REVIEW & OUTLOOK

Mr. Spitzer's Allies

The news for insurance broker Marsh & McLennan keeps getting worse, with shareholders reeling from a 40% drop in the stock price and 3,000 workers soon to be laid off. Which brings up the unexplored question of precisely who benefits from Eliot Spitzer's campaign against the insurance world.

How politicians and the trial bar share a common anti-business interest.

To listen to the New York Attorney General, this is about cleaning up corruption on behalf of the public and insurance customers. And certainly Mr. Spitzer has unearthed some isolated examples of wrongdoing. Employees of at least one insurer have pleaded guilty to using fake quotes to drive up insurance prices.

Yet while society is served by holding individuals accountable for fraud, a bigger mystery is who gains from Mr. Spitzer's more sweeping assault on basic industry practices. So far as we can see, the answer is that these anti-corporate campaigns largely end up benefiting politicians and their allies in the trial bar. The mutual back-scratching between those two camps, conducted in full view on a growing number of public policy issues, deserves far more scrutiny.

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Mr. Spitzer's assault on "contingent commissions"—or payments insurers provide to brokers who secure or renew them a certain amount or type of business—is an instructive example. The AG's outrage is strange considering that "contingents" have been around for decades and have only grown more transparent over the years. State insurance regulators have never moved to bar them. Even the main industry group for insurance customers (the supposed victims of contingents) hasn't condemned the payments.

Bill Lerach

Meanwhile, Mr. Spitzer's suggestion that insurance clients will get a better deal without contingents is debatable, to say the least. Insurers don't pay contingents to brokers for nothing; they pay because these middlemen provide a service in vetting clients and guaranteeing good return business. Insurers will either have to pay someone else to do that job, or swallow more risk. Either way premiums will remain as costly, if not costlier.

So why the Spitzer campaign, and why now? Consider the following timeline, dating back more than five years. That's when contingents first became a subject of public debate. Insurance clients were criticizing the brokerage industry for not divulging enough payment information, and so starting in 1998 a leading brokerage trade group began recommending full disclosure, while the large brokers entered into formal agreements with clients to do so. The New York state regulator even issued a rule for greater transparency.

The industry's reward for making these adjustments was to become the new trial-bar target. Several law firms filed test lawsuits—arguing that contingents were unfair business practices, "kickbacks," or worse—in tort friendly arenas such as California and Illinois. Things went quiet as cases worked their way through the system—that is, until last fall.

That's when the tort bar got a few green lights from the judiciary in Illinois. In one case, first filed against broker Arthur Gallagher in 2000, an appeals court reinstated the suit after it had been dismissed by a lower court. And in another against giant Aon, a judge refused the company's request to dismiss; by July the judge had cleared the way for the suit to become a national class action.

Within months, Mr. Spitzer had launched his own investigation into contingents. (It wasn't until September that the AG stumbled across the illegal bid-rigging.) A few of his usual partners-in-lawsuits, Connecticut AG Richard Blumenthal and California insurance commissioner John Garamendi, weren't far behind. The tort bar seemed to be apprised of various probes. One partner at Anderson, Kill and Olick—behind a California suit against insurers—said in May that he'd been contacted earlier in the year by "regulators" from two states about contingents.

By August—two months before Mr. Spitzer announced his charges—the giant of class-action firms, Milberg Weiss, had landed a lawsuit against the top brokers. When Mr. Spitzer finally filed his complaint, it was met with glowing headlines to add to his scrapbook for his upcoming Governor's run. And Milberg was perfectly positioned to expand its lawsuit within a few days to include a half-dozen more deep pockets, ahem, brokers.

The Spitzer complaint also inspired a flood of new lawsuits within days of his going public, including a class action suit from the king of trial lawyers, Bill Lerach—this one against insurers. Mr. Lerach's firm was rewarded for its pluck when Mr. Garamendi (who is himself eyeing the California governorship) hired it to pursue any state claims against the industry.

In an interview on Friday, Mr. Spitzer told us he didn't have any knowledge of the lawsuits save "one case filed out West" before he began his investigation, and that what inspired his probe was a letter from the Washington Legal Foundation. He said his office may have spoken to people in the trial bar industry, including Eugene Anderson (of Anderson, Kill and Olick), though solely "to understand the issue" at the beginning of the probe, adding that "we do not work with the plaintiffs bar." He also argued that lawyers may be worse off due to his complaint, since his goal of recovering financial damages from defendants would leave less money for lawyers.

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We want to be clear that we aren't alleging formal collusion among these parties. But regardless of motive and communication, there certainly is a clear community of interest at work: Trial lawyers target an industry; politicians later get media kudos for pursuing said industry; lawyers, in turn, find their original cases bolstered in court. The targeted industry, meanwhile, has every incentive to settle the cases to limit its headline risk and put the matter behind it—never mind that most of the practices in question have been, and still are, perfectly legal.

The lawyers and politicians certainly do well, but about the broader society we have our doubts. The legislators or appointed regulators chosen by voters to make these public policy decisions are made irrelevant by Mr. Spitzer's legal *force majeure*. The companies involved pay a huge ransom to the trial bar, while shareholders watch the value of their holdings plummet, employees lose their jobs, or consumers pay more for goods and services once companies are forced to pay billions of dollars in settlements.

One way of fixing some of this is the tort reform President Bush has said he wants passed in his new term. But another is simply for the public, and especially the press corps, to begin asking who really benefits from these anti-corporate assaults.

Gay Lessons

So John Kerry lost the election not because most of the nation rejected his approach to Iraq or health care or taxes. Rather, he lost because President Bush succeeded in energizing the Bible-thumping homophobic masses averse to redefining marriage.

Trusting democracy instead of the courts.

Or so goes the story line emerging from Blue America media outlets. It's been extrapolated from exit polling on the primacy of "moral values," and from the fact that referendums to ban gay marriage passed easily in the 11 states where they were on the ballot. But we think these returns tell a different story, and it's one that liberals who are so contemptuous of Red America ignore at the risk of more political peril down the road.

True, weekly churchgoers voted overwhelmingly for Mr. Bush. But they comprised the same 42% of the electorate as four years ago. It's self-described moderates (some 45% of the electorate), who made the difference this year. Nearly half went for the President, and if opposition to gay marriage was one of the issues that stirred these swing voters, don't blame bigotry or ignorance. It's more accurate to say that proponents have overreached.

The country is engaged in an honest and open debate about gay marriage. On the one hand, 41 states have bans in place, and polls show that the public opposes same-sex marriage by roughly 2 to 1. On the other hand, most Americans also oppose amending the U.S. Constitution to prohibit same-sex marriages and seem amenable to allowing gay couples something short of the "marriage" designation. Fifty-two percent of Bush voters are in favor of civil unions, as is the President himself.

The 11 gay marriage bans that passed on Election Day represent a public backlash against efforts by liberal courts and others to end this national conversation prematurely. Americans aren't intolerant but they don't want unelected judges and grandstanding public officials imposing their own moral standards by legal diktat. You needn't be a bigot to have a problem with four out of seven judges on the Massachusetts Supreme Court taking policy decisions out of the hands of voters and legislatures, or with San Francisco Mayor Gavin Newsom defying state law (and invoking Rosa Parks) to issue more than 4,000 marriage licenses to gay couples.

The lesson here for gay rights activists is to trust the democratic process, rather than use the courts to circumvent it. Public attitudes toward homosexuality are much different than they were even 20 years ago, with (for example) many companies already offering benefits to gay partners. Letting voters reach a democratic consensus on their own schedule is also a good way to avoid a repeat of the endless cultural warfare that has stemmed from that monument to judicial activism known as *Roe v. Wade*.

In the meantime, if liberals really care about discriminatory legal protections and benefits, they might consider agitating for a repeal of the death tax, which puts gay couples at a disadvantage. Married couples are allowed an unlimited transfer of assets to a spouse before death, a tax benefit denied gay couples. And only heterosexual spouses can inherit each other's assets without paying estate taxes.

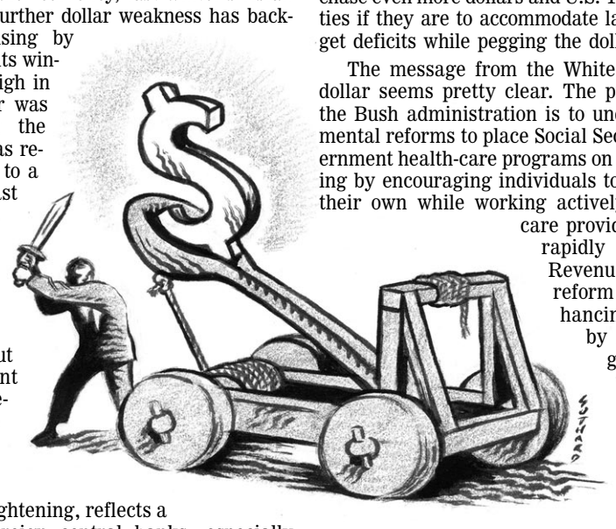
Every poll we've seen shows tremendous support among gays for eliminating the tax. And it's certainly a more productive use of energies than branding the majority of Americans homophobic for taking time to consider whether the 5,000-year old institution of marriage needs to be upended.

For a Few Dollars More

By John H. Makin

Concern abroad about dollar weakness has risen sharply in recent weeks as the trade-weighted dollar has dropped by 6% since Labor Day with two-thirds of the fall coming in the last few weeks. This recent dollar fall continues a weak dollar trend that began at the end of 2002. The trade-weighted dollar fell by about 20% between late 2002 and the winter of this year. During February and March, the dollar's slide was temporarily reversed by a concerted program of dollar-buying intervention led by Japan's Ministry of Finance that purchased an extraordinary $130 billion (about a quarter of one year's U.S. current account deficit) in the space of a little over a month. Overall dollar purchases by foreign central banks during the first quarter of this year amounted to over half of the U.S. current account deficit, an unprecedented level of currency intervention.

As with most episodes of currency intervention aimed at trying to fight fundamental pressures for a weaker currency, last winter's Asian stand against further dollar weakness has backfired. After rising by about 7% from its winter lows to a high in May, the dollar was steady during the summer, but has resumed its drop to a level below last winter's lows that prompted the Asian intervention surge.



David Gothard

The dollar's recent bout of persistent weakness, despite the strong fundamentals of the U.S. economy and Fed tightening, reflects a decision by foreign central banks, especially those in Asia, to reduce their dollar buying and subsequent accommodation of a rising U.S. current account deficit through purchases of U.S. Treasury securities. In the weeks following Oct. 1, foreign central bank holdings of treasuries have risen by just $9 billion. That amounts to an annual rate of $95 billion, still substantial, but far below the U.S. annualized $600 billion current account deficit. Some of the reduced purchases of U.S. government and agency securities may reflect a decision to keep intervening in currency markets while diversifying accumulated reserves into other currencies, like euros, instead of buying U.S. Treasury bills or notes or agency paper. Either way, the dollar falls.

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There are three reasons why foreign central banks have decided to reduce their accommodation of U.S. external deficits. First, and most compelling, is the simple fact that heavy dollar buying by Asian central banks to prevent deflationary appreciation of their currencies amounts to a subsidy to U.S. consumption, which, in turn, produces higher and higher U.S. current account deficits while encouraging excess capacity in Asian export industries. The U.S. current account deficit measures the supply of dollars flowing into foreign exchange markets. The outcome whereby dollar buying by foreign central banks leads to the need for still more dollar buying has, over the past six months, led the Asian central banks to discover that their dollar-buying efforts are destabilizing. Buying $1 today to prevent dollar depreciation requires buying $1.50 tomorrow to achieve the same goal.

The U.S. trade deficit (which constitutes the bulk of the U.S. current account deficit) averaged $51.8 billion per month in the three months ending September. This is up sharply from the $41.4 monthly average in 2003. Little wonder, since as a result of heavy Asian central bank dollar buying, the dollar has only depreciated by 2% against the Japanese yen over the past year and, of course, has depreciated not at all against the Chinese yuan by virtue of the Chinese government's decision to peg its currency to the dollar. The currency adjustment mechanism is not being allowed to operate against the countries (China and Japan) which have the largest ($226 billion annualized through September) trade balance surpluses with the U.S. that are also among the fastest rising.

The problem with China is especially acute. By virtue of the Chinese currency peg to the dollar, China and the U.S. have the same central bank—the Federal Reserve—but need very different monetary policies. If the U.S. were growing at over 9% with inflation having accelerated rapidly to nearly 6% during the past six months, as has occurred in China, the Fed would surely be tightening much faster than at its current "measured" pace. Based on fundamentals, the yuan needs to appreciate while the dollar needs to depreciate. Preventing this adjustment places a greater burden on other currencies, such as the euro and the yen, to absorb dollar weakness.

Beyond the decision by Asian central banks to reduce their dollar purchases, are two other proximate reasons for the enhanced weakness of the dollar over recent weeks. As the cost of oil (priced in dollars) has risen, the temptation to allow one's currency to appreciate in order to stabilize the local currency price of oil imports has increased. With the euro and the yen rising against the dollar, the price of oil measured in those currencies has risen less as they have appreciated against the dollar. Central banks and finance ministers in Europe and Asia have said as much.

Finally, the strong re-election victory of President Bush has been taken abroad as a signal, rightly or wrongly, that the U.S. government's dis-saving (budget deficits) will continue to rise, thereby obligating foreign governments to purchase even more dollars and U.S. Treasury securities if they are to accommodate larger U.S. budget deficits while pegging the dollar.

The message from the White House on the dollar seems pretty clear. The primary aim of the Bush administration is to undertake fundamental reforms to place Social Security and government health-care programs on a sounder footing by encouraging individuals to save more on their own while working actively with health-care providers to contain rapidly rising costs. Revenue-neutral tax reform aimed at enhancing efficiency by lowering marginal tax rates while closing loopholes is also on the agenda.

While undertaking these important reforms, which will allow markets to work better to enhance the long-run growth path of the U.S. economy, the Bush administration is also prepared to let markets determine exchange rates. That means that European and Japanese pleas for the U.S. government to join in intervention efforts to stabilize the dollar will go unheeded. Their choice comes down to either letting the dollar adjust or buying ever-increasing quantities of dollars.

The second message to governments in Europe and Japan, who fear the deflationary impact of further appreciation of their currencies against the dollar, is to press the Chinese to allow their currency to float upward. China's currency peg to the dollar has meant that its currency has depreciated rapidly along with the dollar. Inflation pressures in China have increased while the cost of oil imports for China's heavily oil-dependent export industries has increased as well.

China's domestic economy has also been destabilized by its currency peg to the dollar. Higher inflation and pegged interest rates leading to potential disintermediation in China's inflexible financial system have already forced Beijing to begin to allow interest rates to rise. Chinese savers don't want to earn 2% on bank deposits while 6% inflation erodes the purchasing power of savings. China's recent move toward greater flexibility of interest rates, hopefully, portends more overall flexibility in China's financial system that will include currency appreciation in order to reduce its need to purchase dollars while simultaneously cushioning China's oil-dependent economy from higher oil prices. Even a moderate 10% or 15% revaluation of China's currency, perhaps through a transition to a Singapore-style currency basket, would ease the pressure for dollar weakness against other currencies like the euro, the yen, and the currencies of Korea and Taiwan.

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The reluctance of America's trading partners to allow dollar depreciation, even as the U.S. current account deficit has grown to a point where nearly $2 billion a day must be purchased in order to keep the dollar stable, has created a massive global imbalance. U.S. consumption is being artificially elevated to support rising excess manufacturing capacity in Asia and Europe. While adjustment will involve some transitional pain, the emergence of a virtually zero U.S. saving rate, while Chinese investment rises at a 40% annual rate, is not sustainable. Another year of dollar pegging will mean a U.S current account deficit of over $700 billion and a negative U.S. saving rate. Better to start the adjustment now and let markets determine exchange rates.

Mr. Makin is a visiting scholar at the American Enterprise Institute.

What's Wrong With Combat Pay?

By John Berlau

American soldiers are risking their lives in Fallujah. No one would say that they don't deserve a special bonus for wearing America's uniform in these embattled times. No one, that is, except many members of Congress—Republican and Democrat. While these pols fall all over themselves to argue how much they support the troops, they back a policy called "pay parity"—which sends the message that the soldier risking his or her life in Iraq is just like any other government worker.

"Pay parity" dictates that federal military and civilian workers must get the same percentage increase in pay. The concept has governed in most of the last 20 years of congressional appropriations, but the Bush administration has argued that a special raise is in order for the armed services. The administration's budget for fiscal year 2005 provides for across-the-board pay increases of 3.5% for military employees and a smaller raise for federal civilian workers.

But even with a war on, government employees' unions and many in Congress still make the argument that soldiers serving in Iraq and bureaucrats at the IRS are equally important to the well-being of America. Tom Davis (R., Va.), who represents suburbs of D.C. that many federal workers call home, states that "both civilian and military employees are the government's greatest asset." House Minority Whip Steny Hoyer (D., Md.), with a similar constituency, asserts that "Congress and the White House should not undermine the morale of dedicated federal public servants by failing to bring their pay adjustments in line with military personnel." Colleen Kelley, president of the National Treasury Employees Union, says that ending pay parity would send to federal employees the message "that their work is . . . not as valued, and not as vital as that of . . . military counterparts."

Yet if members of Congress are as concerned about soldiers as they say they are, the message to Ms. Kelley and her ilk must be that, as important as some of the work done by civilian employees is, their work is not as indispensable as that done by the soldiers keeping our country free. Congress still has a chance to change this policy in the lame duck session.

Opponents of pay parity also warn that sticking to existing policy in the coming years could hamper the efforts to retain the best soldiers in the military. They also refute arguments used to support pay parity based on the supposedly large pay gap between federal-civilian and private-sector workers. Rep. Ernest Istook (R., Okla.) points out that over the last four years, pay raises for federal civilians have been double the Consumer Price Index's cost-of-living increase. Federal workers also get the day off with pay on 11 federal holidays, more paid time off than most private-sector jobs provide. And, of course, American troops in Iraq and Afghanistan don't get any holidays from being in harm's way.

Besides, in wartime, federal civilian workers should understand why the military should get priority in pay raises. As Ramona Fortanbary, editor of Veterans' Vision, writes, "These patriotic men and women, who after all did choose government service over more lucrative private employment, can and will understand that . . . at times of great demand upon the military services . . . the troops need the money more."

Mr. Berlau is a journalism fellow at the Competitive Enterprise Institute.

To Be or Not to Be

By Bernard Lewis

The death of Yasser Arafat again raises the question of whether there is any possibility of negotiating a peace between Israel and the Palestinians, now under a new and perhaps different leadership.

There are many aspects to this problem but one crucial one that often goes unmentioned. The demand for a Palestinian state is accepted by most people, including most Israelis, as a reasonable one. There is, however, a serious question—is their objective a Palestinian state alongside Israel or in place of Israel? In other words, is the issue the size of Israel, or the existence of Israel? If it is the second, then obviously there is no hope of a negotiated peace. No government of any country is going to negotiate on whether it should or should not exist, and there is no compromise position, at least for a state, between existing and not existing.

If one assumes that the very existence of Israel is illegitimate, then any action against Israel, including a suicide bombing in a Tel Aviv discotheque, is defensive, while any Israeli action to prevent such attacks is offensive. The discourse on the Arab side, especially but not exclusively in Arabic, leans heavily in the direction of an existential issue in which, therefore, the best that one could hope for is a tactically conceded truce, to gain time for regroupment.

If, on the other hand, the issue is the size of Israel, and this is accepted in internal as well as external discourse, then it becomes what one might call by comparison a straightforward frontier question—like Alsace-Lorraine or Texas or Kashmir; in other words, neither simple nor easy, but manageable and in time solvable, with the right dose of realism on both sides.

For the moment, however, the clear message from the Palestinian camp and from many of their Arab and other supporters is that the issue is the legitimacy, that is to say the existence, of Israel as a Jewish state. As long as this remains so, the struggle can only end when the Arabs either achieve or relinquish their purpose. Neither seems very likely at the present time.

Mr. Lewis, professor emeritus at Princeton, is the author, most recently, of "From Babel to Dragomans: Interpreting the Middle East," (Oxford, 2004).

Time to Grow Up

By Dave Hoppe

July 14, 2009: The Senate Judiciary Committee is holding its first day of hearings on the newest Supreme Court nominee. The buzz is louder than normal because this confirmation is critical. Unless the Senate is able to make a decision and confirm a justice by the first Monday in October, the Court will start its next term without a quorum of six. Implausible that we might one day have four unfillable vacancies on the Court? Think again.

How to fix the entire nominations system in the Senate? While Senate judicial confirmation problems get the most press, they're but the tip of the iceberg. The public rarely sees the subsurface difficulty of getting nominees approved for any position. This process also threatens to leave important positions unfilled and deters qualified candidates from accepting nominations—leaving those positions to be filled by whoever can thread his way through the maze, as opposed to the best person who can be found on either side of the aisle. I believe the Senate should adopt a logical, bipartisan solution to this problem, and the faint blush of goodwill following the Bush re-election offers a perfect moment for compromise.

My proposal would be to change the Senate rules so that every nominee would be *guaranteed* a vote on the floor. The committees would retain an advisory role, but wouldn't be able to scuttle a nominee. After a nominee is submitted to the Senate and has handed in the paperwork, the committee would have 20 session days to hold a hearing. Then the committee would have another 20 session days to vote on the nominee. If after these days have elapsed, the committee has not voted on the nomination, the nominee would be discharged from the committee and placed on the executive calendar. Then the full Senate would have 20 session days to vote on the nominee on the floor. If it has not voted after these days have elapsed, any senator would be allowed to bring up the nomination for a four-hour debate and vote. No extended debate would be allowed on a floor vote on a nomination. Every nominee could get a vote in the Senate after his nomination has been in the Senate for 60 session days.

Yes, this would require a Senate rules change that might be hard to achieve, but that very difficulty protects it from becoming a political football. It takes a bipartisan coalition to change these rules. Specifically, the solution is to amend the basic rules by which the Senate operates, the Standing Rules of the Senate. Procedurally, Senate rules changes can be stopped by a mere 34 members. In 1975, the change was made to lower to 60 the number of senators it takes to bring to a close a filibuster on legislation, but the number it takes to cloture a debate on standing rules changes in the Senate was left at 67. Thus once changed, rules are not likely to be changed back without bipartisan support. This curtails the possibility of changing the nomination rules back and forth in a procedural game of "gotcha."

Either party could say no to this change, and it would fail. But at what price? The GOP has already developed a "nuclear option," which reportedly has almost the 50 votes necessary to make a procedural change that would stop all filibusters on judicial nominations. Changing the precedent in this way would lead to open warfare in the Senate. Still more importantly, it is subject to being changed back anytime a coalition of 51 senators (or 50 plus the vice president) wishes. It can be turned on or off by a simple majority.

On the other hand, changing the Standing Rules of the Senate cannot be reversed on a whim, but would take a broad supermajority. Such a partisan majority is not likely to happen in any foreseeable future. Clearly, if this change is made now, or early in the next session, the Democrats would be handing to President Bush the opportunity to have every one of his judicial nominations get a confirmation vote in the full Senate. However, in return, they would get the chance for any Democrat president to get a vote on every one of that person's judicial nominees.

Isn't that a better solution for the institution in the long run?

Mr. Hoppe, a Washington lobbyist, served as chief of staff for Sen. Trent Lott from 1996-2002.