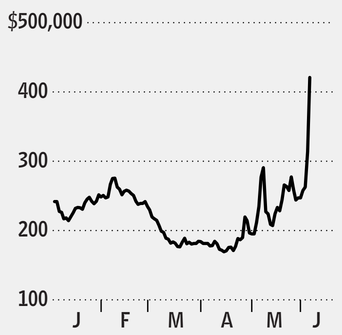
Hungary has drawn about €10 billion ($12 billion) from its IMF loan and an additional €5.5 billion from an EU facility. It hasn't drawn on either credit line so far this year, despite being qualified to do so.

In exchange, it promised to curtail government spending and shrink its budget deficit. The target for this year is 3.8% of gross domestic product.

Dominique Strauss-Kahn, the head of the IMF, which has been closely monitoring Hungary's compliance with its credit agreement, said the country's financial situation provides "no reason for special concern."

Fresh doubts

The cost of insuring against Hungary's sovereign debt default for five years



Source: Markit

The forint regained ground Monday. The Polish zloty stabilized and the Czech koruna bounced back after getting caught up in the Hungarian-inspired selloff last week.

Still, shock waves from the market turmoil continued.

Neighboring Romania, which is also struggling to curb state spending, on Monday failed to sell $340 million in one-year Treasury bills after potential buyers asked for yields higher than the government was willing to pay.

Investors' push for higher yields was a sign of their worry that the government in Bucharest would be unable to push through proposed austerity measures—a fear exacerbated by Hungarian comments that the country might exceed its deficit targets.

Hungarian officials met with IMF and EU representatives in Budapest Monday for informal discussions on the new government's economic "action plan." Cabinet members spent the weekend hammering out details of the plan, which Prime Minister Viktor Orbán is scheduled to announce Tuesday.

Government officials have scrambled to restore confidence after remarks Thursday and Friday by politicians raised the specter of a larger-than-hoped-for deficit and the potential for Hungary to follow in the footsteps of Greece.

On Monday, the government's economy minister, György Matolcsy, reiterated promises made by other government officials over the weekend that Hungary was still aiming to keep this year's budget deficit within the 3.8% limit.

Mr. Matolcsy said Monday morning in a television interview that "a very fine-tuned action plan is needed, to reach the official deficit target and put the economy on the growth track at the same time."

Opposition politicians and analysts said the governing party, Fidesz, which won by a landslide in April elections after promising tax cuts and stimulus measures to spark economic expansion, appeared to be looking for ways to explain the need for continued belt-tightening to the electorate.

"Fidesz set a trap for itself," said Kornelia Magyar, managing director of Budapest-based political-analysis firm Progresszív Intezet. "They won't be able to keep their election promises and it will be hard to explain that to voters."

U.S. NEWS

Financial regulation: faces and fates

As the U.S. financial system gets its biggest overhaul in 80 years, impact runs from Wall Street to Main Street

It isn't just bankers.

Auto dealers, attorneys general and derivatives traders are among those sitting anxiously as Congress enters the final stretch of its financial-regulation revamp. The two bills approved by lawmakers contain numerous differences, and negotiations to hammer out a compromise will begin in earnest this week. All told, they will represent the biggest change to the U.S.'s system of financial oversight in 80 years.

Reflecting the all-encompassing nature of the legislation, some of the widest gaps affect people far from Wall Street. Auto dealers are lobbying hard to be excluded from oversight by a proposed consumer-finance regulator. Retailers want relief from what they say are punitive fees charged by credit-card companies. Non-financial companies are fighting for more flexibility in using derivatives.

Here is a look at some of the differences that have to be hammered out and those most likely to be affected by the outcome.

Associated Press

The big bank

Few provisions are more important to Wall Street than whether the biggest banks and securities firms can continue to trade derivatives, the complex financial instruments that helped cause the financial crisis. The Senate version would force Wall Street firms to separate their derivatives units from their deposit-taking banks—or even jettison them entirely.

Nowhere is the issue more important than at **J.P. Morgan Chase** & Co., the largest U.S. derivatives dealer. One Wall Street analyst estimates that derivatives account for 8% of the New York company's total revenue. The Senate provision could shrink its earnings by 26%.

In a 47-story office building on Madison Avenue in midtown Manhattan, the former headquarters of Bear Stearns, a few hundred J.P. Morgan employees who market derivatives to U.S. corporations are awaiting word on their fate.

The group offers derivatives known as swaps that help companies issuing floating-rate debt or protect the value of their international sales. Companies that disclose regular use of derivatives to hedge foreign-exchange risk include **Apple** Inc., **Caterpillar** Inc. and **Pfizer** Inc.

"Most of our clients prefer to use the bank that provided the loan to swap that loan to a fixed rate," says Kelly Coffey, Morgan's head of corporate derivatives marketing.

Critics of the Senate provision warn that such business might migrate to less-regulated venues, such as hedge funds or outside the U.S. Partly because the Senate provision was introduced recently, Ms. Coffey's group hasn't done extensive contingency planning. "It's been so fluid, there's not a whole lot you can do about changing anything," she says.

—Randall Smith

The retailer

Retailers want a provision currently only in the Senate bill that would lift constraints imposed by credit-card networks. They want to be able to offer discounts on cheaper forms of payment, or impose a minimum charge for card payments.

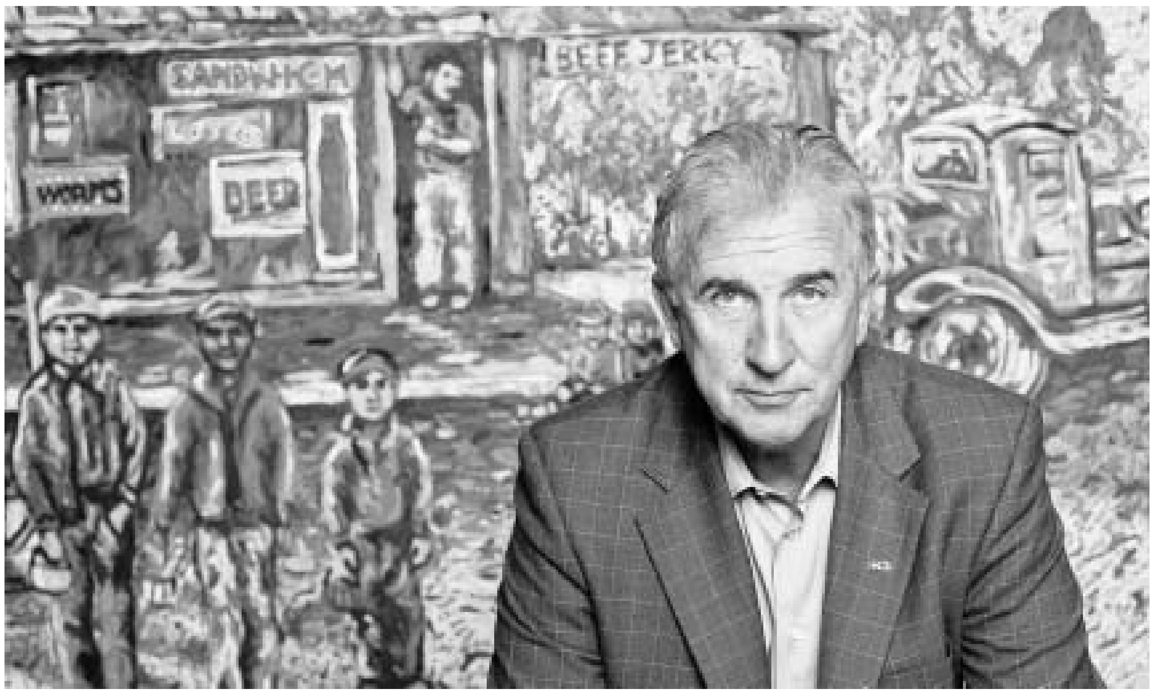
Networks currently charge retailers a fixed fee of 1.5% to 2% of the purchase price on credit-card transactions. Debit cards generally cost slightly less.

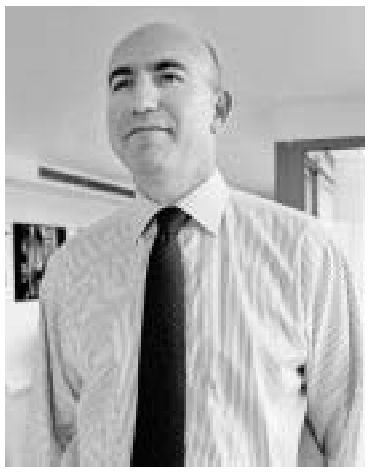
"Most of my friends and customers are going, 'Why should you care?' " says Jay Ricker, chairman of **Ricker Oil** Co., an operator of 49 gas-station convenience stores in Indiana. "Because I pay for debit," he says. "I'm losing money in many cases. If it's a packet of gum, I'd be better off to just give them the packet of gum sometimes."

Mr. Ricker says he would offer discounts of two or three cents per gallon of gas for customers paying with debit cards. He would also invest in lighted price signs showing different prices for debit- and credit-card transactions.

"The inside of the store is where I really want them to buy something," he says. Such fees are a goldmine for some of the nation's largest financial companies, which are fighting hard to strip the bill of the provision.

—Louise Radnofsky





The attorney general

Both versions of the financial-overhaul legislation empower state officials over national regulators and U.S. regulations, but the House's version goes further than the Senate's. State officials, who tend to be more litigious than their federal counterparts, have hankered for such powers.

"My preference would be the House version," says Tom Miller, a Democrat who has been Iowa's attorney general almost continuously since 1978. "I think fundamentally both of the versions are good," he adds, noting that U.S. states would be able to enact their own rules for products including credit cards and mortgages.

On enforcement, Mr. Miller says the House version gives attorneys general "somewhat broader authority." But both bills still give state officials the chance to work with a new consumer financial-protection agency.

Big banks want to deal with a single set of national rules, not 50, which is why they oppose empowering state officials. National regulators also are leery of the idea.

—Louise Radnofsky

The derivatives trader

Auto dealers don't want to be regulated by a proposed consumer-financial agency. They were successful in wining an exemption in the House bill, but not the Senate.

"Dealers are not banks, so to include us in financial reform, with something really directed at Wall Street, is a mistake and reflects a misunderstanding of what we do," says Vince Sheehy, head of 20 auto-dealership franchises in Virginia and Maryland.

Mr. Sheehy worries that the agency would prohibit high interest rates on financing for customers with poor credit, even though those are sometimes the only rates that high credit risks can get. While he doesn't expect to stop offering financing altogether, "at a minimum, it's going to raise the cost" of providing it, and particularly onerous regulation "could put a marginal dealership over the edge," he says.

"I can certainly see a scenario where we might not be able to assist a customer with certain types of financing," Mr. Sheehy says. "We are the folks of last resort who are able to find that loan for a customer when they're ready to buy a car."

The White House opposes any exceptions and has stuck to a hard line on the auto dealers so far. Representatives of military personnel are lobbying especially hard to ensure the legislation includes dealers, citing horror stories of soldiers targeted by predatory lenders.

—Louise Radnofsky

The auto dealer

Beyond the move to force Wall Street banks to spin off their derivatives business, the entire market is set to see new rules, including pushing derivatives transactions onto open exchanges. Those financial instruments now are traded through private outlets such as **Super Derivatives** Inc., a firm founded by former trader David Gershon.

Mr. Gershon's risk tolerance soon could be tested more than ever, depending on how far lawmakers go to expose derivatives trades to daylight.

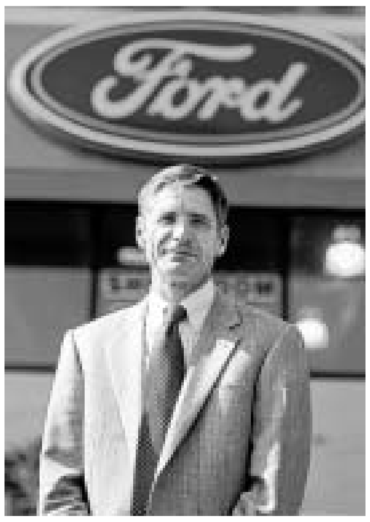
"You know that there's going to be some change coming, so you certainly need to be adaptive," he says. "The reality is that they haven't reached the first stone in the road in working out the details."

The Israel-born Mr. Gershon, a former currency trader for the Barclays Capital unit of Barclays PLC and Deutsche Bank AG, is a relatively small player in the derivatives market. But his competitive streak—he trains as a swimmer under a former Olympic coach—led him to devise a pricing system in the late 1990s to gain an advantage over big rivals. Until then, pricing largely consisted of working the phones.

Mr. Gershon believes business will spill over from public exchanges that won't be able to accommodate customized contracts. Mr. Gershon also expects to make money licensing technology to public exchanges.

"In the short term, I think they should get through it fine," says Lewis Ranieri, a SuperDerivatives board member who is widely credited with helping to invent interest-rate derivatives in the 1980s as a trader with Salomon Brothers. "In the long run, of course, it changes things for everyone."

—Peter A. McKay



Associated Press (Miller); Brendan Hoffman for The Wall Street Journal (Sheehy); Katie Orlinsky for The Wall Street Journal (Gershon); Stephen Voss for The Wall Street Journal (Ricker)

U.S. NEWS

Associated Press(top); Getty Images (bottom)

The tea-party movement has influenced Republican California candidates Meg Whitman, top, and Carly Fiorina, bottom.

California tests tea party

Movement finds challenges in replicating smaller-market wins

By Stu Woo
And Jim Carlton

The raucous and costly Republican primary races in California and Nevada, like those in other states, attest to the tea-party movement's rising influence. But Tuesday's votes in the two states will be the first big test of the movement's promise and limits—and offer clues to its nationwide strength this fall.

In Nevada, voters are poised to deliver an upset in the race for the GOP Senate nomination, as tea-party favorite Sharron Angle leads her establishment-supported rival in recent polls.

The pride of the California tea party, Chuck DeVore, has failed to catch fire in the Republican Senate race to challenge Democratic Sen. Barbara Boxer. On Tuesday, polls suggest he will finish well behind Carly Fiorina, a wealthy former Hewlett-Packard Co. chief executive endorsed by the GOP establishment.

The California and Nevada primaries illustrate a potential weakness of the tea-party movement: The bigger and more complex the stage, the more money and organization the movement needs. It has little of either now.

Tea-party activists, in their crusade to reduce government spending and taxation, have notched three victories so far this year. But all occurred in small-turnout, low-cost Senate races: a state-convention vote in Utah, a primary in Kentucky and a special election in Massachusetts, although other factors were also at play there. Nevada, with its population of 2.6 million, promises to provide the next victory in this category.

In California, with a population nearing 40 million, the movement has had trouble sustaining itself without adequate resources. That suggests some populist candidates may face challenges in the general election, which draws far more voters than primaries and requires more money for advertising.

"We are 14 months old as an organization," said Steve Brandau, co-ordinator of the Central Valley Tea Party in California. "We're not quite as effective as we want to be all over, but by the 2012 election we will be a force to contend with."

Political experts say the tea party could still sway the California vote. The movement has already forced establishment candidates such as Ms. Fiorina to stake out more-conservative positions. And a populist candidate could yet win Tuesday if voter turnout is low and tea-party activists vote in disproportionately high numbers.

In Nevada, Ms. Angle garnered just 5% support in April polls. But with the backing of groups such as the Tea Party Express and anti-tax Club for Growth, she grabbed the lead by late May. The GOP governor, Jim Gibbons, is also surging on tea-party support, despite a series of ethics scandals that prompted many in the Republican establishment to abandon him.

By contrast, California's Mr. DeVore seemed the perfect embodiment of the tea-party mantra. A state assemblyman known for his outspoken stance on limited government, he ran billboards depicting himself beside the U.S. Constitution and the motto "Support and Defend."

Yet Mr. DeVore has consistently trailed Ms. Fiorina in polls. In recent weeks, she even picked up the support of voters who consider themselves tea-party members. This comes despite her more-liberal stances on issues such climate change.

Mr. DeVore, in an interview Friday, wasn't ready to concede defeat. But he said the race shows the realities facing the movement in a state like California. "The issue is there are so many more of them in California," he said of tea-party members, "and there is no central leadership like there would be in a smaller state. But it's the nature of California, where one-eighth of the country lives and [which] is very diverse."

Analysts credit Ms. Fiorina's edge to her spending power. As of May 19, she had spent $6.7 million in her largely self-funded campaign, versus $2.1 million by Mr. DeVore and $1.7 million by Tom Campbell, an ex-congressman who is a social moderate.

Still, Ms. Fiorina called the movement "incredibly important" after an appearance in Bakersfield Saturday. "You can't be winning without that support from the tea party," she said.

The movement has influenced Ms. Fiorina and former eBay Inc. CEO Meg Whitman, who is aiming for the governor's office, to stake out more-conservative positions. But both appear to have safe polling leads, with Ms. Whitman and Ms. Fiorina leading their closet opponents by 26 and 15 percentage points, respectively, in a Field Poll released during the weekend.

—Tamara Audi and John R. Emshwiller contributed to this article.

Republican brawl gives 'vulnerable' Reid a chance

[Capital Journal]

By Gerald F. Seib

Given his political condition, Senate Majority Leader Harry Reid was always going to have to win ugly in his race for re-election this year, if he was to win at all.

And thanks to a remarkable Republican brawl heading into Tuesday's primary in Nevada, the GOP just might be giving him a chance to do exactly that.

It's hard to overstate the political perils facing the Senate's top Democrat as he seeks his fifth term. Polls show a majority of his state's citizens have an unfavorable view of Sen. Reid. Until recently, he lost hypothetical poll match-ups against his principal potential Republican foes. National Republicans have put a giant bull's eye on his back.

In short, Harry Reid is the latest in a long line of prominent senators from center-right states—Tom Daschle of South Dakota, Wyche Fowler of Georgia, Jim Sasser of Tennessee—whose roles as leaders of the national Democratic party caused them big problems back home. As it happens, all those other gentlemen were eventually beaten by Republicans in Senate races.

"I think Reid is just incredibly vulnerable, just amazingly vulnerable," says Whit Ayres, a Republican pollster who recently conducted focus groups with Nevada voters. "The only question is whether Republicans nominate a strong challenger."

Ah, there's the rub for the GOP. Like just about everything else this political cycle, Tuesday's primary election in Nevada isn't going as planned. It may end up crowning neither of the two candidates originally considered Reid's strongest general-election foes. Instead, the Republican nominee may well be a candidate most analysts once would have considered, at best, the third strongest person to face Harry Reid.

The conventional wisdom about who's strongest could well be all wrong, of course, as so much conventional wisdom is this year. Still, the picture for now suggests Harry Reid is either very lucky or very good—or both.

Heading into Tuesday's primary, polls suggest Nevada Republicans are most likely to nominate Sharron Angle, a tea-party favorite and former state legislator who couldn't win the Republican nomination for Nevada's Second Congressional District back in 2006.

She started the year with a mere $146,000 in campaign cash on hand, and running well behind establishment favorite and former state party chairwoman Sue Lowden, as well as businessman Danny Tarkanian, thought to be the favorite of the tea-party crowd.

Then things started to happen. Sen. Reid's camp, sensing that Ms. Lowden was the strongest potential challenger, started going after her. She played into the assault with an ill-advised comment suggesting that the health-care economy might deteriorate to the point where people might have to barter for health care in the way voters' grandparents might "bring a chicken to the doctor"—an innocent aside that took on mythical proportions.

Meantime, anti-establishment fervor began to grow, making Ms. Lowden's status as former state party leader as much liability as asset. She's gone from a candidate who beat Sen. Reid by 13 points in a hypothetical match-up in February to one who was a point behind him in a new survey by Mason-Dixon and the Las Vegas Review-Journal released Sunday.

Like just about everything else this political cycle, Tuesday's primary election in Nevada isn't going as planned.

Meantime, a big chunk of the tea-party movement decided to ride the candidacy of Ms. Angle rather than Mr. Tarkanian (the son of a legendary basketball coach), and ride it hard. The Tea Party Express, a group that backs conservative, small-government candidates, announced over the weekend that it has pumped $500,000 into the Angle campaign. Bottom line:

In the new poll, Ms. Angle has an eight-point lead over Mr. Tarkanian, and a nine-point lead over Ms. Lowden. In the same poll she beats Mr. Reid by three percentage points.

That's just fine for Reid partisans, for Ms. Angle is the most controversial of the three potential Republican nominees and the one easiest to portray as outside the mainstream. That's because she's suggested at various times abolishing the federal tax code, privatizing Social Security for younger Americans and eliminating the Education Department.

In short, the very positions that make her most exciting to the tea-party movement make her easier to attack and caricature in a general election. At least that's the Democrats' suspicion.

And Sen. Reid will have ample resources on hand to paint his kind of picture of the general-election race. As of mid-May, he'd raised $17.9 million for this campaign cycle, and had $9 million of that still on hand.

"His only strategy is to make his opponent an unacceptable alternative," says veteran Republican strategist Ed Rollins, who has endorsed Ms. Lowden. Imagine voters are shopping for a new car, he says, and "what Mr. Reid has to do is flatten the tires, put a few dents in the side and spill some coffee on the seat."

Of course, maybe voters are so angry they will go for an unconventional, even dented option this year. Either way, a great political story is unfolding.

WORLD NEWS

Kim Jong Il shakes up North Korean leadership

Moves seen as consolidation of his power before son takes over

By Jaeyeon Woo

SEOUL—North Korean leader Kim Jong Il shook up his country's leadership ranks, a move that appeared part of a broad strategy to consolidate his power before he passes control to his son.

North Korea's official media said Monday that Mr. Kim installed his brother-in-law to a role considered the country's second-most-powerful. He also named a longtime family confidant to what is in effect the No. 3 position, the premiership.

That represents North Korea's highest-level leadership shuffle since the beginning of this year, a period in which 11 prominent members of the regime have died, been replaced or been shuffled out of view, according to a count by the website NK Leadership Watch.

The meaning of the moves is subject to speculation, as is much of the trickle of official news out of the secretive and authoritarian North. The appointments didn't appear to be a direct response to the sinking of a South Korean warship in March, analysts said. The North's announcement didn't mention the ship, the Cheonan, or the subsequent standoff with Seoul, which has accused the North of sinking it.

"There was no discussion about the Cheonan stuff," said Kim Young-soo, a professor at Sogang University in Seoul. "It was more focused on internal politics and administration."

Yet in a broader sense, analysts have seen Pyongyang's leadership shuffle and the Cheonan sinking as components of Mr. Kim's strategy to rein in disorder and rally North Koreans around its military before what they believe is his plan to hand power to his third son, Kim Jong Eun. Since the North Korean leader suffered a stroke-like episode in August 2008, the country has tested missiles and a nuclear device, a series of provocations analysts believe are meant to rally the country. They speculate that the North's alleged sinking of the Cheonan was a continuation of this effort.

North Korea's frayed relations with South Korea have cut off an important source of income, forcing it to rely more heavily on China, which is under international pressure to rein in the North.

Pyongyang has also been coping with protests, hunger and deaths since the government's apparently unsuccessful attempt late last year to manage economic reform. Pyongyang's issuance of new currency and closure of markets in December backfired, causing the regime to look for people who could take blame away from Mr. Kim.

Those efforts resulted in shake-ups in several lower positions Monday, said Professor Kim Young-soo, noting the use of the term "recall" in the North's official announcement.

"In North Korea, when the regime 'recalls' an official, it means the person wrongly implemented policies and should take responsibility for it," said Mr. Kim. "So the recalled officials, not Kim Jong Il, are publicly blamed for their failed handling of the administration."

Monday's announcement by North Korean official media said Mr. Kim named Jang Song Taek, who is married to Kim Jong Il's younger sister, as vice chairman of the National Defense Commission, North Korea's highest state body. Analysts have considered Mr. Jang the second-most-powerful person in the country in recent years, a role certified with Monday's posting.

Kim Jong Il is chairman of the Defense Commission, his only official title.

The leader also named longtime family confidant Choe Yong Rim to the premiership, a position that is nominally the second in command but that analysts believe ranks below the job he gave to his brother-in-law. Mr. Choe succeeds Kim Yong Il, whose travels overseas gave him more contact with foreign leaders than even Kim Jong Il. The two Kims aren't related.

Mr. Kim personally presided over a parliamentary session where the changes were approved. The meeting was special because it was the second time parliament met this year; it usually meets once. Mr. Kim didn't attend its regularly scheduled meeting in early April.

This year has seen several other changes in Pyongyang's inner circle. Last week, a close associate of Mr. Kim's, Ri Je Gang, died in a car accident one day after attending an art performance with Mr. Kim. Mr. Ri, who was 80, held a high-ranking job in the ruling Korean Workers' Party. His influence was believed to trail only that of Mr. Kim and his brother-in-law.

Mr. Ri was active in promoting heir apparent Kim Jong Eun and had been close to his late mother. It isn't known whether Mr. Ri was a candidate for the premiership. His death has fueled speculation that he may have been deliberately killed in a power struggle, but analysts note that if that were the case, it is unlikely his passing would have been announced in North Korea's state media.

The high-level death followed the disappearance earlier this year of another official, Pak Nam Gi, who some South Korean media reports said was executed for the country's economic-reform mess.

Reuters

North Korean leader Kim Jong Il, center, presides over parliament Monday.

Mr. Jang has been seen since 2007 as Mr. Kim's closest aide, and is believed to play a key role in rallying support among the country's elite for Kim Jong Eun to succeed the dictator.

Mr. Jang, who is 64 years old and whose background is in political operations of the regime, was appointed just last year to the Defense Commission.

"Kim wants to keep more tight grip on party elites and people by giving more power to Jang," says Cheong Seong-chang, director of inter-Korean studies at the Sejong Institute, a private think tank in Seoul.

Mr. Jang becomes one of four vice chairmen of the 11-person commission, though he is the one closest to Kim Jong Il.

The new premier, Mr. Choe, 81, has been associated with the ruling Kim family for decades. He served as a confidential secretary to Mr. Kim's father, Kim Il Sung, who started North Korea in 1948 and led it until his death in 1994. He most recently served as chief secretary of the Pyongyang City Committee of the Korean Workers' Party and, in recent months, attended numerous public functions with Kim Jong Il, including a trip to the remote city of Hamhung and the opening of an indoor swimming pool in Pyongyang.

Mr. Choe was economic planning minister in the 1980s, mining minister in the 1990s and chief prosecutor in Pyongyang earlier this decade.

Turkey's handling of Gaza affair sparks rift

By Marc Champion

Turkey, united in its reaction to last week's events when Turkish citizens on a Gaza-bound ship were killed by Israeli defense forces, is dividing over the government's handling of the affair and the role of the Islamist charity that organized the aid convoy.

Opposition politicians and some newspaper columnists have expressed concern that the government has been riding public anger at Israel's actions. That, they say, puts at risk Turkey's delicate balance between East and West and allows the charity, the Humanitarian Relief Foundation, or IHH, to have a hand in determining the nation's political agenda.

"The [European Union] and the U.S. consider Hamas as a terrorist organization. We should be careful," Kemal Kilicdaroglu, head of the main opposition Republican People's Party, told Turkish NTV television Monday, referring to the support the IHH and Turkey's government have shown to Hamas. He also demanded the government release communications with Israel prior to the incident, suggesting it let the flotilla proceed despite knowing that violence was likely.

Prime Minister Recep Tayyip Erdogan dismissed Mr. Kilicdaroglu as an Israeli "advocate," in remarks to reporters over the weekend. The government denies it is shifting away from the West and says it sought to persuade the IHH against taking the convoy to Gaza, but was unable to stop an independent organization.

IHH leaders on Monday responded to a growing number of media reports finding that the Israeli commandos resorted to live fire only after three of their soldiers were captured and several were stabbed by activists armed with clubs and knives.

Two doctors aboard the Mavi Marmara said at the charity's Istanbul headquarters that activists were shot and killed before any soldiers were captured. Ercan Kayrak said the Israelis shot percussion grenades onto the ship while those on deck were in the midst of their morning prayers, followed quickly by shooting live ammunition.

"Our friends tried to hit the soldiers once they saw that their friends were shot," said Dr. Kayrak. An IHH executive on board said the Israeli soldiers fired live rounds as they rappelled down ropes from the helicopters. Israel has said its commandos initially used only paintball guns.

On Sunday, Israel Prime Minister Benjamin Netanyahu said Israel had evidence that dozens of the activists on the Marmara "boarded separately in a different city, organized separately, equipped [themselves] separately and went on deck under different procedures. In effect, they underwent no checks. The clear intent of this hostile group was to initiate a violent clash with IDF soldiers." Mr. Netanyahu offered no evidence.

Asked about those claims at a joint news conference with Syria President Bashar al-Assad Monday, Mr. Erdogan said of Israel: "They lie like a lie-making machine, they always do it." He also described Hamas as "resistance fighters," and said Hamas, which rules Gaza, had agreed for Ankara to mediate in talks with its rival Fatah, which runs the Palestinian Authority in the West Bank. Mr. Assad was in Istanbul for a Eurasian summit that starts Tuesday.

Reuters

IHH leader Bulent Yildirim, center, at an Istanbul airport on Thursday.

Mr. Erdogan continued to raise the temperature of Turkey's dispute with Israel over the weekend. In a speech in Bursa, a city about 80 kilometers south of Istanbul, Mr. Erdogan said the world now perceives "the swastika and the Star of David together."

Skepticism concerning the IHH version of events on the Mavi Marmara appears to have accelerated as a result of unexpected criticism of the IHH's actions from influential Turkish spiritual leader Fethullah Gülen, in an interview last week with The Wall Street Journal. Analysts saw the intervention by a figure venerated by many in the government as a warning that the storm of anti-Israeli feeling risked getting out of hand.

—Erkan Oz contributed to this article.