



Mexico's Calderón defends his expanding drug war

THE BIG READ 14-15

Lenders resist U.K.'s push for 'living wills' for banks

BUSINESS & FINANCE 17

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A soldier yells for help after capturing a Red Shirt protester inside the antigovernment group's encampment during a government crackdown on Wednesday in Bangkok.

German shock on short-selling splits Europe

BY CHARLES FORELLE AND PATRICK MCGROARTY

Germany's restrictions on some bearish financial bets caught much of the rest of Europe by surprise, and signaled that the euro zone's largest economy is willing to move ahead with tighter oversight of traders while the European Union's own regulatory package trundles along.

In France, the euro's second-largest economy, Finance Minister Christine Lagarde said Wednesday she wasn't consulted before Germany made its move to ban "naked" short sales of some securities. And the European Commission's top financial-regulation official said he was scrambling to put in place a broader regime "to avoid regulatory arbitrage and fragmentation."

Germany's financial regulator stunned markets late Tuesday with a ban on naked short sales of euro-zone bonds and of 10 financial stocks listed in Germany. The ban, which took effect at mid-

night Tuesday, also extends to uncovered credit-default swaps on euro-zone debt; that is, debt-insurance contracts in which the buyer doesn't hold the security being insured. It doesn't cover business done outside Germany.

The move helped push stocks broadly lower in Asia, Europe and the U.S. German 10-year bond prices surged, and the yield on the country's two-year note at one point hit a record low. Prices on the benchmark 10-year U.S. Treasury also ended the day higher. Bond prices and yields move in opposite directions.

The cost of insuring European sovereign debt against default using credit-default swaps initially dropped sharply, but then widened in thin trade as investors digested the German move.

The European Commission, the European Union's executive arm, suggested that Germany acted preemptively on an issue that would be discussed by all EU finance ministers on Friday.

"These measures will be even more efficient if they are coordinated at European level," said Michel Barnier, European commissioner for financial regulation. "It is important that member states act together and that we design a European regime to avoid regulatory arbitrage and fragmentation both within the EU and globally."

Analysts said Germany's moves spring from Chancellor Angela Merkel's need to sell a controversial, €750 billion bailout package for weaker euro countries to a skeptical and angry public.

"This was driven by the electorate, to gain political support," said Carsten Brzeski, an economist at ING Bank in Brussels. Mr. Brzeski said Ms. Merkel cracked down on short-selling "to show that politics is still ahead of markets and that they are running the show."

Please turn to page 5

■ Heard on the Street: Ban could backfire 18

Violence locks down Bangkok

BY JAMES HOOKWAY

BANGKOK—Enraged mobs of antigovernment protesters set fire to swaths of Bangkok's priciest real estate on Wednesday, sending thick columns of smoke into the hazy air and stoking fears that Thailand's chronic political divides could degenerate into an even-deeper conflict.

Demonstrators and local street thugs started the fires after an early-morning army assault on the so-called Red Shirt protesters' main camp forced the group's top leaders to surrender to police to prevent massive bloodletting. Mobs of roving protesters singled out economic targets for special attention, setting Thailand's stock-exchange headquarters ablaze and torching several banks and the headquarters of the city's electricity provider. Large parts of the

Central World shopping mall overlooking the demonstrators' camp in Bangkok's main commercial corridor were gutted by flames and witnesses said Asia's third-largest shopping mall was close to collapse.

Thailand's government declared a curfew—from 8 p.m. to 6 a.m.—for the first time since pro-democracy protests in 1992, and hospital officials say five protesters and an Italian photojournalist were killed. The Associated Press reported witnesses as saying at least six other bodies were found in a Buddhist temple inside the protest area.

Battles between militant protesters and soldiers continued into the night, turning gritty working-class areas in central Bangkok more dangerous. Prime Minister Abhisit Vejjajiva said in a televised address that order would soon

be restored.

"Please rest assured that the government, officers and I are confident and determined that we can overcome the problems," Mr. Abhisit said.

Government officials said they had expected a violent backlash when they moved to shut down the monthslong antigovernment protest.

Political analysts, though, worried that the situation has worsened a struggle between Thailand's conservative establishment and a rural, populist movement inspired by ex-Prime Minister Thaksin Shinawatra, who lives in self-imposed exile to avoid imprisonment on a corruption conviction, but supports the movement from abroad.

Some said Wednesday's crackdown and the violent reprisals pose a fresh risk to the political survival of Mr. Abhisit. Please turn to page 10

The Quirk



Why a good umbrella is hard to find, and what's being done about it. Page 29

World Watch

A comprehensive rundown of news from around the world. Pages 30-31

Editorial & Opinion

Khodorkovsky and Russia's legal nihilism. Page 12

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PAGE TWO

Blame is still a matter of speculation

[Agenda]

BY MARTIN VANDER WEYER

Do speculators increase the volatility of markets, or the range between peak and trough? Any sensible real-world observer would say: of course they do, look at the spikes in crude oil and soft commodity prices in 2008. Yet it is remarkable how many economists will tell you that they do not, or make only a marginal difference.

Then again, do short-sellers turn "normal" downswings into destructive panics? And is it morally wrong to go short—of U.K. bank shares prior to the collapse of RBS and HBOS, for example, or of Greek government bonds now—in circumstances where rampant panic or social disorder is a possibility?

That's a trickier one, but any professional will tell you that short-selling is a familiar, long-established tool of portfolio investment; and most will argue that any eruption of negative market sentiment, whatever its form, can be a force for good if it encourages weak management or bad government to change for the better.

These aren't clear-cut debating issues. But they have been brought to the fore this week by the actions of EU finance ministers in approving a directive to constrain hedge funds, and by an unexpected German ban on naked short-selling of shares in financial institutions and euro-zone government bonds, and equivalent transactions through the credit-default swap market. Chancellor Angela Merkel has added the threat of a new tax on financial markets, which Germany will impose unilaterally if the proposal doesn't find international agreement.

So the message Europe's leaders would like us to absorb is: speculators are to blame both for the financial crisis of 2008 and for the euro crisis of 2010. In both cases, the message goes, what



The DAX on the Frankfurt stock exchange: speculators in action?

might have been manageable problems have been turned into meltdowns by ruthless, amoral traders—by those who made billions betting the subprime market would collapse, then doubled their money by betting the shares of the banks involved would crash too; and now by those who are betting Portugal and Spain will follow Greece into the abyss.

European leaders' message: Speculators are to blame for the financial crisis of 2008 and the euro crisis of 2010.

Those meltdowns could only be halted by massive bailouts, so the other half of the message to European taxpayers is "don't blame your wise leaders for striving to keep market sharks at bay." Ms. Merkel is the most urgent advocate of this case, sandwiched as she is between a stinging election defeat in North Rhine-Westphalia that followed the announcement of the €750 billion (\$915 billion) euro-zone "rescue package" two weeks ago and a parliamentary vote this Friday on Germany's €150 billion contribution to the deal. With a sharp downturn in economic optimism (the ZEW index of expectations is down to 45.8 in

May from 53.0 in April) reflecting the perceived impact of the rescue deal and euro turmoil on growth prospects, she knows her citizens are hopping mad. So her response is to try to turn the anger against speculators, especially those of the Anglo-Saxon variety.

That is understandable as political grandstanding, but not as serious economics. Hedge funds didn't create the banking crisis of 2008, however relentlessly they upped the ante on the subprime collapse and drove bank shares down. Banks caused that crisis, by lending irresponsibly and using securitization to overexpand; regulators made it worse, by failing to stop them; ratings agencies went along for the ride; and central banks made it possible in the first place, by making money too cheap. The speculators merely read the tea leaves, placed their bets, and added to the mayhem. But in the terminology of crime, they were no more than accessories after the fact.

Likewise in Europe's rumbling volcano of a sovereign-debt crisis. "Speculators" played no part in creating it: it is the handiwork of profligate, incompetent, over-indebted governments, led by Greek politicians who deliberately disguised the true state of their national accounts in order to meet euro membership requirements in the first place.

It is the inevitable result, euro skeptics would argue, of creating

a common-currency structure that would always be at the mercy of its weakest members because it doesn't have the unified fiscal structure needed to make them conform to its rules.

If markets didn't believe that the first bailout for Greece was sufficient, and still don't believe that the bigger, IMF-backed rescue package is anything more than a temporary stopgap, that is a judgment they are entitled to bet on. The German measure against short selling euro-zone bonds is a mere token, which hedge funds and investment banks will easily circumvent.

And if they do so to such an extent that the eventual cataclysm fractures the euro and leaves behind a currency that looks a lot like the Deutsche mark, German taxpayers will, in the long term, be deeply grateful to them.

Meanwhile, we British taxpayers can watch the euro crisis from the sidelines, but not without a thought for what it means for us. If, some months hence, the Conservative-Liberal Democrat government has failed to tackle the deficit and speculators respond by driving the pound off a cliff and short-selling gilts, will we blame them for causing a national crisis? Or will we remember to blame the departed Labour government for wrecking our public finances?

Let us not forget the last time a wave of market sentiment crashed onto our shores: on Black Wednesday in 1992, when George Soros and others drove the pound out of the European Exchange Rate Mechanism, to which the Conservative government of the day was misguidedly clinging.

And what happened as a result? Our economy was redirected onto a decadelong growth path, outpacing our European neighbors. We never looked back. And we had ruthless, amoral speculators to thank. Perhaps one day our European neighbors will be able to say the same.

—Martin Vander Weyer is editor of *Spectator Business*.

What's News

■ **The euro bounced** strongly off four-year lows on market speculation that European authorities were preparing a response to the currency's recent decline. Uncertainty surrounding the fragility of the euro zone hit stocks. 23

■ **Germany's Commerzbank** sought to quell shareholder worries about its exposure to Greece and its progress in propping itself up following the financial crisis. 19

■ **Accor will become** a hotel franchiser and operator instead of primarily an owner as it scrambles to catch up with its competitors. 17

■ **U.S. consumer prices** edged 0.1% lower in April, the first decline in over a year, as retailers hesitated to pass higher costs to consumers. 7

■ **At least two passengers** visited the cockpit of the Polish president's plane minutes before it crashed last month in Russia, investigators said in a preliminary report. 6

Inside



Togetherville offers social networking for the family. 27



The careful aesthetics of the UEFA Champions League. 28

ONLINE TODAY

Most read in Europe



1. Euro Party Is Over. What Now?
2. Call for Unity on Short-Selling Draws Ire From France
3. Germany to Ban Some Naked Short-Selling
4. Agenda: The New Euro Skeptics
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"The message she doesn't want to hear is investors' vote of no confidence in the future of the euro."

Allen Mattich on Angela Merkel and Germany's ban on naked short-selling



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Previous results

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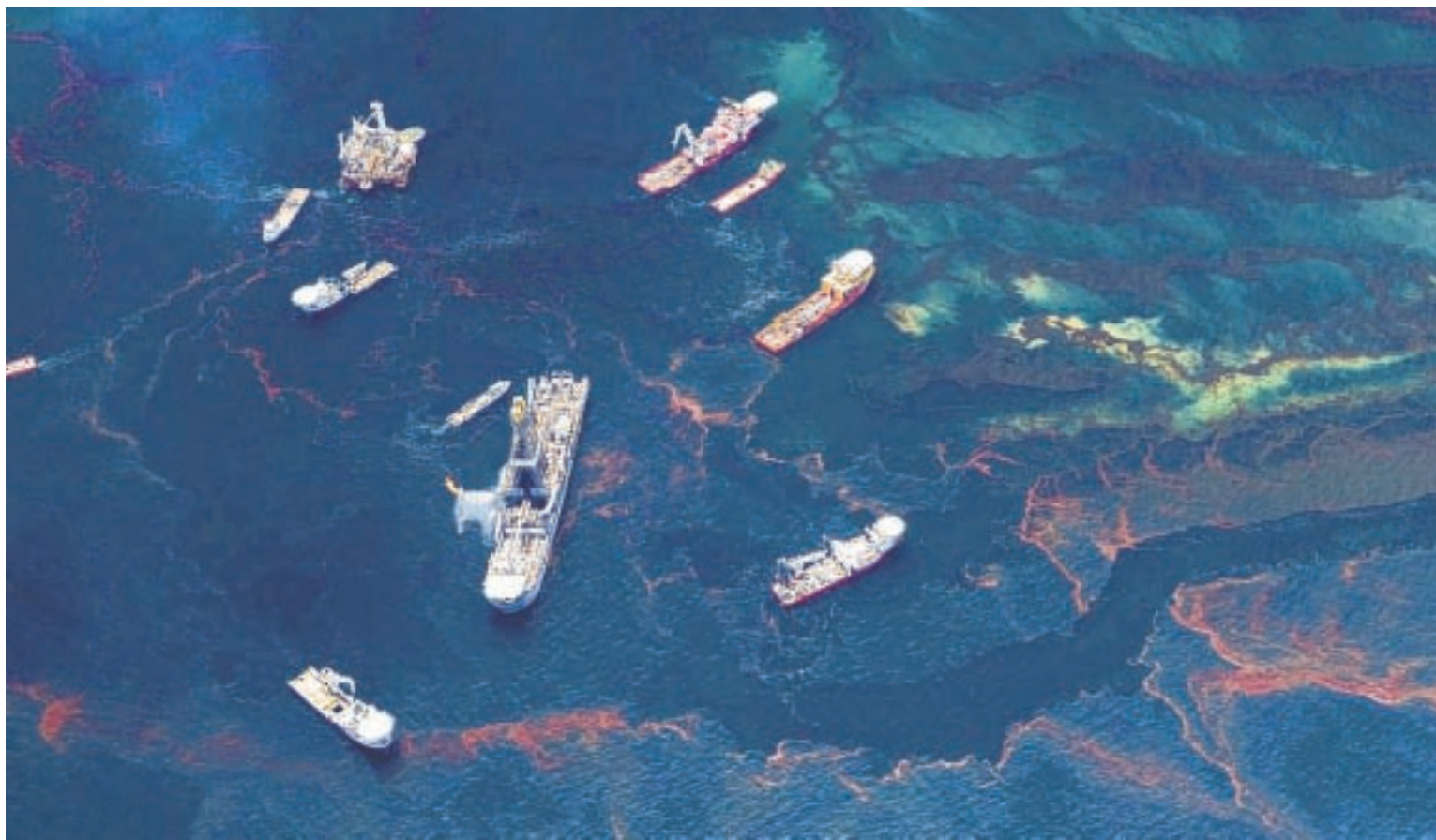
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NEWS



Getty Images

Oil floats in the Gulf of Mexico, off the Louisiana coast. The U.S. said it was closing a fifth of federal waters in the Gulf to fishing because of the oil leaking from the ocean-floor well. Tar balls that came ashore in the Florida Keys weren't from the Gulf spill, the Coast Guard said Wednesday.

Fear of oil riding on current

Officials said moving water could carry spilled crude to Florida and up East Coast of U.S.

By JEFFREY BALL AND COREY DADE

An ocean current could carry oil leaking into the Gulf of Mexico around Florida and up the East Coast of the U.S., officials said.

A thread of oil from the spill already may have entered a movement of water in the Gulf known as the Loop Current, said Jane Lubchenco, administrator of the National Oceanic and Atmospheric Administration.

Oil in the Loop Current could reach Florida within 10 days and then start heading up the East Coast, she said.

According to private forecasters at AccuWeather, tendrils from the rust-colored oil slick have already entered the Loop Current, Reuters reported.

However tar balls, or globules of oil, that washed ashore in the Florida Keys weren't from the Gulf spill, the Coast Guard said Wednesday, the Associated Press reported.

The U.S. and Cuba were holding talks on how to respond to the spill, a U.S. State Department official said, underscoring worries about the oil reaching a strong current that could carry it to the Florida Keys and the pristine white beaches of Cuba's northern coast, the AP said.

As the slick spreads, government officials on Tuesday announced they were closing one-fifth of federal waters in the Gulf to fishing—a major blow to the seafood industry—due to the threat of oil still leaking from a well opened by the Deepwater Horizon drilling rig, which burned and sank late last month.

On Wednesday, Transocean Ltd.,

which owns and operated the rig leased by BP PLC, suggested that cement blew up through the well that federal regulators didn't oversee tests of a critical safety device.

Transocean Chief Executive Steve Newman told lawmakers he was aware of reports that a vessel alongside the rig reported receiving cement-like debris on its decks after the explosion.

"For the well, the cement that's in the well, to have thrust upward from where it was installed, up through the well bore, out to the rig, out from the rig and onto the deck of this vessel I think is an indication of the magnitude of this catastrophe," Mr. Newman told the House Transportation Committee.

The panel is the latest to probe the events leading up to the April 20 explosion and the response.

Mr. Newman also said that a blowout preventer, which is a last-resort mechanism to shear off a well in the event of a catastrophic pressure surge, had been "fully tested," most recently on April 10 and April 17. But he said that those tests didn't occur in the presence of the Coast Guard or the Interior Department's Minerals Management Service.

"Those tests are conducted by Transocean under the watchful eye of BP," Mr. Newman said. He said that regulators "aren't present on the rig when those tests are conducted."

Meanwhile, wildlife experts are worried about ecological impacts that aren't yet visible—including how the oil, and chemicals sprayed to break it up, may be harming deepwater corals as well as whales and birds that live miles offshore.

"What concerns us most is what we can't see," said Rowan Gould, acting director of the U.S. Fish and Wildlife Service.

In an attempt at ecological triage, those fighting the spill are applying hundreds of thousands of gallons of chemical "dispersants" onto the slick, aiming to break it into tiny particles that then can be digested by naturally occurring bacteria in the water.

But scientists say they don't know how that much dispersant, combined with the thousands of barrels of oil that officials estimate are continuing to gush out of the well every day, will affect sea life.

To answer those questions, government officials and scientists are scrambling to dispatch research ships to collect information.

"There is going to be groundbreaking science to really get a handle on the total impact," said Roger Helm, chief of the U.S. Fish and Wildlife Service's division of environmental quality. "But we all feel very strongly that the impact is very significant."

St. Jude's, Glaxo test ways to fight malaria

By JEANNE WHALEN

Researchers have identified a slew of chemical compounds that could ultimately yield new malaria drugs, according to a study released in Nature magazine Wednesday, as resistance to existing drugs spreads in some parts of the world.

Spread by mosquitoes infected with parasites, malaria kills nearly a million people every year, mostly in the developing world. Existing malaria drugs and other tools, such as bed nets, have helped reduce the disease's impact in some countries. But the malaria parasite has developed a resistance to many available drugs.

Two teams of scientists reporting their findings in Nature set out to find potential new drugs by screening thousands of chemical compounds for those that appear to attack the malaria parasite and prevent it from replicating.

One of the groups, from drug maker GlaxoSmithKline PLC, said it would set up a database with the chemical structures of all the drugs that appeared effective, so that any researchers could carry out further tests on the chemical compounds.

"Neither group claims to have discovered the next antimalarial drug. Instead, they provide a remarkable diversity of novel chemical structures on which to base new antimalarial drug discovery and development campaigns," David Fidock, an associate professor at Columbia University Medical Center, wrote in an editorial published alongside the papers in Nature.

The Glaxo scientists screened almost two million compounds from the company's experimental drug library, finding 13,500 that appeared effective at inhibiting the parasite's growth by more than 80%. About 8,000 of these were also active against strains that are resistant to multiple malaria drugs.

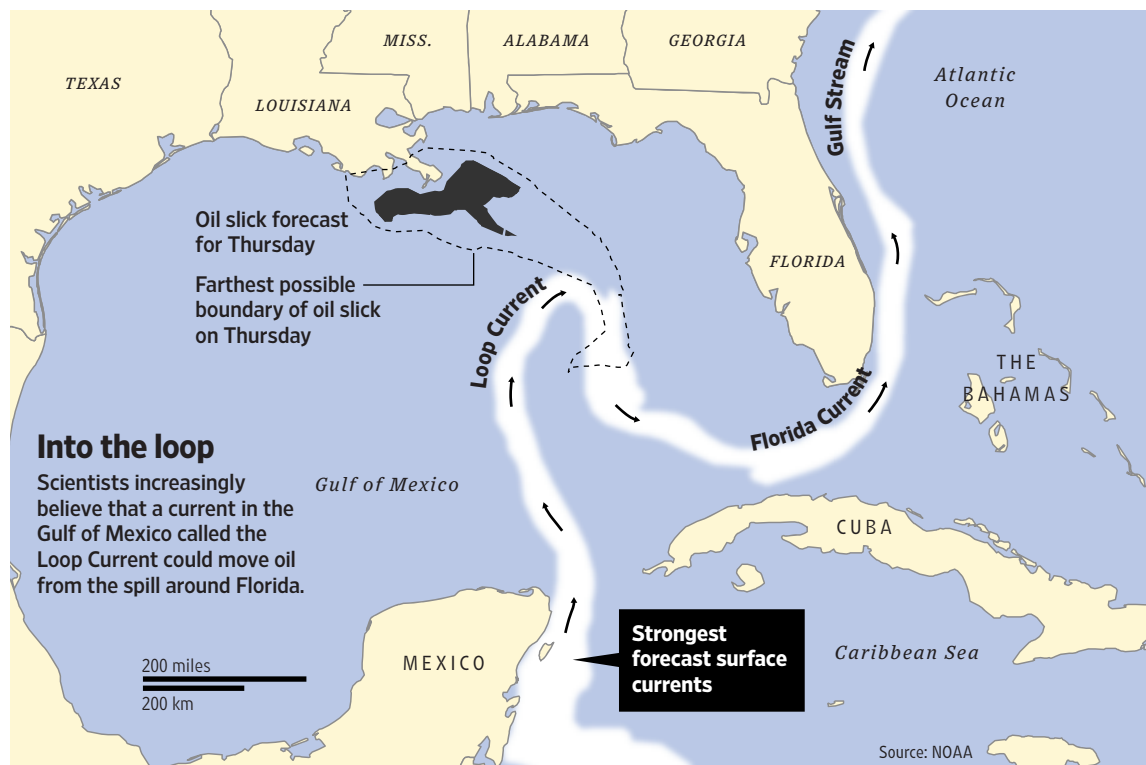
Glaxo then confirmed that several of the compounds are closely related to existing drugs. It said that reinforces the possibility that some of the other compounds might also make effective drugs.

In an interesting twist, Glaxo said that drugs that stop kinase enzymes from working appeared particularly effective at curbing the parasite's growth, suggesting that they were inhibiting these enzymes within the parasite. A number of kinase-inhibiting drugs are already on the market to treat diseases such as cancer; Glaxo's finding could lead to similar drugs for malaria.

Another team, led by researchers from St. Jude's Children's Research Hospital, in Memphis, Tenn., bombarded the malaria parasite with 310,000 different compounds and found that about 1,100 inhibited the parasite's growth by more than 80%.

The scientists whittled these down to the most promising, and tested one in mice, where they found it effective—although positive results in animals often don't translate to humans.

"We're not going to solve the problem ourselves," Patrick Vallance, head of drug discovery at Glaxo, said of the public database the company is setting up.



EUROPE NEWS



Reuters

A man holds a sheep's legs as he shouts antigovernment slogans during the protest

Romanian protests

IMF-mandated cuts generate one of the largest post-Soviet rallies

Associated Press

BUCHAREST—Tens of thousands of public workers gathered in the Romanian capital Wednesday to protest planned government wage cuts meant to shore up the country's ailing economy, threatening to call a general strike if the cuts went ahead.

About 40,000 public workers, teachers, doctors and retirees blew whistles and yelled "Down with the lying government!" and "You have pawned our future," as they protested outside the government offices in Bucharest. The two-hour protest blocked traffic in the city center.

"The government brought us to the streets. Shame on them!" trade union leader Ion Popescu told the crowd. "We are asking the government for the right to a decent life."

The government said the measures are necessary to reduce the budget deficit. Central bank governor Mugur Isarescu said earlier this week that the funds available in the state budget can cover only 20 days out of every month, for the other 10

the state must borrow money.

Romania took a €20 billion (\$24.42 billion) loan from the International Monetary Fund, European Union and the World Bank last year to pay state wages when its economy shrank by 7.1%.

Despite the pandemonium outside his office, Prime Minister Emil Boc said he would ask parliament to

'We are aware that the government will not stop at these measures. In a few months they will increase VAT and the income tax.'

approve the cuts to come into effect on June 1, calling them "the only viable solution for the country's future."

Economy minister official Marcel Hoara was booed and pelted with water and stones after he took part in a live televised debate in the mid-

dle of the protest. Police escorted him from the area.

Union leader Iacob Baci said a general strike will be called May 31 if the government goes ahead with the planned wage and pension cuts. Finance Minister Sebastian Vladescu has said the number of jobs in the state sector must be cut by 70,000 by 2011. There are 1.36 million state-paid workers.

"Our salaries are very small. They weren't good before, but with the cuts we don't see anything good coming," said Valentina Voinea, a 33-year-old nurse who earns 900 lei (\$261) a month.

Unions have rejected the government's plan to lower public wages by one-fourth and pensions by 15%. Workers said they feared the government would raise taxes in the fall.

"We are aware that the government will not stop at these measures. In a few months they will increase VAT and the income tax," said Constantin Dragomir, a 64-year-old teacher. He said that young teachers would be severely affected, because their salaries are lower.

Osborne aims at corporate tax

BY LAURENCE NORMAN
AND ALISTAIR MACDONALD

LONDON—The U.K. corporate tax rate will be lowered and the rules simplified over coming years, Chancellor of the Exchequer George Osborne was due to say Wednesday evening in his first keynote speech as finance minister.

Mr. Osborne vowed a five-year reform of the corporate tax system in a speech to the Confederation of British Industry, although he didn't give details as to how quickly the tax rate will be cut.

The Conservatives had promised before the election to cut the corporate tax rate to 25% from the current 28%, paid for by reducing what they said were "complex relief and allowances." It was understood the tax cut would take place in April 2011.

However with the Conservatives failing to win a majority at the May 6 election and entering into a coalition with the Liberal Democrat party, Prime Minister David Cameron has had to reverse some of his party's tax pledges to accommodate Liberal Democrat promises.

Amid signs of unhappiness from some Conservative lawmakers, the coalition government is due to release a more detailed vision of its platform on Thursday. Underpinning this coalition is the shared belief that "the days of big government are over," the document will say.

The 32 chapter headings underscore the influence of the Liberal Democrats with headings such as equalities, political reform and civil liberties.

On jobs and welfare the coalition promises a number of Conservative policies such as reassessing all claimants of a benefit paid to those deemed physically unable to work and giving the unemployed access to business mentors and start up loans. On education, the document details the Liberal Democrat proposal of increasing the amount of money spent on children from poorer backgrounds and will give schools the ability to pay teachers more based on their performance.

Mr. Cameron has made some significant concessions to Liberal Democrats and some Conservatives have been at odds with aspects of the coalition deal. Deputy Prime Minister Nick Clegg, the Liberal Democrats' leader, said Wednesday said that an appeal court was right to stop two men regarded as a serious danger to

national security from being deported to their native Pakistan due to the risk of torture there. Earlier that day, Conservative Home Secretary Theresa May had criticized the decision. Mr. Clegg also said Wednesday that the government shouldn't withdraw the U.K. from the European Union's Human Rights Act, a key Tory campaign promise.

Several Tories have also criticized the government for proposing a rule that would require 55% of lawmakers, rather than a simple majority, to dissolve a government. The Conservatives' original corporate tax-cut plan had raised some concerns among British businesses. While the reduction in the headline corporate tax rate was broadly welcomed, the plan to abolish some tax allowances raised some concerns.

Mr. Osborne's office confirmed in March the conservatives didn't plan to reduce research-and-development tax allowances but would instead "refocus" them to boost U.K. exports and key sectors like high-tech products.

In his first days in the job, he has already set his sights on the U.K.'s fiscal challenges, promising to deliver £6 billion (\$8.6 billion) in spending cuts and creating a powerful fiscal council to police tax and spending policy and said the government would deliver an emergency budget on June 22.

In his speech, Mr. Osborne was expected to promise a "wholesale" reform of Britain's tax system to make it "both more competitive and more fair."

The reforms would include re-considering the Controlled Foreign Companies rules to make the U.K. more attractive to multinationals. Concerns about taxation of foreign profits had led some multinationals to leave the U.K. although the previous Labour government were also reforming the rules.

"I want multinationals coming to the U.K. not leaving," Mr. Osborne was also due to say.

In a veiled reference to the previous Labour government, he is expected to say "even now there are still those who argue seriously that yet more increases in public spending are the answers to our problems."

Meanwhile, introducing Mr. Osborne, CBI President Helen Alexander sent a word of warning about the Conservatives' sometimes strained relationship with the European Union.

Spain to increase taxes on wealthy

Associated Press

MADRID—Spain will raise taxes for high-income earners to help chip away at the country's outsized deficit, the prime minister said Wednesday.

José Luis Rodríguez Zapatero said most Spaniards agree with him that a special effort can be expected from those better off as the government enacts austerity measures like cutting the salaries of civil servants and freezing pensions.

Mr. Zapatero provided no details

of his tax plans, but said any increase would be of a "limited" nature and not affect the middle class.

"In my opinion, any citizen feels that the effort should be greater from those who have more," the premier told a news conference during a European Union meeting with Andean countries.

As for when an increase might be approved, he said "it will be when the government deems it appropriate, in line with its program for deficit reduction."

Mr. Zapatero's government an-

nounced public-sector wage cuts and other spending reductions last week under pressure from the EU and jittery markets to narrow Spain's deficit. It was the equivalent of 11.2% of gross domestic product last year, well above an EU limit of 3%.

The cuts—also affecting government investment, overseas aid and other spending—are designed to save €15 billion (\$18.32 billion) this year and next.

The cabinet is expected to approve the spending cuts in a decree on Thursday.



Associated Press (Clegg); Agence France-Presse/Getty Images (Osborne)

Nick Clegg, left, pushed for human rights; George Osborne laid out a tax pledge.

EUROPE NEWS

New risk for the euro: central banks

Hedge funds have been much derided for helping to propel the euro's recent decline. But analysts say a larger and more pernicious wave of selling is now unfolding that could drive the common currency even lower.

By Mark Gongloff,
Neil Shah
and Alex Frangos

Some of the world's largest money managers and central banks—which wield far more influence in currency markets than hedge funds—say they are becoming increasingly skeptical of the euro and European assets.

Even if central banks and large managers don't dump euro assets, even a pause in their buying could have a large impact on the currency.

The euro on Wednesday rose to \$1.2386, bouncing from \$1.2143, its lowest level against the dollar in four years hit during the day, and from \$1.2210 late Tuesday in New York. It was only the second gain in seven days against the dollar for Europe's shared currency, which has slumped nearly 15% against the dollar this year.

South Korea's central bank said this month that the euro zone's sovereign-debt problems make the euro, used by 16 nations, less attrac-

tive as a reserve currency. Iran's central bank chief this week said that country may rethink its reserves, which the Central Intelligence Agency estimates around \$81 billion. It's unclear how much of that was in euros. And Russia said it shifted its mix of reserves away from the euro last year.

Mutual-fund data show that in recent weeks, European and U.S. investors have shifted out of euro-zone equity funds. Asia's largest bond fund, **Kokusai Asset Management's** Global Sovereign Fund with \$40 billion under management, lowered its euro allocation from 34.4% in March to 29.6% on May 10, according to a company manager. And portfolio managers with huge money pools, such as **Pacific Investment Management Co.** and **Baring Asset Management**, expressed caution on the euro in interviews with The Wall Street Journal.

Not all money managers are selling euros, and some see the currency's weakness as a buying opportunity. An adviser to China's central bank, a key player in currency markets, said this week it planned to keep diversifying its vast dollar holdings, which has in the past involved buying euro.

While some central banks began paring their euro exposure last year, analysts say the wariness is becoming more apparent.

On the rebound?

How many dollars one euro buys



Money flowed out of Europe at an annualized pace of \$50 billion in the first two months of 2010, according to Jens Nordvig, managing director of currency research at Nomura Securities International. That pace has likely increased in recent months, contributing to the euro's recent decline.

That outflow is likely due almost entirely to large investors, partly because hedge funds likely have reached the upper limit of their ability or desire to place bets against the euro, he suggests.

"Somebody new is selling now," he said.

And unlike speculative investors, long-term investors likely won't quickly change their recent behavior even if the euro enjoys a respite.

"I think it's too early in the evolution of this particular crisis to assume all's well and investors should jump back into places that have burned them in the past few weeks," said Scott Mather, head of global portfolio management at Pimco, the world's largest bond-fund manager.

Many so-called "real money" investors that might be expected to buy the euro on dips in value are staying on the sidelines given Europe's discouraging economic outlook and persistent grumblings in Germany over the cost of bailing out crisis-racked Greece.

"It's making a few people think, 'What am I getting into?'" said Colin Harte, director of fixed-interest and

currencies at the London office of Baring, which has more than \$47 billion under management. "What if you buy the euro and the Germans vote with their feet and leave" the currency union?

While Mr. Harte would normally buy the euro at its current rate, he says he can't predict where it will go from here. His forecast ranges from \$1.10 to \$1.34 by year-end.

Central banks, which held a combined total of around \$7.5 trillion in reserves at the end of last year, form the backbone of the currency markets. Their slow and steady shifts out of the dollars they generally receive from trade or commodities exports, and into other currencies, play a big role in determining exchange rates.

Reserve managers wouldn't need to sell euros at this point to hit the currency hard. Instead, they would merely need to slow down the pace of euro purchases, and that risk is needling market watchers now.

Central banks "are not as active as they had been," said Adam Reynolds, co-head of currencies and fixed income at Société Générale in Hong Kong. His firm, like others, processes currency trades on behalf of central banks, sovereign wealth funds and private investors.

—Katie Martin and Min Zeng contributed to this article.

Germany's move on short-selling roils Europe

Continued from first page

Popular opinion in Germany has cast financial markets as a key cause of Europe's debt crisis, making it harder for Ms. Merkel to paint the bailout as Germany's responsibility and push it through parliament.

Members of her own party have joined in demanding that approval be linked to new restrictions on financial markets. Support is also building in Germany for a financial-sector tax that would make banks bear some of the cost of further bailouts of weak governments.

Speaking in the German lower house of parliament Wednesday, Ms. Merkel cast the bailout package as essential. She said that the euro is undergoing an "existential test" and that the "euro is at risk."

The euro rose in Wednesday trading after slumping overnight Tuesday, though it is still off sharply against the dollar this year.

It wasn't clear whether other countries would follow Germany's lead with the bans on speculative trades.

Ms. Lagarde, expressing displeasure that France and other euro-zone debt-issuers weren't consulted, said France wasn't planning similar restrictions on trade in credit-default swaps. "It's a very narrow market and that sort of trading is not very active in Paris," she said.

Belgium's financial market regulator CBFA was discussing whether to follow Germany's ban on the naked short-selling of euro-zone government debt and credit default swaps, a spokeswoman said. She said talks were being held with other national regulators through the Committee of European Securities Regulators.

In the U.K., the Financial Services Authority said Germany's ban doesn't cover the branches of German companies in the U.K. or busi-

Short response time | Germany caught Europeans off guard with its announcement of restrictions on trading certain derivatives.

<p>"If we don't avert this danger then the consequences for Europe are inevitable. Because if the euro is failing, then Europe is failing...This will all remain in place until other rules [other than those in Germany] are established on a European level."</p> <p>Angela Merkel, German chancellor</p>	<p>"Governments affected should be consulted. France is not considering banning naked [credit-default swaps] on sovereign debt. It's a very narrow market and that sort of trading is not very active in Paris."</p> <p>Christine Lagarde, French finance minister</p>	<p>"It is important that member states act together and that we design a European regime to avoid regulatory arbitrage and fragmentation both within the EU and globally."</p> <p>Michel Barnier, European commissioner for financial regulation</p>	<p>"When you do something like this, you don't take a long run-up."</p> <p>Wolfgang Schäuble, German finance minister</p>

ness done outside Germany. An FSA spokeswoman declined to comment on whether a similar ban is possible in the U.K.

Chancellor Merkel, speaking in German parliament Wednesday, said the regulation will stay in force until it is replaced by an EU-wide statute.

She said German finance ministry officials would present Germany's ideas to representatives of other EU countries in Brussels on Friday.

That date marks the first meeting of a task force set up by Herman Van Rompuy, president of the Euro-

pean Council of governments, to study better ways to resolve economic crises and improve budget discipline across the EU. The task force includes representatives from each of the 27 EU states, with most countries expected to send their finance ministers.

The German finance ministry said the German ban could be expanded to include naked short-selling of all German shares, stock derivatives, derivatives related to euro-zone government bonds and any euro-currency derivatives that "don't

have a role in hedging against currency risks."

The current ban covers 10 financial stocks: **Aareal Bank AG, Allianz SE, Commerzbank AG, Deutsche Bank AG, Deutsche Börse AG, Deutsche Postbank AG, Hannover Re AG, MLP AG and Munich Re AG**, as well as **Generali Deutschland Holding AG**, a German unit of Italian insurer **Assicurazioni Generali SpA**.

Mr. Barnier, who has been pushing broad, EU-wide regulation of financial markets, said he "fully understand[s] concerns about possible

impacts of naked short-selling." He said a formal proposal on trading regulations would come by October and that he was looking at naked short sales "very closely indeed."

A version of a hedge-fund regulation bill in the European Parliament would broadly ban naked short-selling in the EU. That bill would need to be approved by the council of EU governments to become law.

—David Gauthier-Villars, Andrea Thomas, Nathalie Boschat, Adam Cohen, and Jonathan House contributed to this article.

EUROPE NEWS

Russia pursues U.S. teamwork in space effort

By ANDY PASZTOR

WASHINGTON—Russian leaders are trying to use the current thaw in relations with the U.S. to enhance cooperation in space, pushing for joint exploration efforts extending past the life of the international space station.

Russian Deputy Prime Minister Sergei Ivanov spoke over the weekend with Charles Bolden, head of the National Aeronautics and Space Administration, and gave the Kremlin's strongest indication to date that it wants to team with the U.S. to explore more deeply into the solar system.

In a speech and brief interview Monday, Mr. Ivanov said the time is right for the two countries to share financial and engineering resources on possible ventures that would be launched past 2020 and travel beyond low-earth orbit.

The two countries already collaborate extensively on the space station, an international consortium that includes Russia, the U.S. and several other countries. The station is slated to continue for at least another decade.

Both countries need increasing international support to advance in

space. With the U.S. space-shuttle fleet slated for retirement next year and Congress and the White House at loggerheads over its replacement, NASA will be entirely dependent on Russian rockets and capsules to get astronauts to the space station for the next several years. Russia's space ambitions, meanwhile, require outside financial support. In his speech to a meeting organized by the Nixon Center, a foreign-policy group, on Monday, Mr. Ivanov pointedly referred to the immense cost of space exploration.

The Obama administration has also opened the door for enhanced space cooperation, and Kremlin officials appear persuaded the time is right to begin talks about new ventures. Mr. Ivanov said in the speech that "I firmly believe that all our cooperation in space" so far "should bring more and more fruits." Although he didn't mention details, Mr. Ivanov said that "it's time to look beyond" low-earth orbit.

Mr. Ivanov, who has oversight of Russia's aerospace efforts, said after the speech he was "pleased with the tenor of the discussions" with the NASA chief. A NASA spokesman said Tuesday that "building upon several decades of successful cooperation,"



U.S. astronaut Tracy Caldwell Dyson and Russia's Mikhail Kornienko in March at a space center near Moscow.

agency officials and their Russian counterparts "are continuing discussions on potential future cooperative activities in space."

Preliminary discussions have focused on ways to team up to develop more-powerful rockets capable of reaching Mars and other destinations, according to people familiar with the matter. But even with both sides eager for cooperation, major difficulties remain. Mr. Ivanov, for example, was quoted in the Russian media as saying his country wants to aggressively push ahead to develop nuclear-powered engines for rockets. But such a proj-

ect would run into huge political and technical opposition in the U.S., which instead is looking to develop less-costly conventional boosters for longer space flights.

Until recent changes in direction instituted during the Obama administration, NASA policies effectively barred the agency from working with Russian or European partners to develop next-generation rockets or spacecraft intended to take astronauts back to the moon and eventually, on to Mars. By contrast, Mr. Bolden for months has been giving speeches and telling Congress that international cooperation is essen-

tial if NASA hopes to revive its manned-exploration programs.

In his speech, Mr. Ivanov put potential space ventures into a broader context of closer U.S.-Russian ties in various high-tech arenas, including nuclear energy and possible joint manufacturing and marketing of what would be the largest mass-produced cargo aircraft.

Referring to the positive results from joint training of space-station crew members, Mr. Ivanov held out "possibilities for furthering our cooperation in high-tech sectors, such as coordinating" rival satellite-navigation systems.

Kyrgyz leaders seek order

By KADYR TOKTOGULOV

The interim government of Kyrgyzstan declared a state of emergency in the restive southern stronghold of ousted President Kurmanbek Bakiyev, after politically tinged ethnic clashes left at least two people dead.

The interim leadership, in an effort to secure its grip, said Wednesday that acting President Roza Otunbayeva will serve through the end of next year.

Mr. Bakiyev was ousted from power in April during deadly clashes between street demonstrators and security forces in Bishkek, the capital. More recent disorders have pitted supporters and foes of Mr. Bakiyev in the south, touching off fighting between ethnic Kyrgyz backers of the former president and Uzbek adversaries.

On Wednesday, hundreds of ethnic Kyrgyz protesters stormed the University of People's Friendship, which serves as the center of the Uzbek community in the southern city of Jalal-Abad. The protesters were demanding the handover of Kadyrjan Batyrov, a businessman and Uzbek community leader who protesters accused of leading a mob that burned down the deposed president's family home in a nearby village last week, news agencies reported.

A witness in Jalal-Abad said police fired into the air trying to separate the armed rival groups.

Mr. Batyrov told the Associated Press the crowd was led by people close to the Bakiyev family. He said police retreated and the attackers entered the university, smashing



Kyrgyz troops stand guard outside a university in Jalal-Abad Wednesday.

windows and trying to set fire to buildings. Officials said 71 people were wounded in the clashes. Many of them were hit by gunfire, witnesses said.

Ms. Otunbayeva sent the interior and defense ministers to the region in an effort to restore order. A nightly curfew was in force.

The government issued a statement accusing supporters of Mr. Bakiyev, who fled the country after his ouster, of stirring up ethnic hatred in an effort to return him to power.

"We condemn all attempts to foment violence and sow the seeds of discord among our people, especially between Uzbeks and Kyrgyz," Ms. Otunbayeva said in Bishkek.

Ms. Otunbayeva's appointment must be approved by a constitu-

tional referendum scheduled next month. Voters are due to elect a parliament in October. The interim government has yet to set a date for presidential elections; Wednesday's announcement indicated they would be held by the end of 2011. It said Ms. Otunbayeva wouldn't be eligible to run.

The interim government is trying to draft a new constitution and hold elections in the former Soviet republic, which hosts U.S. and Russian military bases.

A violent land dispute between Uzbeks and Kyrgyz in 1990 killed hundreds in southern Kyrgyzstan, which borders Uzbekistan and includes a part of the volatile, densely populated Ferghana Valley, also shared by Uzbekistan and Tajikistan.

Report sheds light on Polish air crash

By RICHARD BOUDREAU

MOSCOW—At least two passengers visited the cockpit of the Polish president's plane minutes before it crashed last month, Russian and Polish investigators said Wednesday in a preliminary report that drew no conclusions about the cause of the tragedy.

The disclosure, based on analysis of voices on the flight recorders, came amid speculation that President Lech Kaczynski or someone in his delegation may have pressured the pilot to ignore an air controller's advice and to try landing in thick fog. But the investigators offered no details about what was said on the recording, and said the theory requires further examination.

Mr. Kaczynski, his wife and all 94 others on board died in the April 10 crash outside the western Russian city of Smolensk. The passengers, including senior Polish government and military officials, were on their way to commemorate the 1940 Soviet massacre of some 22,000 Polish officers and intellectuals.

Tatyana Anodina, the chief Russian investigator, told a news conference that the probe had ruled out an attack, fire, explosion, mechanical failure or faulty ground radar as reasons for the crash of the Polish Tupelov-154 military plane as it descended toward the Smolensk airport. She said the plane was in good condition and had undergone proper inspection.

Wednesday's report by Ms. Ano-

dina, other officials of the Moscow-based Interstate Aviation Committee and a Polish envoy monitoring its work revealed several new details about the flight that pointed to possible factors in the crash.

But perhaps mindful of the two countries' sensitive relations, they avoided definitive conclusions. Russian officials had irritated the Poles last month by speaking of pilot error as the likely cause.

Alexei Morozov, head of the aviation committee's technical commission, said the plane's Polish air force crew had been assembled a few days before the flight and hadn't received regular training that could have helped them cope with unusual conditions. He said the crew had left Poland without a forecast of the weather in Smolensk.

Mr. Morozov said rolling terrain around the Smolensk airport may have distorted instrument readings. The plane crashed about a kilometer away from the runway, in a ravine 15 meters below runway level.

He said investigators also were studying whether the use of cell-phones aboard the plane affected its navigation.

The most intriguing detail turned up by the probe was the presence of at least two voices not belonging to crew members on cockpit recorders. They were heard between 16 and 20 minutes before the crash, officials said.

"The voice of one of them has been identified exactly," Ms. Anodina said.

U.S. NEWS

Inflation muted despite higher costs

Retailers hesitate to pass increases in tab for supplies on to customers amid slack economy; consumer prices dip

BY SARA MURRAY

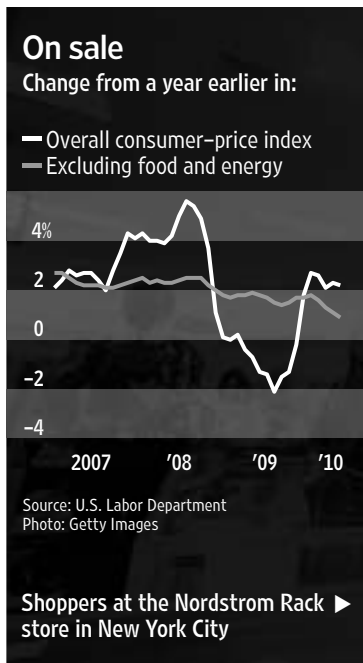
U.S. retailers aren't passing along higher prices to consumers, even though raw-material costs from lumber to cotton have ticked up.

The consumer-price index showed that prices fell 0.1% in April from the prior month, the Labor Department said Wednesday. Stripping out volatile food and energy items, core prices were flat. Core prices were up just 0.9% compared with the same time a year ago, the smallest 12-month increase in 44 years.

Even as producers and wholesalers grapple with rising costs for raw materials, few of those increases are making their way into retailers' price tags. Consumers are still weakened by high unemployment and stagnant wages—real average hourly earnings rose just 0.1% in April, the Labor Department said Wednesday—and are resistant to price hikes.

"Consumers really are getting a huge break as a result of producers not being able to pass through those higher commodity input prices," said Anika Khan, an economist for Wells Fargo Securities.

To remain competitive, home-improvement retailer **Lowe's Cos.** hasn't increased lumber prices even as wood costs have risen, executives said this week. **Wal-Mart Stores Inc.** also reaffirmed its commitment



Shoppers at the Nordstrom Rack store in New York City

to low prices this week, laying out a plan to roll back prices on some items even as certain food costs were rising. And the average price per item at **Whole Foods Market Inc.** has remained flat, despite a spike in produce costs earlier this year and looming concern that the price of meat was likely to increase.

"You need to stay competitively priced in every market that you serve," said Walter Robb, co-chief

executive of **Whole Foods**. "I'm not sure that demand is there to really drive serious inflation."

Prices fell last month for a range of products, from apparel to personal computers to household furnishings. Meanwhile the index for shelter remained flat.

The latest data help to settle a debate inside the Federal Reserve about whether the economy's slack has been pushing inflation lower

still, even after the recovery set in.

Core inflation has been flat or fallen in four of the past six months.

Fed board members last month saw inflation remaining low into 2012, even as they raised their forecast for U.S. economic growth this year to 3.2% to 3.7%, because of slack remaining from the recession, according to minutes from their latest meeting released Wednesday.

However, there is currently little

will at the Fed to do more to stimulate the economy and halt the inflation slowdown. That means core inflation would need to fall significantly below the Fed's forecast of 1.1% to 1.7% this year to spur the Fed to more action.

Producer prices for finished goods, minus food and energy, rose just 0.2% in April. But raw-material prices, except food and energy, were up 4%.

For most companies the rise in materials costs hasn't been large enough, or widespread enough, to warrant higher price tags.

"I still think that even the pressures down the pipe are not that strong," said Gregory Daco, an IHS Global Insight economist. Plus, he said, companies' "final objective ... is to sell. And if they increase their prices in the current conditions they're just not going to sell."

Not every company has been able to swallow cost increases by cutting costs or squeezing profit margins.

Bucyrus International Inc., which makes mining equipment for international users, is raising prices because of escalating costs for raw materials, such as steel, as well as improved demand. "The market remains incredibly strong," said Tim Sullivan, chief executive officer.

—Robert Guy Matthews and Jon Hilsenrath contributed to this article.

U.S. presses China on business, trade

BY DEBORAH SOLOMON IN WASHINGTON AND ANDREW BATSON IN BEIJING

Treasury Secretary Timothy Geithner plans to press Chinese officials to improve the climate for U.S. companies trying to do business in China during a high-level dialogue in Beijing next week.

Mr. Geithner is expected to urge Chinese officials to reverse policies that limit the ability of foreign companies, including U.S. firms, to compete, and to argue that Beijing's efforts to relax discriminatory rules don't go far enough, according to U.S. government officials.

"We need to continue to work to make sure that American companies are competing on a level playing field," Mr. Geithner said during remarks in Seattle Tuesday. "The Chinese government has taken some steps to address these concerns, but we have some more work to do in this area."

The Chinese have their own concerns about U.S. trade policies, specifically efforts by U.S. industries to block what they view as unfair competition from Chinese imports. China's commerce ministry says the U.S. took 23 trade-remedy measures against Chinese goods in 2009, 53% more than in the previous year.

U.S. Commerce Secretary Gary Locke said Wednesday that trade frictions between China and the U.S. have been exaggerated, and argued that the punitive measures imposed by both governments affect only a small portion of the trade between the two countries. "Ninety-seven

percent of the [Chinese] exports to the U.S. aren't affected by these duties," Mr. Locke said in Shanghai.

Another key U.S. goal—persuading China to allow its currency to appreciate—may not dominate talks as originally expected, due to concerns over Europe's ability to contain its sovereign-debt crisis. That could anger some U.S. lawmakers who say China undervalues the yuan against the U.S. dollar to give its exports a competitive advantage.

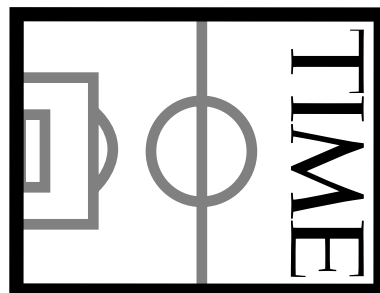
Mr. Geithner will be joined by several officials, including Secretary of State Hillary Clinton and Mr. Locke, for the annual U.S. Strategic and Economic Dialogue, to be held May 24 and 25 in Beijing.

Last month, Mr. Geithner said he planned to use the dialogue, as well as multilateral discussions in June, to push China toward a more market-oriented exchange rate. He delayed a report to Congress on the currency policies of major trading partners, including China, saying the coming meetings "are the best avenue for advancing U.S. interests at this time."

Now, many observers think the turmoil in Europe could further delay any move by China away from the yuan's de facto peg to the U.S. dollar.

"The last thing the Chinese seek is to make their financial markets more volatile," said Kenneth Rogoff, an economics professor at Harvard University.

—Ian Talley, J.R. Wu, Liu Li and Tom Barkley contributed to this article.



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U.S. NEWS

Races show voter appetite for change remains strong

[Capital Journal]

By GERALD F. SEIB



Barack Obama discovered in 2008 that “change” was the most powerful word in American politics. It still is—and there’s no reason to think its potency will dissipate between now and November’s congressional elections.

Tuesday’s batch of primaries, the biggest and most telling of the year so far, brought that reality into sharper relief. Senate candidates who should have won in Kentucky and Pennsylvania suffered defeats that would have been unimaginable just a couple of months ago, because of the unquenched public desire to change the status quo.

And in Arkansas, an incumbent senator who once seemed beyond a challenge from within her own party now has to fight on in a runoff to save her seat, a sure sign that the search for change cuts within both parties as well as across party lines.

All that suggests that President Obama didn’t catch the national change wave at its crest, as many thought at the time, but rather jumped on it only as it was gathering strength. In some ways, all that has changed are the issues fueling the public’s desire to change the political makeup of their capital.

In 2008, Mr. Obama found that the power behind the change wave came from dissatisfaction with two wars and a meltdown in financial markets, and a desire to push aside the Republican party.

The campaigns run by Tuesday’s election victors suggest the forces pushing the change wave at this point are deficit, debt, hatred of Wall Street and dismay over corporate bailouts. Those figure to be the issues that fuel the change impulse through the general election, and incumbents who want to avoid being washed out to sea will have to find messages that work on those subjects.

The other difference, of course, is that an undiminished desire for change this year, unlike in 2008, naturally translates into a desire by voters to push Democrats rather than Republicans out of power. “They want to register their dissatisfaction with the status quo,” says Frank Donatelli, a Republican strategist who helps local GOP candidates around the country. “That makes it much easier for a Republican to be a change agent than a Democrat,” he says.

But Tuesday’s results also suggest that there are ways Democrats can avoid being swamped by the change wave in November. The survival formula for Democrats emerges from the campaigns of Sen. Blanche Lincoln in Arkansas, who by night’s end led a nasty three-way primary in her state, and newcomer Mark Critz, who prevailed in a special election in Pennsylvania to fill the vacant seat of the late Rep. John Murtha.

In both cases, the way to survive is to embrace some populist rhetoric on economic issues, find a solid footing in the political center on social issues and craft an intensely local message.

Ms. Lincoln convinced Democratic primary voters that she knew how to look out for Arkansans; Mr. Critz rode the Murtha legacy of delivering the goods for his Pennsylvania district. In a year when Republicans are developing a national message of opposition to a Democratic president and Democratic congressional leaders, a more local message may be the best way to counter.

As that suggests, some Democrats will be able to ride out the change wave. But just how hard the task will be for others was proven in Pennsylvania’s Democratic Senate primary, which ended the career of 80-year-old Sen. Arlen Specter, the man who is, in the words of Mr. Donatelli, “the ultimate status-quo candidate.”

Mr. Specter tried his own version of catching the change wave by switching parties a few months ago to become a Democrat, a change that brought

The outcome of several U.S. primaries also suggest that there are ways Democrats can avoid being swamped by the change wave in November.

him the support of the national party and President Barack Obama and all the advantages that should carry in a primary election.

But finding a new party didn’t shake the stigma of being the very embodiment of the political establishment, and Mr. Specter, a man whose congressional career began in 1980, lost in the primary to Rep. Joe Sestak, whose career began in 2006. In today’s environment, having 26 years more experience in Washington proved a detriment, not an advantage.

A similar sentiment prevailed in Kentucky, where Rand Paul, now the rival of Sarah Palin for maximum hero among the tea-party set, prevailed by not being the choice of his party’s establishment. Just as having Mr. Obama on his side didn’t help Mr. Specter, so having Senate Republican Leader Mitch McConnell didn’t help Mr. Paul’s foe, Trey Grayson.

Change means not having to apologize for the establishment.

The question for Democrats now is whether Mr. Obama, the man who convinced the nation two years ago that he was the agent of change, can both run Washington and convince voters that he and his party are still interested in changing Washington. The task was a lot more fun in 2008.

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



Rand Paul, bottom, at victory party Tuesday in Bowling Green, Ky., with his wife, Kelley, and other family members.

Voters rebuke parties

Primary results show anti-incumbent trend extends to three states

By PETER WALLSTEN
AND NAFTALI BENDAVID

Sen. Arlen Specter of Pennsylvania, a national figure during 30 years in the Senate, was defeated in a Democratic primary Tuesday, as the election year’s anti-incumbent trend extended to three more states.

In Kentucky, tea-party favorite Rand Paul soundly defeated Secretary of State Trey Grayson, the hand-picked candidate of top GOP officials, including Senate Minority Leader Mitch McConnell.

In Arkansas, Sen. Blanche Lincoln was pushed into a June run-off by a union-supported candidate who portrayed her as a friend of Wall Street banks.

In all three, voters showed they were ready to sever ties with candidates too closely identified with Washington and its political leaders.

“We’ve come to take our government back,” declared Dr. Paul in a victory speech. “This movement, this tea party movement, is a message to Washington that we’re unhappy and we want things done differently.”

In Pennsylvania, Mr. Specter had joined the Democratic Party only last year, concluding that his centrist views meant he could no longer win a Republican primary. Despite his brief time as a Democrat, Mr. Specter had been backed by Presi-



Rep. Joe Sestak with daughter Alex

dent Barack Obama and by Pennsylvania’s Democratic governor and leading labor figures.

His challenger, Rep. Joe Sestak, had argued that the change was emblematic of self-serving moves by Washington political figures to preserve their own power. On Tuesday night, Mr. Sestak cast his victory as “a win for the people over the establishment, over the status quo, even over Washington, D.C.”

Pennsylvania’s Democratic governor, Ed Rendell, a Specter backer, said the public’s distaste of incumbents was “dramatic.”

“There is just a lot of anti-incumbent feeling out there, and it’s tough,” Mr. Rendell said.

Already this season, voters denied Sen. Robert Bennett (R., Utah) the right to stand for a new term, complaining about his vote for Wall Street recovery funds. In West Virginia, Rep. Alan Mollohan lost his bid for a 15th term.

For Democrats, Tuesday’s results revealed a possible toolkit for navigating the year’s challenging political climate. In a closely watched Pennsylvania congressional race to replace the late Democratic Rep. John Murtha, the Democratic candidate, Mark Critz, successfully wooed conservative voters in his party by

opposing Mr. Obama’s health-care law, and by opposing abortion rights and gun control.

Mr. Critz defeated a Republican in a Johnstown-area district that had voted for Republican presidential candidate John McCain in 2008.

As an incumbent, Ms. Lincoln made a virtue of her position in Washington, describing her chairmanship of the Senate Agriculture Committee as a pedestal for her to serve her state’s local needs in the face of an uncaring Washington. Her strategy might foreshadow the tactics of other incumbents later this year. Her challenger in the June run-off is Lt. Gov. Bill Halter.

Republican leaders welcomed to the fold Dr. Paul, whose victory marks a high-water mark for a tea-party movement that has been harshly critical of Republicans and Democrats alike. Dr. Paul, 47, a Bowling Green, Ky., eye surgeon, is the son and protégé of Republican presidential candidate Ron Paul, whose anti-war views made him a GOP pariah in 2008.

“Rand Paul’s campaign recognized the political environment,” said Kentucky’s GOP chairman Steve Robertson. “He tapped into the frustration and concern over the growing federal deficit and the corruption in Washington.”

For both parties, choosing new names for top offices carries risks. Democrats argue that Dr. Paul’s victory in Kentucky leaves them better positioned to pick up the Senate seat now held by the retiring Sen. Jim Bunning, a Republican. They note that Dr. Paul has said the Social Security retirement age probably needs to be raised, and that he wants new controls on the Federal Reserve Board.

The race has given Ms. Lincoln a “greater understanding about the facts at play among the voters and why they’re upset, why they fear the future,” said Steve Patterson, Ms. Lincoln’s campaign manager. “She’s heard the voters and understands their frustrations with Washington.”

—Stephanie Simon
contributed to this article.

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WORLD NEWS

China growth accelerates, poll says

Surprising pace explains why Beijing recently implemented tougher-than-expected policies to cool the economy

BY ANDREW BATSON

BEIJING—China's growth unexpectedly accelerated in the first quarter of 2010, a new poll by The Wall Street Journal shows, as a rush of new bank lending and a raging property boom defied the government's efforts to keep its massive stimulus program from overheating the economy.

The finding helps explain why the Chinese government, which had been taking only mild measures to cool growth, changed tack in mid-April with the announcement of a tougher-than-expected package of restrictions on property lending and purchases. The move has sent the local stock market falling in recent weeks and has raised concerns in other countries that the clampdown on the property market may go too far and damage one of the major drivers of China's recovery.

The poll, the latest in a series the Journal has done quarterly since last year, asks economists for their estimates of China's growth in seasonally adjusted quarter-to-quarter terms. That method is how most major economies report their gross domestic product, but China officially reports changes in GDP relative only to a year earlier—a measure that can be less sensitive to turning points in the economy. The National Bureau of Statistics has said it will start publishing seasonally adjusted sequential growth rates, but hasn't done so yet, so private-sector economists make their own calculations.

According to the median estimates of 12 economists surveyed by the Journal, China's GDP in the first quarter expanded 10.7% over the previous quarter on an annualized, seasonally adjusted basis, picking up from the 10.2% annual growth rate



A construction site in Nanjing, China. A property boom helped fuel surprisingly rapid growth in the first quarter.

in the fourth quarter of 2009.

That acceleration wasn't anticipated by professional forecasters. In the Journal's previous poll in February, the median forecast of economists was for the first quarter's growth to slow to 9.6%. Analysts had expected China's economy to continue slowing gradually from its peak in the second quarter of 2009, when the impact of Beijing's stimulus plan was the strongest.

The economists polled generally think a slowing process will resume after the first quarter's rise. For the second quarter of 2010, the median forecast is for a 9.8% annualized expansion from the previous quarter.

Official numbers also show economic growth accelerating recently, to 11.9% year-to-year in the first quarter from 10.7% in the fourth quarter last year. Yet the government had publicly cautioned against reading too much into the high number for the first quarter, because it was boosted by the comparison with the extremely weak economy in the first quarter of 2009. The estimates of the private-sector economists polled by the Journal suggest the first-quarter pickup wasn't all due to that base effect.

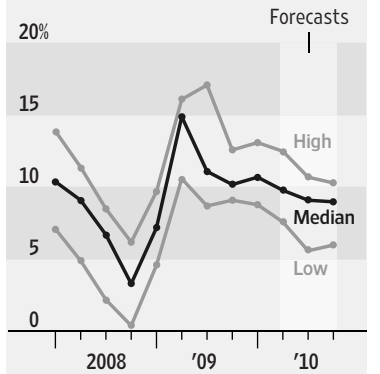
Nonetheless, the opinions of forecasters on China remain divided. Of the 12 respondents to the Jour-

nal's poll, six think growth picked up in the first quarter compared with the fourth quarter, and six think it slowed. The wide range of views, which was also seen in previous polls, reflects the difficulties that even professional economists have in figuring out the direction of the world's third-largest economy.

Without that clear read, China's leadership faces an even trickier task of balancing the risk that the boom may get out of control and lead to an asset bubble, and the risk that activity could slow too much and cause unemployment. Some work by government bodies also had pointed to overheating risks

China's GDP

Estimates of change from previous quarter at a seasonally adjusted annualized rate



Source: The Wall Street Journal poll

early this year. Unofficial estimates from the People's Bank of China, China's central bank, also show GDP growth accelerating in seasonally adjusted quarter-to-quarter terms in the first quarter, though its numbers have tended to show what private-sector analysts say is a suspiciously smooth growth trajectory.

Differences in how economists seasonally adjust GDP can produce big changes in the final number, a problem aggravated by the incomplete and sometimes conflicting official data. The latest poll results also reflect the result of recent revisions by the National Bureau of Statistics to quarterly GDP figures for previous years to show the results of an economic census in 2008.

Most economists see China settling into a path of somewhat slower growth of 8% to 9% by the end of this year. That is close to what many economists think is likely to be a sustainable growth rate for China in future years.

Beijing risks little in Iran compromise

BY SHAI OSTER

BEIJING—China stands to lose little under the compromise on United Nations sanctions to pressure Iran over its nuclear program.

A key holdout on a U.S.-led drive to get a new draft of sanctions before the U.N. Security Council, China has managed to protect its commercial and strategic interests in Iran's vast oil and natural-gas reserves, while helping patch up ragged relations with the U.S.

China has backed three previous rounds of U.N. sanctions targeting Iran's nuclear program starting in 2006. While the U.S. won some significant new measures, in some important aspects, for China, the newest draft doesn't change much from before, and leaves other measures voluntary.

The deal was reached after 20 rounds of "intensive consultations" and "hard bargaining," according to China's state-run Xinhua news agency, citing China's U.N. diplomats.

The draft resolution puts no direct restrictions on investing in Iran's energy sector, which should

allow Chinese oil companies to continue working in Iran. However, tougher limits on financing could make it harder to raise capital for projects, and could affect China's banking sector's work with Iran, and hinder some other trade.

China's support for the sanctions reflects growing frustration in Beijing with Iran's continued stalling on its nuclear program. While the U.S. and others say Iran is seeking to develop nuclear weapons—which Tehran denies—Beijing has more broadly called for a nuclear weapons-free Mideast.

On Tuesday a foreign ministry spokesman expressed hope that the actions of the Security Council can support nonproliferation, as well as peace and stability in the region.

Putting tougher restrictions on the table could encourage Iran to rejoin negotiations—part of the dual-track approach that Beijing has advocated.

China's role in Iran could get bigger if Western companies leave under the threat of sanctions. Already, Iran is threatening to kick out Western firms for dragging their feet on investments.

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WORLD NEWS

Seoul to blame North for ship attack

Officials expected to point to telltale torpedo parts; South Korea will seek penalties while trying to avoid escalation

BY EVAN RAMSTAD

SEOUL—South Korea Thursday will formally blame North Korea for sinking a South Korean warship and killing 46 of its sailors, and the South's foreign minister said Wednesday it had marshaled enough evidence to seek international penalties.

North Korea has been suspected from the moment an explosion tore apart the Cheonan patrol ship, sinking it near the inter-Korean border in the Yellow Sea on March 26.

But South Korean officials waited until recovering the ship's bow and stern before explicitly stating that a torpedo caused it to explode. And now, after three weeks of examination by investigators from the U.S., Britain, Australia, Sweden and South Korea, the Seoul government is ready to officially point the finger at Pyongyang.

South Korean defense officials have described some of the findings in recent weeks, including how satellite photography of a North Korean port showed a submarine was missing for several hours before and after the Cheonan sank. Investigators also found explosive residue and metal fragments of a torpedo that matched one of North Korean origin, officials have said.

Several South Korean newspapers on Wednesday reported that investigators found a torpedo propeller with lettering that appears to be from North Korea. A spokesman for the defense ministry declined to confirm those reports, however.

Also on Wednesday, Foreign Minister Yu Myung-hwan told reporters it was "obvious" that North Korea sank the patrol boat. "We will take appropriate measures in a firm and cautious manner," Mr. Yu said.

He added that the South's inves-



Associated Press

The Cheonan's wreckage is said to bear signs of North Korea attack; a soldier from the North at the DMZ on Wednesday.



tigation yielded enough details to seek a penalty at the United Nations Security Council but that it was premature to discuss such action.

The North has blamed South Korea for the incident but hasn't explicitly denied involvement.

Senior government officials, including Mr. Yu and Defense Minister Kim Tae-young, on Tuesday listened to investigators describe what they found. President Lee Myung-bak, who received a separate briefing, plans to speak on the matter in a national address next week, a spokesman said.

South Korean officials are expected to seek penalties, starting with some

form of censure or sanctions imposed by the U.N. North Korea reacted harshly to U.N. sanctions imposed after it tested a nuclear weapon last May. Some analysts say North Korea may undertake another nuclear test in the face of further international condemnation.

South Korean officials have also been discussing unilateral penalties, including cutting the few remaining economic connections with North Korea, restarting official government-sponsored radio broadcasting aimed at the North and changing some of the procedures its military uses when confronting the other country.

But neither South Korea nor the

U.S. have much ability to punish North Korea militarily because of the North's long-held ability to attack the South with hundreds of rockets and missiles. South Korea's capital, Seoul, is just 50 kilometers from the North-South border.

Senior U.S. officials said Secretary of State Hillary Clinton, who is scheduled to leave Thursday for a visit to the region, will raise the issue while in Beijing, Tokyo and Seoul.

Washington wants to demonstrate a strong response to Pyongyang without risking a military escalation between the two Koreas, the U.S. officials said. They said one casualty of the Cheonan issue will

likely be the six-party negotiating process over North Korea's nuclear program, which includes the U.S., China, South Korea, North Korea, Japan and Russia. Pyongyang has refused to take part in the talks for more than a year, instead seeking international recognition as a nuclear-weapons state.

Mrs. Clinton will also face the delicate task of discussing the Cheonan matter with officials in China—North Korea's largest trade partner, economic benefactor and supporter. Seoul was irked when Beijing waited nearly a month to offer condolences for the South Korean sailors killed. Chinese President Hu Jintao two weeks ago hosted North Korean leader Kim Jong Il in Beijing.

North Korea's state media in recent weeks issued critical statements in response to South Korean news reports about the Cheonan investigation.

Pyongyang said Tuesday that its parliament would convene early next month for the second time this year, an unusual step for a group that usually meets once a year to rubber-stamp actions taken by Mr. Kim. North Korea didn't say why the group would meet, though analysts in Seoul speculated on a connection to findings in the Cheonan incident.

Tensions between the Koreans have remained high since the Cheonan's sinking. On Sunday, a North Korean fishing boat and naval patrol boat crossed south of the inter-Korean maritime border. The fishing boat turned back after South Korea's military issued a radio warning. The military vessel returned only after a South Korean patrol boat fired two warning shots.

—Jaeyeon Woo in Seoul and Jay Solomon in Washington contributed to this article.

Violence rocks Bangkok after crackdown on protesters

Continued from first page
hisit's government, which has now withdrawn an offer to hold elections in November.

"The list of episodes that embitter people on the Red side has just been lengthened," said Michael Montesano, an expert on Thailand and a visiting research fellow at the Institute of Southeast Asian Studies in Singapore.

At the same time, the Red Shirts may be capable of outflanking the armed forces with hit-and-run attacks. "The Reds feel they've been disenfranchised, and now they don't respect the system anymore," said Thitinan Pongsudhirak, a professor of political science at Bangkok's Chulalongkorn University.

Outside Bangkok, protesters in the northern city of Chiang Mai built barricades around government buildings while demonstrators set fire to government offices in Udon Thani and damaged the City Hall in Khon Kaen, both in northeastern Thailand. Later, the Thai government expanded the curfew.

Economists said Wednesday's rioting could further damage Thailand's economic prospects at a time when its peers are rebounding sharply from the global financial slump.

At dawn Wednesday, hundreds of

soldiers began massing on the approach roads to the heavily fortified protest camp. Midmorning, armored tanks rammed barriers constructed from sharpened bamboo staves and kerosene-soaked tires, and soldiers slowly ventured into the camp as protest leaders prepared to surrender and hard-liners fired grenades.

Speaking at the protesters' main stage in the early afternoon, one of their leaders, Jatuporn Prompan, explained they had to call off the rally to prevent any more people dying. Around 70 people have been killed since the demonstrators launched their campaign, with more than half of those deaths in recent days.

As he spoke, explosions could be heard and militant Red Shirts in the area began setting fires, filling the afternoon air with choking black smoke. People in the crowd, many of them women and elderly, wept and pleaded for Mr. Jatuporn and another leader, Nattawut Saikua, to change their minds. Instead, the two men went with other Red Shirts to surrender at Bangkok's police headquarters nearby, and Thailand's crisis entered a dangerous and unpredictable new phase.

—Eric Bellman, Patrick Barta, Wilawan Watcharasakwet and Alex Frangos contributed to this article.



European Pressphoto Agency

Antigovernment protesters flee as smoke rises at the Central World mall during clashes in Bangkok on Wednesday.