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THE WALL STREET JOURNAL.

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THE WALL STREET JOURNAL.

EU defers fund decision

By Stephen Fidler
And Charles Forelle

Spain surprised Europe's finance ministers Tuesday by postponing a decision on a law governing hedge funds, following a plea from British Prime Minister Gordon Brown.

Spain currently holds the chair for European Union ministerial meetings and removed the item on short notice from the agenda of a finance ministers' meeting in Brussels.

British and Spanish officials said the postponement followed a telephone call late Monday by Mr. Brown to his Spanish counterpart, José Luis Zapatero.

The meeting had been expected to deliver a serious defeat to London on financial regulation. The deferment postpones that prospect until after the U.K.'s general election, expected to be held on May 6.

"We have a need to do yet more work on this over the next few weeks," Spanish Finance Minister Elena Salgado told reporters.

She said governments would decide on a position by midyear.

According to someone familiar with the prime ministers' conversation, Mr. Brown told Mr. Zapatero that a global approach was needed to regulate hedge funds and that the City's fund industry could help drive European economic growth.

The U.K. is home to many of Europe's hedge, private-equity and venture-capital funds. All of those funds would come under the new law.

Alistair Darling, U.K. Chancellor of the Exchequer., said, "I'm very clear that the hedge-fund industry does need to be effectively supervised...but equally I fear that there was never going to be a deal at any price. It's important that Europe gets this right."

Britain's opposition is based on the way the law would treat investment funds based in countries outside the bloc.

U.S. Treasury Secretary Timothy Geithner argued in a letter to European officials this month that the proposal would discriminate against American fund managers.

The U.S. fears the proposal would give funds based in the EU access to the entire 27-nation bloc, but require American and other third-country funds to operate under 27 sets of national rules.

The U.K. shares those worries and is also concerned that the proposal could hit the large number of London-based managers who keep their funds outside the EU, in places such as the Cayman Is-

Please turn to page 5

Shell sees projects starting to pay off

Royal Dutch Shell PLC predicted strong growth in output and cash flow and declared 2009 its best year for exploration success in a decade—reflecting growing confidence at Shell less than a year after Peter Voser took the reins as chief executive.

Mr. Voser launched a big efficiency drive, axing 5,000 jobs, shaking up the company's structure and slashing costs by $2 billion. He went even further Tuesday, saying 2,000 more staff would be shed by the end of 2011.

But greater efficiency hasn't yet translated into improved financial performance, partly as a result of a severe downturn in refining caused by overcapacity and declining demand for petroleum products in the U.S., Europe and Japan.

Meanwhile, Saudi Arabia, the world's biggest crude exporter, signaled it won't be shy about putting more barrels into the market to quell runaway oil prices. Saudi Arabia, as OPEC's leading member and the group's moderate voice that keeps OPEC's more hawkish nations in check, sits on a mountain of spare production capacity exceeding 4 million barrels a day that it could discharge into world markets to damp prices.

Tensions continue to flare in East Jerusalem

European Pressphoto Agency

Palestinians burn tires amid clashes with Israeli security forces after Hamas called for 'a Day of Rage' over plans to expand Jewish settlements. **Article on page 14**

China officials criticize foreign luxury goods' quality

By Sky Canaves

BEIJING—An attack by Chinese provincial officials on foreign luxury brands, including fashion houses **Versace**, **Hermès**, **Zara** and **Dolce & Gabbana** underscored the vulnerability of designer goods in one of their most important markets.

Authorities in wealthy Zhejiang province, near Shanghai, marked consumer's day on Monday by taking aim at the quality of imported designer fashions.

In a statement posted on its Web site, the Zhejiang Administration of Industry and Commerce said: "International designer clothes, blindly worshipped by Chinese consumers and enjoying 'super national treatment' in the country, have once again proven unsuitable for China."

The targeting of foreign designer brands for defective products is the latest wrinkle for foreign businesses in China.

It comes as **Google** Inc. is preparing to shutter its Chinese language search business and as **Hewlett-Packard** Co. came under scrutiny from Beijing for problems in some of its laptops sold in China.

According to the Zhejiang notice, 48 out of 85 samples of imported clothing from 30 international brands failed to meet Chinese product quality standards. The brands also included **Tommy Hilfiger** and **Hugo Boss**.

The authorities say they have impounded all of the clothes with the same model numbers as the samples that failed to meet the standards, but the rest of the companies' products aren't affected.

It was unclear whether fines would be levied.

The harsh tone of the attack appeared to be out of proportion to the infractions: half of the complaints were over usage labels, including laundry instructions that failed to meet Chinese requirements.

Nevertheless, the statement was carried widely by China's official media.

While the immediate financial impact of the sanctions against the luxury brands is likely to be limited, the negative publicity could be damaging.

Foreign brands sell at a huge premium to local brands, justified in part by the perception of quality.

The China market has taken on greater importance to the makers of luxury goods in recent years as sales in other major markets have declined.

In an October forecast, consulting firm **Bain** & Co. said it expected luxury-goods sales in mainland China to increase by 12% last year, to €6.6 billion (£6 billion), com-

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Green Revolution: What Europe can learn from Ireland. **Page 18**

What's in Alistair Darling's future?

[Agenda]

By Iain Martin

Where will Alistair Darling be in two months? Right now it looks highly unlikely that he will be inside the U.K. Treasury on Whitehall as chancellor of the Exchequer.

His party may well have narrowed the Conservative opposition's lead in the opinion polls for a time (although the latest evidence suggests the Labour advance has stalled and even gone into reverse). But even if Gordon Brown pulls off an extraordinary win on May 6, he isn't going to be inclined to call Mr. Darling and ask him to stay on in the post. Between a pair who were once such close friends has flowed far too much bad blood in recent years. Mr. Brown tried to sack and replace him with the prime minister's protégé, Ed Balls, and relations between Number 10 and Number 11 have been notoriously difficult. This was the case especially after Mr. Darling warned that Britain was facing the worst recession in 60 years and Mr. Brown, in the chancellor's own words, famously unleashed "the forces of hell" against him in the shape of briefings by his aides.

So, it is likely he will find himself out of office, Britain will have a new finance minister and Mr. Darling will have potentially the most interesting set of late-period New Labour memoirs if he chooses to write them.

Mr. Darling's career has actually been rather interesting. He is one of only three ministers to have served continuously in the cabinet since Tony Blair won power in 1997—Mr. Brown and Jack Straw being the other two. Mr. Darling's move to the Treasury shortly before the financial crisis and the implosion of Mr. Brown's economic model was what is deemed in sports as a "hospital pass."

Reuters

Even if Gordon Brown (left) wins May 6, Alistair Darling isn't likely to stay on

In fairness, Mr. Darling has emerged with some credit from the resulting chaos—but that is mainly in respect of his powers of endurance when it comes to his neighbor.

If Mr. Balls had replaced him as chancellor one suspects that Britain would be on to its fourth post-crisis fiscal stimulus by now and gazing longingly at Greece as a model of relative fiscal probity.

It's that old political question: Is it to be country before party or the other way round?

All of this Mr. Darling can soon contemplate from semi-retirement—presumably involving a sinecure at a large financial institution or stint as a respected regulator.

First, however, there is the pressing question of his legacy. That now depends, to a large extent, on what he says when he stands up in the House of Commons next week to deliver the last budget of this parliament.

His previous offerings on these occasions can hardly be said to have been unqualified successes. The best that can be said, by his supporters, is that if you thought they were bad you should have seen what reckless initiatives Number 10 wanted instead.

Will this be a wholly honest budget? Will he announce a set of measures aimed at improving the position of the country or that of his party?

It's that old political question: Is it to be country before party or the other way round?

Again, under pressure from Mr. Brown to make impossible spending promises and unbelievable commitments to "investment," the word is that the chancellor is going to fudge it and try a bit of both. If that does turn out to be the case, then that is a mistake. Quite correctly, the European Commission has already warned this week that Britain should do more to tackle its deficit, with further immediate cuts somewhere in the region of £20 billion.

Notionally, Mr. Darling has several billion to play with from the windfall tax on the banks. The figure of £2.5 billion is mentioned. Of course, this should all go straight to the bottom line, to help reduce a deficit running at 12.7% of GDP in this fiscal year.

It is understood that it is more likely to be sliced up, with some going toward various schemes aimed at youth unemployment. This is what Mr. Brown wants in order to create a dividing line with the Conservatives: so that he can say during the election campaign that his party is somehow in favor of job creation but that the wicked Conservatives aren't.

This is really not the time for such games; for footling schemes and yet more fraudulent job creation initiatives involving the spending of money Britain doesn't have. The situation is too dangerous for all that. What will drive job creation is growth, and that will be only be spurred by keeping taxes on businesses as low as conceivably possible within the constraints of the deficit.

The risk to Mr. Darling of his getting mired in these games is twofold. It isn't inconceivable that the markets will view a fudged political budget as a reason to doubt Britain's seriousness about tackling its deficit and then create a sterling crisis just in time for the election.

And even if that worst case scenario doesn't play out, his legacy will be tarnished and potentially trashed.

At a crucial juncture in his country's economic history Mr. Darling risks being seen as overly partisan when he might, instead, have earned the credit for administering a dose of reality.

A senior member of David Cameron's team remarked to me yesterday that this budget is a "joke," in that it is widely understood to be meaningless, because it must be followed by a real budget after the election of a new government.

Well, perhaps. But it isn't a very funny joke.

A lot can still go wrong for Britain and Mr. Darling ahead of his departure from the Treasury. He can limit the danger only by delivering a budget with a laser-like focus: faster deficit reduction, to clear the way for growth.

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"The grandchildren of Europe will curse this generation to their last breath."

Reader **Jason Frank** comments on Patience Wheatcroft's column "U.K. Needs Commitment to Low Taxes"

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Question of the day

Vote and discuss: Will Tiger Woods win another major golf tournament?

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

Previous results

Q: Will David Beckham's absence from the World Cup make it a less attractive event for you?

Yes **18%**

No **82%**

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NEWS

This banker wades into new markets

With her ATM on the Amazon, Luzia Moraes keeps customers afloat with banking services from a riverboat

By Paulo Prada

ABOARD THE VOYAGER III—Most bank managers fret about bad loans or a run on deposits. Luzia Moraes has to worry about a leak in the hull, bandits and rainstorms that keep clients away for weeks.

Ms. Moraes, a 43-year-old former housewife, is at the helm of a swashbuckling venture in Brazil—as manager of the first floating bank branch on the Amazon river system. From a riverboat, she peddles banking services in a frontier where people don't have much money—let alone experience with ATMs, savings accounts or personal loans.

Besides supporting a bank branch and carrying passengers, the 125-foot, triple-decker Voyager III stocks 500 tons of beans, chicken, bleach and other goods that it sells over a 1,000-mile course and a dozen ports of call.

Every two weeks, along with about 200 other passengers, Ms. Moraes boards the diesel-powered riverboat for a nine-day voyage from the central Brazilian Amazon into muddy tributaries bordering Colombia and Peru. As passengers hang hammocks, she strings a red banner outside her branch—a cramped closet that until recently was a storeroom.

In a region where villagers travel days to get to a market or a hospital, the branch offers services including savings and checking accounts, personal loans and direct deposits from the government for public servants, pensioners and the poor. The office consists of Ms. Moraes, her laptop, a printer, and an automated teller. "People don't know what to think," says Ms. Moraes, "but it's not hard to explain that a bank can make things easier."

Modest but steady growth in Latin America's largest economy over the past decade has catapulted millions of poor Brazilians into the middle class. Launched in November by Banco Bradesco SA, operator of the country's largest retail-banking network, the riverine effort shows how far into Brazil's corners the changing economy will reach. The number of bank accounts in Brazil has tripled during the past decade, from just over 42 million in 1997 to nearly 126 million at the end of 2008, according to the Brazilian Banking Federation.

Paulo Prada/The Wall Street Journal (2)

Every two weeks, Luzia Moraes (right photo, far right) boards a diesel-powered riverboat (above) for a nine-day voyage on the Brazilian Amazon

In less than four months, more than 300 clients have opened accounts aboard the floating bank. Dozens of others have done so on day treks that Ms. Moraes, the branch manager, takes in canoes and rafts into villages beyond where the riverboat moors. The Voyager III's owners were robbed at gunpoint underway a few years ago. The bank lets them offload as much as 800,000 reais, about $460,000, in cash collected from sales during each voyage. The branch, linked via satellite to Bradesco servers, uses the boat's own cash flow to fund withdrawals and loans and then wires reimbursement, plus a small commission per transaction, into the boat's account.

"Before, I hid money all over the boat," says André Araújo, the vessel's 28-year-old manager.

Ms. Moraes was born and raised in Benjamin Constant, a boggy logging town across a tributary from Peru. She never had a bank account until she was 30. After dropping out of school at 16 and having three children, she decided in 1997 to leave her mechanic husband and start a career. Earning a high-school equivalency certificate, she landed a job as a town clerk, then worked her way up to bank clerk and teller jobs.

Last year, Bradesco executives chose Ms. Moraes, a local familiar with the hamlets and habits along the river, as the first manager.

One recent morning, Ms. Moraes, a short woman with long hair, stepped into a speedboat for a 10-minute voyage to Bom Caminho, a community of 800 upriver from her hometown. She introduced herself to the local *cacique*, or chieftain, who had a schoolteacher announce her presence. A flurry of native Tikuna—interspersed with the Portuguese words for bank, account, and money—blared over a public-address system.

Within minutes, a dozen people gathered on the porch of a nearby cabin, her makeshift office. As villagers asked what they needed for an account, she explained the bank doesn't require an initial deposit, just an identity card, taxpayer number, and proof of residency, such as a water bill. "We don't have water," said the chief, wearing a denim cap.

"A light bill?" she asked, to which he nodded affirmatively.

In two hours, Ms. Moraes opened seven accounts. A visit a week later generated 40 more.

A day's voyage to the east, in Belém do Solimões, some of the branch's earliest customers embrace the relationship. In January, Leidinet Guedes boarded the riverboat and made a beeline for Ms. Moraes. She took a 100-real loan to buy flour for her husband, a baker. On the vessel's previous call, the bank granted her a credit line of up to 400 reais, so she has credit that arrives with the floating supermarket.

Tiger Woods to return to golf at Masters

By Reed Albergotti and Matthew Futterman

Tiger Woods said Tuesday he planned to return to professional golf at the Masters Tournament in Augusta, Ga., in early April, ending a five-month hiatus spurred by revelations of extramarital affairs.

"The Masters is where I won my first major and I view this tournament with great respect," Mr. Woods said in a statement. "After a long and necessary time away from the game, I feel like I'm ready to start my season at Augusta."

Mr. Woods, 34 years old, last played in a tournament in November.

Later that month, he was injured after crashing his sport-utility vehicle into a fire hydrant and a tree near his home outside Orlando, Fla. In subsequent weeks, at least a dozen women claimed or were reported to have had affairs with him.

On Dec. 2, Mr. Woods said via his Web site that "I have let my family down," and nine days later he said he would take an indefinite break from golf.

Associated Press

Tiger Woods speaks to the media at the 2007 Masters in Augusta, Ga.

Mr. Woods apologized in public Feb. 19, and since then speculation has focused on when he would return to competition.

Mr. Woods said Tuesday that while he had set a date for his return, he still had a lot of work to do in his personal life.

"I have undergone almost two months of inpatient therapy and I am continuing my treatment," he said in Tuesday's statement.

"The major championships have always been a special focus in my career and, as a professional, I think Augusta is where I need to be, even though it's been a while since I last played," Mr. Woods said in the statement.

The Masters begins April 8.

The PGA Tour, which runs the three major men's professional golf tours in the U.S., said it welcomed Mr. Woods's decision to play at Augusta.

"He has invested a lot of time taking steps, both in his personal and professional life, in order to prepare for his return," said PGA Tour Commissioner Tim Finchem.

Augusta is where Mr. Woods became a household name, winning the Masters in 1997 at age 21.

Not only was he the youngest-ever winner of the tournament, but he also set records for 72-hole score (270) and victory margin (12 strokes).

He also won at Augusta in 2001, 2002 and 2005.

In addition, it's a tournament where Mr. Woods often finishes near the top of the field even when he doesn't hit the golf ball particularly well. He hasn't missed the cut—when the field of players is pared down after the tournament's second day—at Augusta since his 1997 pro debut.

In his latest Augusta win, in 2005, Mr. Woods hit wildly off the tee, but used his skill with his short irons to land his ball on the green with two putts to make par.

Since that win, at the Masters Mr. Woods has finished second twice, third once and last year he tied for sixth.

Augusta also is in many ways the most comfortable environment in which Mr. Woods could make his comeback.

Augusta National exerts tighter controls on both the crowd and the media than any other event on the PGA Tour calendar.

Crowds are typically significantly smaller than at the other major tournaments, and it's the only major tournament in the U.S. where reporters aren't allowed inside the ropes, the area limited to players, caddies and officials.

Mr. Woods has won 14 major championships in his career, the others being four PGA Championship titles, three U.S. Opens and three British Opens.

Athens to sell some holdings

Government weighs shedding some of its diverse portfolio, in an effort to repair finances

By Alkman Granitsas
And Sebastian Moffett

ATHENS—The cash-strapped Greek government is putting a host of state assets on the block, but has drawn the line at offloading islands in a bid to reduce its crushing debt burden.

Officials plan to sell some of the country's eclectic holdings, which include jumbo jets and stakes in banks and a famed casino. Prime Minister George Papandreou recently dismissed a suggestion by a few German politicians that Athens sell some of the country's uninhabited islands, telling the Financial Times, "There are more imaginative and effective ways of dealing with the deficit than selling off Greek islands."

Instead, the government figures that by selling its stakes in a bank and a betting company, as well as its share of the national telecommunications company, it can raise €2.5 billion ($3.76 billion)—the equivalent of 1% of gross domestic product, its target for this year. That would only scratch the surface of Greece's debt—which has surpassed the country's €250 billion-a-year GDP—but would underscore for financial markets that Athens is serious about fixing its public finances.

The government also may put up for sale its shares in 15 other companies, including the water utility in Athens, a leading oil refiner, and several casinos. The Greek Finance Ministry also wants to get rid of some Airbus A340 planes that it owns from the years before the country's debt-ridden national carrier, **Olympic Airlines**, was privatized.

Although the ruling Socialist party enjoys a substantial majority in Parliament, it is divided about privatization. Economic concerns are more likely than political ones to derail any deals. With confidence in the Greek economy low and the rest of the world stumbling through an uncertain recovery, investors might undervalue the assets, meaning the government would raise less money than in a normal year.

"The privatization plan sounds excellent in theory. If you sell all of the state assets and maybe throw in the Acropolis too, it's possible the government could hit its targets," says Constantine Michalos, president of the Athens Chamber of Commerce and Industry. "But at current market rates they will be going out on the cheap. Because, let's face it, it's not just Greece that's in recession, it's the whole world."

The government has yet to present details of its privatization plan, but has said it is looking at selling or reducing its controlling 34% stake in gambling monopoly **OPAP** SA as well as the 34% it owns of **Hellenic Postbank**, a savings bank that initially was allied with Greece's postal service. Many analysts reckon that the government also will exercise an option to sell 10% of **Hellenic Telecommunications Organization** SA to Germany's **Deutsche Telekom** AG, which owns 30% of the company and has said it wants to buy more.

The most valuable asset to be unloaded is the government's stake in OPAP, the gambling company whose name translates roughly into the Organization for Prognostication on Football Matches. Officials estimate Greece would fetch €1.63 billion from selling its stake in the enterprise, which was established in the 1950s for betting on football. But with a current share price around €15, OPAP's market value has tumbled by more than 30% in the past 10 months and is down 50% from five years ago.

There are other financial considerations. OPAP—like the state gas monopoly, the country's leading electric utility and others—is a profitable company that pays dividends. OPAP's dividends to the government add up to as much as €200 million a year. Selling the government stakes would come on the heels of Greece's latest austerity plan aimed at narrowing a budget deficit that hit about 12.7% of GDP last year, more than four times the EU's 3% ceiling.

While the majority of Greeks are resigned to difficult measures, unions—already incensed by the government's planned wage and benefit freezes—are resisting.

That opposition surged during the recent privatization of the container terminal operations at the Athens port of Piraeus. China's **Cosco Pacific** Ltd., which won a 25-year concession to manage one of the container terminals, was blocked from taking control of the operation in October after workers staged a monthlong series of protests and disrupted business.

"Broader society will accept the need for privatizations," says George Kyrtsos, political commentator and publisher of the Athens newspaper, City Press. "But there will be some union opposition."

In the case of Cosco, the worker protests ebbed amid a €56 million voluntary-retirement package, a formula followed by previous Greek governments in an effort to prepare state-owned companies for privatization. Similar deals have also been struck at Hellenic Telecom, several state-owned banks and Olympic Airlines.

The problem is that in many cases, such programs have transferred the burden of early-retirement costs to Greece's bankrupt state pension system. In January, Greek Labor Minister Andreas Loverdos, who has been given the task of fixing the country's pension system, ordered Hellenic Telecom to pay an additional €100 million that he estimates the company owes the government for its voluntary-retirement program.

"Yes, privatization should go ahead, but it needs to be done correctly. We can no longer afford the old system of taking pension benefits off the books of state-owned companies," Mr. Kyrtsos says. "Because by doing so you have a double problem: Not only do you have a debt problem, but you also have a pension problem."

Bloomberg News

Vehicles for export line up at the Port of Piraeus, near Athens. The government holds a 74% stake in the port's authority.

On the block | Greece wants to sell assets to cut its debt

Company	Description	Equity stake	Value of assets, in millions of euros
OPAP	Gambling company with outlets nationwide for betting on sports and numbers games	34.0%	€1,627
Public Power Corp.	National energy utility	51.0	1,585
Agricultural Bank of Greece	Public financial-services company, begun in 1929	77.0	1,365
Hellenic Petroleum	Major fuel refiner and petrochemicals producer	35.5	888
Hellenic Gas Transmission System Operator (DESFA)	Monopoly natural-gas distributor	65.0	650
Athens Water Supply & Sewerage Co.		61.0	440
Hellenic PostBank	Retail bank established in 1900	34.0	429
Port of Piraeus Authority		74.0	278
Mont Parnes Casino	Athens-area gambling facility that drew jet-setting clientele during its 1970s heyday	51.0	200
Port of Thessaloniki Authority		74.0	111
Airplanes: A340-300	Aircraft bought for onetime Greek flag carrier, Olympic Airlines	100.0	100

Source: Greek Ministry of Finance

Greece dodges cut to rating, for now

Greece avoided a downgrade to its credit rating by Standard & Poor's Ratings Services, which had warned last month that it was considering such a move, although the ratings firm slapped on a negative outlook.

By ***John Kell, Jethrow Mullen*** *and* ***Emese Bartha***

The euro rose in the minutes following S&P's announcement.

S&P credit analyst Marko Mrsnik said the Greek government's plans to reduce its deficit was supportive of the nation's current triple-B-plus long-term credit rating, which is three notches into investment-grade territory. S&P said the government's reduction measures were "appropriate to achieve its 2010 fiscal target."

However, the negative outlook, which means future downgrades are possible, reflected concern about Greece's ability to sustain the reform momentum. "It indicates further downgrade potential if the government fails to address negative deviations from its budgetary consolidation path or implement the currently planned structural reforms," Mr. Mrsnik said.

Earlier this month, the Greek Parliament approved a third set of deficit-reduction measures to reinforce its budgetary consolidation strategy and meet its deficit target of 8.7% of gross domestic product in 2010. But despite the new measures, which affect both the revenue and expenditure sides of the budget, S&P said it will be difficult for Greece to comply fully with its consolidation path in 2011 and 2012.

Greece is struggling with a deficit that was expected to reach 12.7% of GDP last year, more than four times the ceiling set by European Union budget rules. Credit-rating firms have been pessimistic about Greece, which has a poor track record of debt management.

European Commissioner for Economic and Monetary Affairs Olli Rehn said Tuesday that Greece doesn't need financial help at the moment and that the European Commission thinks Greece is on track to make budget cuts worth 4% of GDP this year.

Still, Greek government officials expressed frustration with borrowing costs that remain stubbornly high despite budget reforms and promises of aid from other countries in the 16-nation euro bloc.

Greece would find it hard to cope with borrowing costs if they stayed at current levels, Finance Minister George Papaconstantinou said Tuesday, adding that he expects his country's borrowing costs to decrease as its plan to tackle budget problems gains credibility.

"It's clear that we are not happy to be paying the kind of mark-ups and spreads that we're paying at the moment," he said. "But as we have stated all along it's a question of rebuilding credibility, and it's very clear now that this credibility is being rebuilt."

Tuesday afternoon in Europe, Greece's benchmark 10-year bond yielded 6.25%, nearly double that of Germany, the euro-zone benchmark.

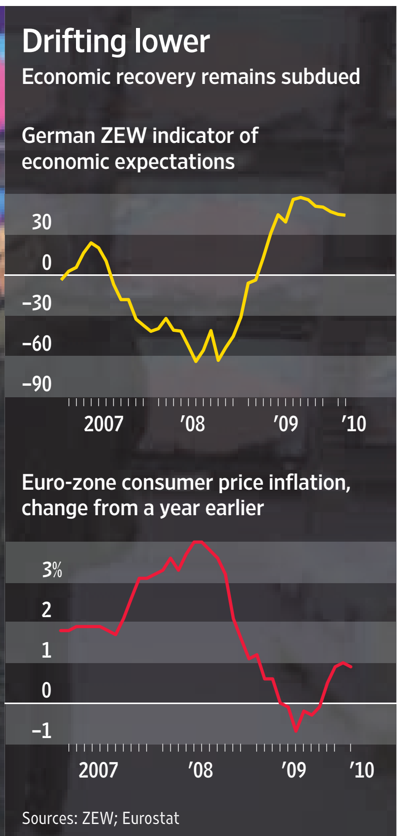
EUROPE NEWS

German economic expectations slow

ZEW index indicates recovery will continue at a slower pace; growth in euro-zone consumer prices also cools

By Nina Koeppen
And Ilona Billington

Bloomberg News



Sources: ZEW; Eurostat

◀ A Metro store in Sankt Augustin, Germany

FRANKFURT—German economic expectations deteriorated in March, indicating the economic recovery is slowing.

The ZEW think tank said Tuesday that its economic-expectations index declined for the sixth straight month, to 44.5 points in March from 45.1 points in February.

Economists said that signals the recovery will continue, albeit at a slower place. The outcome was above economists' average forecast of 43.0 points in a Dow Jones Newswires survey, and above the indicator's historical average of 27.2 points. "German business activity has moved from intensive-care unit to rehab. But it is still far from full recovery," ZEW President Wolfgang Franz said.

Analysts and institutional investors grew more optimistic about Germany's current economic situation in March. The corresponding ZEW indicator rose 2.9 points to minus-51.9 points, its highest level since November 2008. Export-oriented industries, such as mechanical engineering, chemicals and steel, are expected to drive Germany's economic recovery, ZEW said.

"But a full recovery, involving a revival in domestic demand, is still far off," said Isabelle Job, an economist at Crédit Agricole SA.

Indications that the euro-zone recovery stalled in the first quarter have shifted economists' expectations, and now the European Central Bank isn't expected to raise interest rates until late 2010 or later. A muted inflation outlook also supports this view. "Surprisingly, inflation expectations are going down, both in Germany and the euro zone," said ZEW economist Peter Westerheide.

Separately, consumer prices in the 16-nation euro zone rose at a slower pace in February than in January, final official data confirmed. Figures published by the European Union statistics agency Eurostat showed consumer prices rose 0.3% from January, and were 0.9% higher in February compared with a year earlier. Consumer prices fell a record 0.8% on the month in January and rose 1% in annual terms.

The calculation of the annual rate of inflation wasn't revised from the preliminary estimate published March 2, and was in line with expectations. The core measure of consumer price inflation—which excludes the volatile prices of energy, food, alcohol and tobacco—rose 0.4% on the month in February and by 0.8% on the year.

The slowdown in the pace of inflation is in line with European Central Bank President Jean-Claude Trichet's view that inflationary pressures are set to remain subdued for some time. This leaves the ECB free to keep rates at the record low of 1% for some months to come.

By region, Eurostat data show that though consumer prices rose 0.4% in February in Germany, the year-to-year rise was just 0.5%, down from a 0.8% annual increase in January.

Consumer prices in the 16 countries that share the euro rose at a slower pace in February than in January due to broad-based but slight changes in prices, final official data confirmed Tuesday.

Prices of alcohol, tobacco and household goods, as well as transport costs, rose at a slower year-to-year pace in February than reported in January, Eurostat said.

In the wider European Union, consumer prices also rose 0.3% in February from January, and were 1.4% higher from a year earlier.

EU delays a key decision on rules for hedge funds

Continued from first page

lands.

Britain has been pushing for a "passport," where a fund that is approved in one country automatically gains access to the other bloc members.

France worries that weak regulators in one nations could give dubious fund managers access to the entire EU. A French official said the idea of the passport is a "non-starter."

Britain could easily have been outvoted among the ministers, diplomats say, if the hedge-fund rules had remained on the agenda.

Britain, whose position is supported only by the Czech Republic, diplomats say, could have been easily outvoted among the ministers.

Spanish officials say a consensus among the governments would provide a better mandate when it comes to negotiating the final shape of the law in a meeting later this year with the European Parliament and the European Commission, the EU's executive arm.

The parliament, which will be considering close to 2,000 amendments in coming months, and the commission are each working with a draft law that includes the passport idea.

Their versions include another approach—called equivalence—that would also make it easier for American fund managers seeking to gain access to the EU.

This would allow fund managers access to the entire bloc if their domestic regulatory regime was deemed as robust as the European one.

France opposes the equivalence approach, too, saying it would be unworkable.

One important reason for the opposition among some parliamentarians is the requirement for foreign fund managers to operate under separate national rules is that they believe it flies in the face of one of the EU's core principles: the single market.

—Adam Cohen and Nicholas Winning contributed to this article.

Darling defends Britain

By Adam Cohen

BRUSSELS—U.K. Chancellor of the Exchequer Alistair Darling defended the government's budget plans in the face of criticism from the European Commission.

The European Commission on Wednesday will tell London it should do more to cut its budget deficit, estimated to be as large as the shortfall in debt-addled Greece. The U.K. currently aims to cut its budget gap to 4.7% of gross domestic product in the 2014-15 fiscal year from 12.7% of GDP in 2009-10.

But the commission, the European Union's executive arm, says this austerity plan faces risks, since it relies on overly optimistic economic forecasts.

"A credible time frame for restoring public finances to a sustainable position requires substantial additional fiscal tightening measures," the commission said in a draft statement.

The criticism likely will reverberate as Britain heads toward a general election, expected to be held May 6. The opposition Conservative Party has claimed that the commission's report shows a change of government is needed to repair the U.K. economy.

"It's the toughest and it is the most aggressive plan of any advanced economy," Mr. Darling told a news conference following the regular monthly meeting of EU finance ministers.

"I think to go further and faster than that ... would run the risk of seriously derailing the recovery and take our economy back to recession, and I believe that is a risk that we should not take," he added.

The EU as a whole is struggling to control widening budget deficits. Greece, which also is expected to have had a deficit of 12.7% of GDP last year, has sparked fears that it could default on its debts, prompting a flurry of talks about an EU-backed bailout. Worries about Greece have infected other countries on the EU's southern fringe, too, including Portugal and Spain.

Under EU rules, countries are required to keep their budget deficits below 3% of GDP, a ceiling every EU country except Bulgaria is expected to break this year.

Because Greece is a member of the euro zone, the commission and EU finance ministers can order specific changes to its budget plans and levy fines if it fails to comply.

The U.K., which doesn't use the euro, won't face this type of intervention or penalties, but could be shaken by the commission's criticism. Ratings firm Moody's Investors Service last week said the U.K. ultimately could lose its AAA debt rating if it doesn't trim its budget deficit.

London expects the country's economy to grow 2% in 2010-11 and 3.3% in the following four fiscal years. The commission, however, thinks this is unlikely. In November, it predicted the U.K. economy would grow 0.9% in 2010-11 and 1.9% the following year. Last month, the commission cut its forecast for the U.K. economy in 2010-11 to 0.6%.

"The markedly favorable macroeconomic context envisaged in the [U.K. budget] program carries risks for the fiscal projections in the program," the commission said in its draft report.

"Lower-than-expected economic growth from 2011-12 onwards would lead to an overshoot of the government deficit projected in the program," the commission report adds.

The commission's report still could be changed before publication on Wednesday, according to several EU officials. The final report will be presented to EU finance ministers. The ministers could modify the commission's findings, though they seldom do so.

—Nicholas Winning contributed to this article.

EUROPE NEWS

Saakashvili criticized over broadcast

Opposition says he had hand in airing faux footage of Russian invasion, widening rift with pro-Kremlin opponents

By Samantha Shields

TBILISI, Georgia—Opponents of President Mikheil Saakashvili stepped up their criticism of the Georgian leader Tuesday, accusing him of having a hand in a Georgian television broadcast that caused brief panic by showing fake footage of a Russian military invasion.

The broadcast heightened tensions between Mr. Saakashvili, a vocal critic of Russia, and opponents who allege Mr. Saakashvili colluded with the station. "I am absolutely sure that the president himself was behind all this," Nino Burjanadze, head of opposition party Democratic Movement-United Georgia, said in an interview Tuesday.

The broadcast, which aired Saturday on a station widely perceived as friendly to Mr. Saakashvili's government, offered a news-style account that Russian forces were on the way to Georgia's capital, Tbilisi, that Mr. Saakashvili was dead, and that opposition politicians, including Ms. Burjanadze, had sided with Russia. The program bore warnings at the beginning and end that the account was fictional but many who tuned in midway were surprised.

For many Georgians, the scenario bore an uncomfortable resemblance to the events of August 2008, when Russia and Georgia clashed in a brief war in over the separatist region of South Ossetia. Critics and some in the West have accused Mr. Saakashvili of allowing himself to be provoked into conflict with his large neighbor, a charge he has denied. The two sides declared a cease-fire but tensions remain high, and Mr. Saakashvili's reputation has remained dented at home and abroad.

During the 30-minute broadcast, mobile telephone networks collapsed. News organizations said some people suffered heart attacks.

Mr. Saakashvili on Sunday said the broadcast depicted events extremely close to ones that could happen. On Monday, he condemned the program, calling it "meaningless and even harmful to our society." Representatives didn't respond to requests to comment Tuesday.

The European Union Monitoring Mission, which monitors the cease-fire, said such "irresponsible programming" could destabilize the situation close to the boundary lines. "We call on all those with positions of responsibility to fully consider the implications of their actions in future," it said.

Giorgi Arveladze, a former politician who heads the station, Imedi TV, said the channel had apologized for the incident and that it hadn't colluded with the government.

"We understand that the broadcast was damaging and scared a lot of people, which we didn't want," Mr. Arveladze said in a telephone interview Tuesday. "But we felt it was a moment when the country and politicians needed a wake-up call" that such a scenario is possible.

The broadcast followed recent visits by Ms. Burjanadze and another opposition politician, Zurab Noghaideli, to Moscow, where each met with Russian Prime Minister Vladimir Putin. The program also singled out Mr. Noghaideli as having sided with the fictitious invasion.

Georgian Prime Minister Nika Gilauri said in Brussels on Tuesday that the station apparently wanted to show the plans of "some people connected to the Kremlin." He added: "The execution was terrible."

Ms. Burjanadze was part of a group that inspired the 2003 Rose Revolution that swept Mr. Saakashvili to power. She said in the interview that she is a pro-Georgian politician but that Georgia must find a common language with its neighbor.

Georgia has been under increasing criticism over its record on media freedom since the 2007 when Imedi, then critical of Mr. Saakashvili, was shut down by authorities and relaunched with a pro-government tone.

Lawrence Sheets, a Tbilisi-based analyst with the International Crisis Group think tank, said the recent events have raised the political temperature in Georgia for the government and opposition. "Whether or not the government was involved is pure speculation, but Imedi is widely perceived as a pro-government station," Mr. Sheets said.

Opponents have been trying to force Mr. Saakashvili, whose five-year term is set to expire in 2013, to call elections sooner than scheduled. Mr. Saakashvili, in his second term, couldn't run for re-election.

Britain's ambassador to Georgia, Denis Keefe, said Tuesday the incident reflected badly on Georgia's reputation for responsible and independent media. The U.S. and French ambassadors have called Imedi's actions irresponsible.

—Stephen Fidler in Brussels contributed to this article.

European Pressphoto Agency

Georgian President Mikheil Saakashvili welcomes Garry Kasparov, leader of a Russian opposition party, Tuesday in Tbilisi.

China attacks quality of foreign goods

Continued from first page

pared with declines of 16% in the U.S., 10% in Japan and 8% in Europe.

Central authorities didn't respond to requests for comment on the Zhejiang campaign; provincial authorities have wide latitude to set commercial policy.

However, it is consistent with a harder line in general against foreign businesses in China as the country promotes its own brands and companies.

Indeed, Zheng Yumin, head of the Zhejiang administration, was cited in the notice as saying that "consumer rights are an important part of the national competition strategy."

One of the weakest aspects of China's economic development has been its failure to build its own brands.

With a few exceptions, such as Tsingtao beer and Haier white goods, Chinese brands are virtually unknown in Western markets. The fact that foreign brands dominate the China market rankles with central government economic planners, and could embolden local officials to take action, analysts say.

The Zhejiang campaign is part of the local government's self-styled "new consumption movement," which advocates rational and responsible buying and opposes "superstitious" or "abnormal" consumer activity as well as "showing-off," the government said in its statement Monday.

Several of the brands affected by the action didn't immediately respond to requests for comment.

A Versace spokeswoman said: "All Versace products are manufactured 100% in Italy in full compliance of international manufacturing codes. The Versace Group...stands by its product in world standards of luxury quality and craftsmanship."

A Hugo Boss spokeswoman said, "Our products are subject to the highest quality standards and therefore regularly examined by independent testing institutes," adding she had no knowledge of any safety-related problems in China.

An employee in the Hermès public relations department in Shanghai, who declined to be named because he isn't authorized to speak on the record, said the company had learned that there was a problem with its labels in January, and corrected it last month.

The most serious charges were leveled against Italian menswear label **Verri**. The Zhejiang authorities said a pair of the brand's jeans were improperly labeled and contained excessive levels of formaldehyde in the fabric, which can irritate skin or cause respiratory problems.

Marco Brugognone, Verri's chief executive and product manager, said he was "very surprised" to hear of the Zhejiang findings when contacted by The Wall Street Journal Tuesday, and he suggested that the pair of jeans in question might have been fake.

Fake foreign brands are ubiquitous in Chinese markets, adding to the difficulties of luxury goods companies.

Ye Jianhua, head of the administration's news office, said Chinese-made brands are also subject to random sampling and testing.

Luxury imports have been targeted before in China's product safety campaigns. In 2006, the Zhejiang authorities also found defects in a range of other imported goods, including **Louis Vuitton** handbags and computers made by five foreign companies, including **Toshiba** Corp. and Hewlett-Packard.

In a separate case involving a high-profile foreign consumer brand, H-P apologized to Chinese consumers on Tuesday for faulty laptops and offered extended warranties and compensation for those affected.

"For any inconvenience due to product or service problems, Hewlett-Packard earnestly apologizes to customers," the company said in a statement on its Chinese Web site Monday.

In the statement, H-P offered to provide free repairs for all affected models and to extend the warranty on any affected computers for an additional two years from when they are brought in for repair.

H-P said it is also considering providing compensation to customers who have already paid for the shipping and repair of affected computers.

The statement comes after China's product-quality agency launched an investigation on Sunday into the company's handling of a problem with the graphics chips in some of its laptop computers.

A group of Chinese consumers complained last week that H-P had discriminated against them by not offering them the same extended warranty that it gave to U.S. customers in response to the problem, centered on a defect in graphics chips supplied by **Nvidia** Corp. that can cause the chips to overheat.

An H-P spokeswoman said last week that the company didn't discriminate against Chinese customers, and that the complaints may have arisen because of confusion over the terms of an enhanced service program launched in response to the graphics-chip problem.

The spokeswoman couldn't immediately be reached for comment Tuesday.

—Christina Passariello, Gao Sen and Aaron Back contributed to this article.

Switzerland raises forecast for growth

By Martin Gelnar

ZURICH—Switzerland's economic growth will likely accelerate in the course of 2010 and the unemployment rate will be lower than expected this year and next, the Swiss government said.

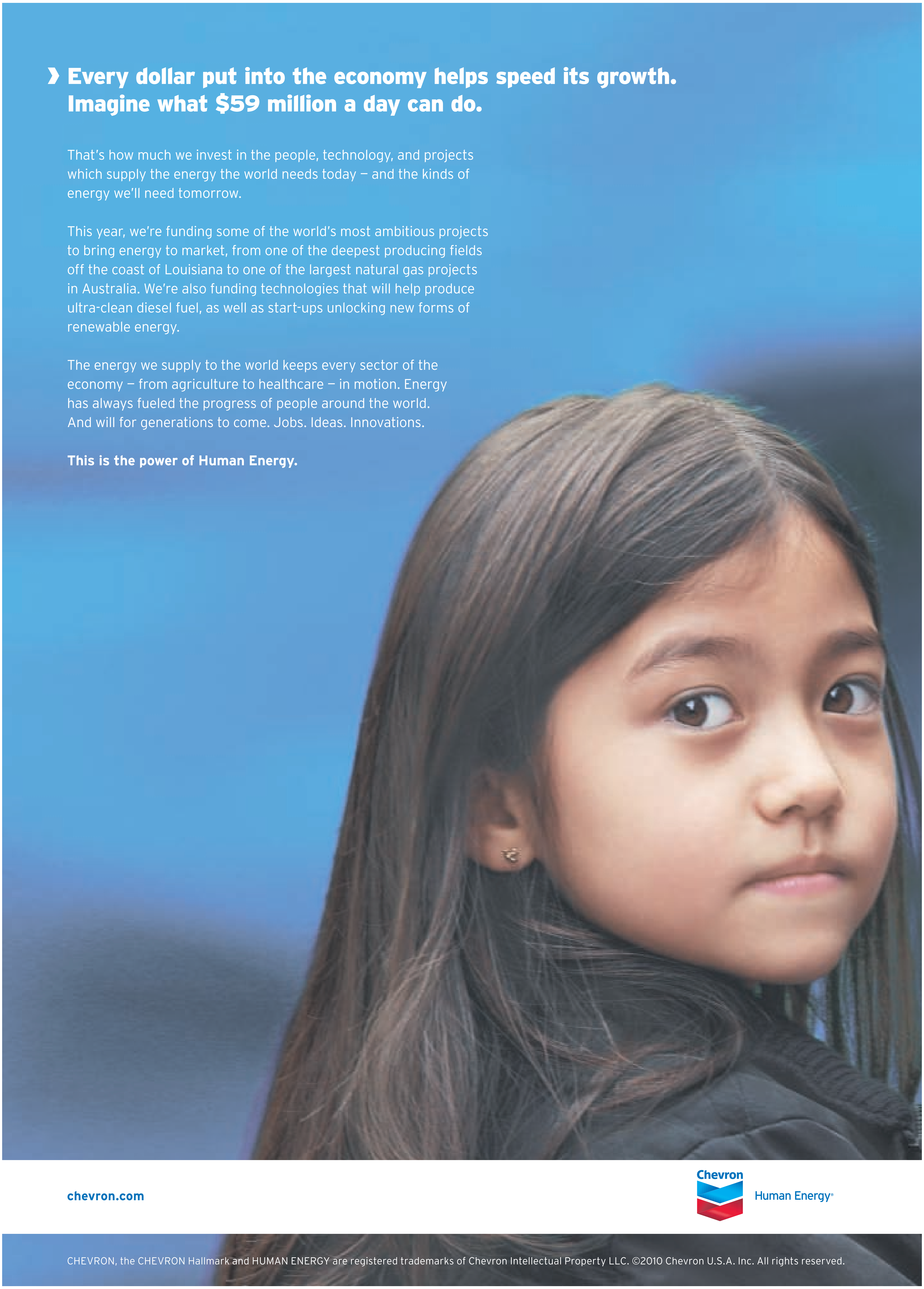
Gross domestic product growth will stand at around 1.4% this year and at 2% in 2011, government agency Seco said, increasing its estimate for 2010 from 0.7% previously. The unemployment rate is expected to be 4.3% in 2010, compared with a previous estimate of 4.9%, and 4.2% in 2011 compared with 4.9%.

Consumer prices are expected to rise 0.8% in 2010 and 0.7% next year, unchanged from previous guidance. The upgrade by the government, a relatively cautious forecaster, follows revisions by many banks.

"The increase in estimates has been quite massive, but we think it's still relatively defensive," Zürcher Kantonalbank economist David Marmet said.

Zürcher Kantonalbank expects Switzerland's economy to grow 2% this year and 1.6% in 2011.

The unemployment rate has recently started to edge lower. In February, it crept down to 4.4% from 4.5% in January.


› Every dollar put into the economy helps speed its growth.
Imagine what $59 million a day can do.
That's how much we invest in the people, technology, and projects which supply the energy the world needs today – and the kinds of energy we'll need tomorrow.
This year, we're funding some of the world's most ambitious projects to bring energy to market, from one of the deepest producing fields off the coast of Louisiana to one of the largest natural gas projects in Australia. We're also funding technologies that will help produce ultra-clean diesel fuel, as well as start-ups unlocking new forms of renewable energy.
The energy we supply to the world keeps every sector of the economy – from agriculture to healthcare – in motion. Energy has always fueled the progress of people around the world. And will for generations to come. Jobs. Ideas. Innovations.
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U.S. NEWS

Opinions harden on health overhaul

Nearly half call plan a 'bad idea' in latest Journal/NBC poll, but Democrats who oppose it risk alienating base

By Peter Wallsten
And Jean Spencer

WASHINGTON—Democratic lawmakers may be tempted to vote against the health-care overhaul plan pending in Congress because it remains unpopular with a broad swath of the public. But a new poll suggests that those who do so risk further dispiriting the core supporters they need to turn out in the November midterm elections.

The Wall Street Journal/NBC News survey found that opinions have hardened around the health plan, with 48% calling it a "bad idea" and 36% viewing it as a "good idea." That gap is consistent with surveys dating to the fall, but now far more people have settled on an opinion, leaving only 15% undecided on the legislation being pushed by President Barack Obama.

The poll was taken March 11, 13 and 14 and surveyed 1,000 adults.

Democratic voters are strongly in favor, particularly constituencies such as blacks, Latinos and self-described liberals that mobilized in 2008 to help elect Mr. Obama but now are far less enthusiastic about voting in this year's midterm elections than are core Republicans.

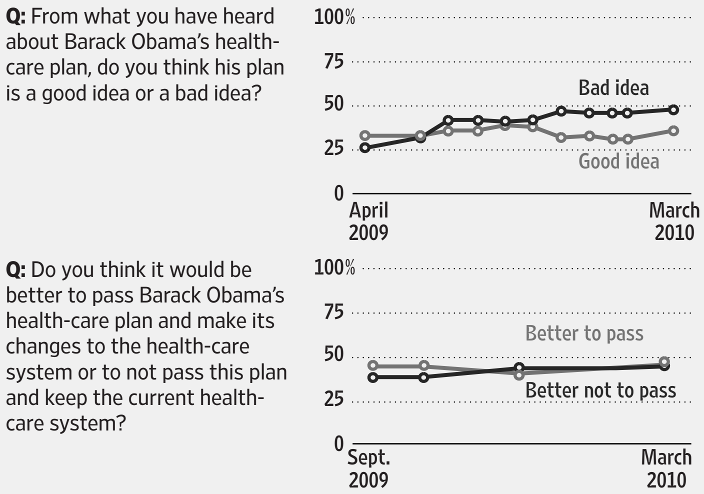
The survey found a 21-point enthusiasm gap between the parties—with 67% of Republicans saying they are very interested in the November elections, compared with just 46% of Democrats.

Agence France-Presse/Getty Images

Protesters demonstrate Tuesday in Washington, D.C., against the health bill.

The public's dilemma

No decisive view on passing the plan



Source: WSJ/NBC News telephone polls; margin of error for March +/–3.1 percentage points

"If the Democrats are going to close that gap, they've got to get their people excited, and I don't see how you get those people if you vote no" on the party's health legislation, said Democratic pollster Peter Hart, who conducted the survey with Republican pollster Bill McInturff. "I don't think it's about winning the middle. It's really about alienating the base."

The survey found that Mr. Obama's job approval rating—now at 48%, with 47% disapproving—has remained steady since his precipitous drop last summer that coincided with rising public opposition to the health plan.

While the health debate has been a drag on Mr. Obama's numbers, it has also been an anchor for Congress, which now has a 17% approval rating. Half of those surveyed said they would vote to replace every member of Congress, including their own representative, if they could.

On health care, the results underscored the argument from liberal activists that defeating the bill would dissuade the party base from voting in November. The Journal/NBC survey shows that majorities of African-Americans and liberal Democrats, as well as a plurality of Latinos, would be less likely to vote for their representative in Congress if he or she voted against the health-care plan.

Complicating the calculation for all lawmakers was that a clear plurality of respondents wanted the issue addressed in some form.

Forty-seven percent said they wanted Congress to consider significant health-care legislation "immediately" if the Obama plan failed in Congress, while an additional 23% wanted that done at least within the next couple of years.

Selena King, a 34-year-old registered nurse and poll respondent in Nevada said she supported an overhaul, but not the current bill.

"I think they should redo it and not pass it at this time," Ms. King said.

Health bill gives insurers a younger market

By Avery Johnson

Although insurers generally oppose the Democrats' health-care bill, an overhaul would give the industry a chance to boost its diminishing rolls with an influx of young customers who tend to be healthy and profitable to cover.

The legislation, which Congress will vote on soon, is designed to get millions of young people to buy health insurance, using a mixture of subsidies to make coverage more affordable and penalties for people who remain uninsured.

The industry has stepped up efforts in recent years to get those people covered, but so far its free-market approach has met with a tepid response.

The reasons young people forgo coverage are many, according to consumers and consultants. Policies are too expensive, too skimpy or too complicated to persuade the roughly 13 million uninsured people between the ages of 19 and 29 that it is worth their money. Most simply gamble that they won't get sick enough to need expensive treatment. In industry circles, they have come to be known as "young invincibles."

" 'Should I spend money on a ski trip or health-care premiums?' " says Paul Markovich, chief operating officer of **Blue Shield** of California, describing the rationale. "It's hard to see the value of insurance if you see yourself as healthy."

But consumers like Jenny Pham, a 27-year-old violinist and teacher from New York, says she doesn't lack coverage by choice. She makes about $3,000 a month teaching and performing. After rent of $1,200, she says insurance—which she has priced at about $250 a month—is out of her reach.

Depending on a person's income, federal subsidies envisioned by the Senate bill now under consideration could reduce that dollar figure significantly.

Senate leaders have designed a young invincible policy for health-insurance exchanges that would offer young Americans catastrophic coverage and a few routine doctor visits.

Critics of the legislation say it is a giveaway to insurance companies because it hands the industry a sizeable new market without restricting profits or forcing it to compete with a government-run plan. But America's Health Insurance Plans, the industry's trade group, opposes the bill because of new taxes and regulations, and worries that the penalties are not stiff enough to make sure that younger people buy policies. The group says bringing young people into the system is essential to bringing down costs for everyone.

"If you are 25 and relatively healthy and have a choice between a $95 penalty and several thousand dollars for health insurance, it's not a hard choice to make," says Robert Zirkelbach, a spokesman for AHIP. The penalty starts at $95 for the first year and increases to $750 in 2016, says Mr. Zirkelbach.

Since 2006, as employers have cut back on benefits, a number of major health insurers have seen steep drops in their enrollment.

Nearly one-third of the uninsured are between the ages of 18 and 29, according to the 2008 Census. But 17% of individual insurance policyholders, or 2.5 million people, are between the ages of 18 and 29, according to consulting firm **McKinsey** & Co. This group is worth $4 billion in annual sales for insurers, according to McKinsey. If insurers could lure in the additional 13 million young Americans, that would mean $21 billion in revenues, McKinsey says.

It could be the industry's last frontier for growth. Health-plan enrollment has been declining since 2006, as employers lay off workers or go without insurance, and rising premiums scare off many individuals. Of the major publicly traded insurers, all but **Aetna** Inc. have seen declines in commercial risk enrollment, which includes individual memberships. **WellPoint** Inc.'s enrollment dropped to 12.4 million at the end of last year, from 14.2 million at the end of 2006, while **UnitedHealth** Group Inc. is down to 9.4 million from 11.3 million over the same period, according to Goldman Sachs Group Inc.

"If you are presiding over a shrinking market and there's an opportunity to triple the size of a piece of it, it gets pretty exciting," says Paul Mango, head of McKinsey's health-care consulting practice.

In the past several years, insurers have been competing for this "good risk" in the market with new plans meant to seem hip. Market leader WellPoint in 2004 launched its "Tonik" policies—with tiers of coverage called "daredevil" and "risk taker"—in California, and has since expanded to six states and sold 224,800 plans. Aetna, which just started a Facebook page, bought a student-health company several years ago and boasts of doubling membership to 500,000.

UnitedHealth started pitching short-term policies to recent graduates last spring, while Blue Cross plans in Pennsylvania and Vermont are pitching policies on college campuses. Last month, **HealthNet** Inc. landed a contract for Stanford University's 8,000 students.

But many young consumers still find health insurance too expensive and confusing. Andria Tieman of Providence, R.I., was uninsured for the majority of her 20s as a graduate student and now is uncovered in a part-time job at age 30. Of health insurance she says, "I don't understand most of it, and I know I can't afford it, so I don't even look. Why tease myself?"

The plans say they have tried to design policies to include coverage that young people might use, such as dental and dermatology. At UnitedHealth, prices on short-term policies start as low as $45 a month. Blue Shield of California has a plan for $52. It's hard to reduce prices by much more, say insurance executives.

But the trade-offs are off-putting: high co-pays and deductibles (Blue Shield of California's is $2,900), and big benefit gaps. Blue Cross Blue Shield of Minnesota, for instance, is promoting a plan in university areas that doesn't cover maternity, and members can't switch out of it if they get pregnant.

Some insurers are seeing moderate growth. UnitedHealth says applications by 18-to-30-year-olds were up 12% in the fourth quarter of 2009, compared with a year earlier. And **Highmark Blue Cross Blue Shield** says members between 19 and 29 are its fastest-growing market, increasing 12% last year.

But plans can experience high turnover—Blue Shield of California sold about 47,000 policies to the 19-to-29 crowd last year, but only 17,000 re-upped when their policies lapsed. Overall, individual plan enrollment for people between the ages of 18 and 29 has increased by just 140,000 members between 2004 and 2008, according to McKinsey.

U.S. NEWS

States turn to a rich uncle—Sam

U.S. governors lobby Washington for more money to plug budget holes as last year's stimulus aid runs out

By Louise Radnofsky

Strapped states, facing up to $180 billion in budget deficits in the next fiscal year, are going hat in hand to Washington.

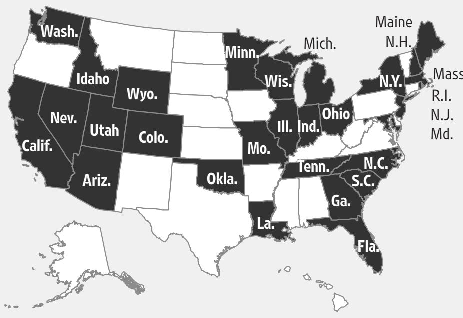
California wants $6.9 billion in federal money for the next fiscal year, and Republican Gov. Arnold Schwarzenegger says he'll have to eliminate state health and welfare programs without it. Illinois, facing a $13 billion deficit that equals roughly half of the state's operating budget, has what it dubs a stimulus team and a group in Washington pressing for additional state aid.

> Congress is balking at further subsidies amid an outcry over the deficit.

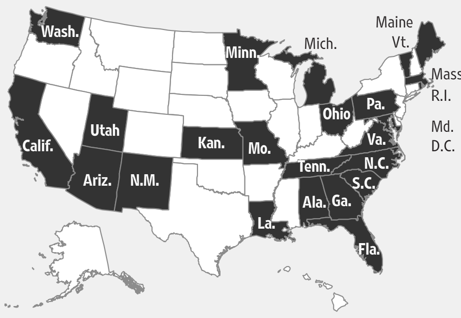
Tough choices | U.S. states make cuts in face of looming deficits

States that have enacted budget cuts affecting state services in fiscal years 2009 and 2010

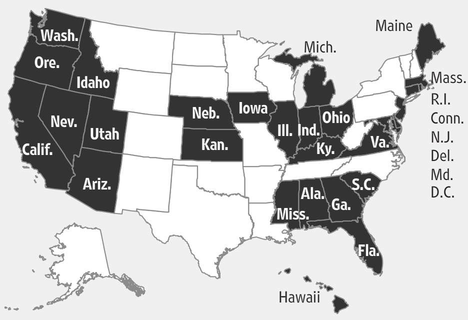
PUBLIC HEALTH PROGRAMS



PROGRAMS FOR THE ELDERLY/DISABLED



K-12 AND EARLY EDUCATION



HIGHER EDUCATION

Note: FY2011 begins July 1 in most states *Washington has a two-year budget

States with the largest projected FY2011 budget gaps

State	Shortfall (billions)	% of FY10 budget
Illinois	$12.8	34.3%
California	12.3	12.5
New Jersey	10.0	34.0
New York	8.2	14.8
Connecticut	4.7	26.7
Florida	4.7	18.1
North Carolina	4.4	21.0
Pennsylvania	4.1	15.4
Minnesota	4.0	26.4
Georgia	4.0	23.2
Wisconsin	3.4	24.6
Ohio	3.2	11.8
Massachusetts	2.7	9.7
Arizona	2.6	26.7
Washington*	2.1	13.3
Maryland	2.0	14.5
Michigan	2.0	8.8
Nevada	1.8	59.8
Colorado	1.8	24.1

Source: Center on Budget and Policy Priorities

Among other things, Illinois is hoping the federal government will keep paying a higher share of Medicaid costs. "That's $600 million we desperately need," said Kelly Kraft, a spokeswoman for Democratic Gov. Pat Quinn's budget office. Those funds already are counted in the governor's budget proposal.

But in Congress, members are balking at further subsidies amid an election-year outcry over the U.S. deficit and federal involvement in the economy.

That tension sets up fierce battles as states work out budgets for the fiscal year beginning July 1. Because they can't run deficits, most states face yet more tough choices: raise taxes, cut services, lay off workers or trim employees' wages and benefits over union opposition.

"Our demand for services continues to grow, especially with underemployment and high unemployment—and we expect this trend to continue as we enter what is expected to be a slow-growth recovery," said Anna Richter Taylor, a spokeswoman for Democratic Gov. Ted Kulongoski of Oregon.

That Western state passed two tax increases this year but still expects a $2.5 billion budget gap for the 2011-2013 period; officials are seeking an extension of federal stimulus aid as well as other funds from Washington.

About a third of last year's economic-stimulus package went to aid states, including $90 billion to help with Medicaid costs and $54 billion for schools and general services, the largest items in states' budgets. Supporters hoped the money would tide over the states for the worst of the recession.

But now those funds have almost all run out. Quarterly payments of Medicaid money are scheduled to end in December, and states will have spent most of their education funds by June. While the economy is starting to improve, unemployment remains high, leaving states with sliding tax revenue and rising costs for welfare services.

The total combined gap in state budgets for the 2011 fiscal year, which begins July 1, 2010 in most states, could be as much as $180 billion, according to the liberal Center on Budget and Policy Priorities.

Many states have already raised taxes and curbed services; Hawaii, for instance, closed its schools on 17 Fridays this year.

Now states are girding for more cuts as they craft budgets for the next fiscal year. The Virginia general assembly Sunday adopted a budget cutting millions of dollars from schools and public-safety spending. Nevada's lawmakers reached a deal with the governor to cut education spending by 6.9% but preserve some Medicaid benefits.

President Barack Obama said last month he was concerned about the potential for state and local government layoffs "because we haven't re-upped" money for states. Christina Romer, chairwoman of the White House Council of Economic Advisers, called for more help for states in a speech last week.

So far, though, proposals for more money for states have struggled in Congress.

Lawmakers wrestled to get a $25 billion provision extending the Medicaid funding by six months, first attaching it to health-care legislation, then to a different bill that the Senate passed last week. Almost half of the states had declared ahead of the vote that their budgets for next year were based on the expectation that they would get the money.

A House jobs plan passed in December included more aid for states' schools and general services budgets, bumping its price tag up by about $24 billion. The legislation stalled in the Senate amid opposition from Republicans and some moderate Democrats to additional large spending measures.

Rep. George Miller (D., Calif.), chairman of the House Education and Labor Committee, last week introduced state aid provisions as part of a new $100 billion jobs plan. But he acknowledged the proposal faces hurdles getting through the Senate.

Rep. Tom Price (R., Ga.), the leader of the conservative Republican Study Committee, called Mr. Miller's plan a bailout and $100 billion slush fund.

Don Stewart, a spokesman for Senate Minority Leader Mitch McConnell (R., Ky.) said he expected to see bipartisan concerns about more deficit spending in any new aid proposals that came to the Senate.

California has been particularly vocal in describing its fiscal woes to Washington in the past year. Mr. Schwarzenegger has tried to prod the California congressional delegation to bring home more federal money by blasting them on national television, saying they haven't done enough for the state.

He has also visited Washington to meet with the delegation and with President Barack Obama. Leaders of the California legislature have also gone to Capitol Hill to lobby for more aid.

But groups that lobby for states, including the Council of State Governments, National Conference of State Legislatures and National Governors Association, say they have little hope of getting much more.

"There just doesn't seem to be the political will to address that issue," said David Shreve, a lobbyist for NCSL.

—Stu Woo, Amy Merrick and Joel Millman contributed to this article.