REVIEW & OUTLOOK

Garamendi's Tollgate

One unfortunate consequence of the Enron mess is that it has emboldened too many politicians to extract dollars and headlines by attacking business as a class. The star of this show has been New York Attorney General Eliot Spitzer, but now giving him a run for everyone else's money is California Insurance Commissioner John Garamendi.

The price of getting a merger approved in California.

Mr. Garamendi has scored his latest victory, if that's the right word, with his political exploitation of the Anthem-Wellpoint merger, a $16.4 billion deal that would create the largest managed-care organization in the country. When the companies first announced their merger more than a year ago, most analysts saw it as a positive development. A larger entity would have more negotiating leverage with health-care providers and would give large, multistate employers greater choices in designing their benefits programs. Both might reduce health-care costs.

Mr. Garamendi, however, saw the deal as an opening to extract some political tribute, not to mention headlines for the Democrat's 2006 campaign for Lieutenant Governor. Insurance commissioners exist to ensure that policyholders are covered by financially secure companies. Their decisions to approve, or disapprove, merger proposals ought to be based on the business and regulatory merits.

But Mr. Garamendi has grander ambitions. In the name of protecting Californians from possible higher premiums and lower quality care, he denounced the "outrageous and extraordinary greed" of the two companies' executive compensation. The link between CEO pay and insurance premiums is hardly direct, but never mind. He proceeded to exploit his chokepoint on the merger by withholding regulatory approval of one portion of it—while hinting that his profound concerns would somehow vanish if the companies agreed to supplement the state health-care budget.

Anthem originally refused to play ball, challenging Mr. Garamendi's authority for this kind of shakedown. Yet after months of delay and legal uncertainty, the companies decided this was an offer they couldn't refuse. So they recently agreed to pony up more than $265 million for state-run programs and causes favored by Mr. Garamendi, on everything from nurse training to health care for children. They also agreed to pay even more, on a dollar-for-dollar basis, if the compensation plan for some 300 executives resulting from the merger tops $265 million.

It's hard to see this as anything but a form of political extortion. Unlike politicians of an earlier age, say Tammany Hall, Mr. Garamendi isn't using his power to line his own pockets. Instead, he is extracting a form of political tribute that he can claim credit for and that will enhance his own career ambitions. The only difference is that the "kickback" here is political, not personal, but of course in the long run the political advantage becomes very personal if the Spitzers and Garamendis end up in powerful state offices.

This method of financing state government also lets politicians off the hook for the consequences of their policy promises. If politicians want to shower "free" health care on voters, they ought to be honest about how they're going to pay for it. And if they want to tax mergers like the Anthem-Wellpoint deal, or impose wage controls on CEOs, they should at least have these policy changes pass through an elected legislature and be signed into law by a Governor. The insurance commissioner is behaving like a feudal highwayman—pay up if you want to pass through Garamendi's Gate.

As it happens, the price of paying off Mr. Garamendi is still rising. The Anthem-Wellpoint merger had at one point secured 10 other necessary state insurance-regulatory approvals, but that was before his fellow commissioners saw the profit in Mr. Garamendi's game. Georgia's insurance regulator, John Oxendine (also planning a run for Lieutenant Governor in 2006), is now saying his state's citizens deserve "better" and has rescinded his merger approval until the two companies talk to him about "sweetening" the deal for his state.

Health-care companies may not be popular with much of the public these days, but that shouldn't limit their right to transact business free of regulatory extortion.

Fullam's Folly

The federal judiciary missed its chance to start reforming the asbestos bankruptcy blob last week, and it's the court system itself that will be worse off for it.

Federal Judge John Fullam was recently asked by a group of commercial creditors in the giant Owens Corning asbestos bankruptcy to order up a study of the X-rays of plaintiffs who'd submitted claims to the company. The request came on the heels of mounting evidence that most asbestos claims don't satisfy minimum medical requirements, and it created a singular chance for a judge to explore the heart of the asbestos scam and set a precedent for future cases.

Instead, Judge Fullam last week issued a cursory order denying the request on the bizarre grounds that we already *know* there's rampant asbestos fraud. He noted there was "substantial evidence" that Owens Corning had dealt with "large numbers of claimants who actually sustained little or no harm from their exposure to Owens Corning's products," and that "no useful purpose would be served" to "prove what is already reasonably well known."

The problem here is that believing isn't seeing. Journalists have revealed how tort lawyers cajole healthy people into filing claims, and academics have used available (if limited) health files to suggest that up to 95% of claims are bogus. But trial lawyers know that this anecdotal or incomplete data count for nothing in a specific court case, an argument Judge Fullam has allowed them to keep making by refusing to order up for examination the pertinent evidence (lung X-rays) in the Owens Corning case.

On the logic of Judge Fullam's own ruling, he should now dismiss the majority of claims this January when he rules on what Owens Corning's ultimate "liabilities" are to tort plaintiffs. More likely, however, he will not rise to the day, and instead will let this judicial scandal continue, with even more damage to the economy, to truly sick claimants who aren't getting compensated, and to the judiciary itself.

Budget Trap

Republicans in Congress have been patting themselves on the back since Election Day, but maybe they should pay more attention to the pummeling they've been taking in the past two weeks. Democrats have been scoring by attacking the majority GOP as the party of big, intrusive government.

Why Republicans are spending like Democrats.

Never mind the irony, Republicans have only themselves to blame. The problem is that they are still trying to pass a budget under a process designed when Democrats were in the majority to make it easier to spend taxpayer money without public or executive oversight. After a decade in control of Congress, maybe it's time Republicans changed the rules to serve their purported belief in limited government.

One terrible habit is to pass most of the annual federal budget in one, giant, last-minute spending bill. Democrats refined this technique to escape Ronald Reagan's veto scrutiny, but now Republicans use it to stuff their own goodies into corners that might be overlooked by the media and White House.

This blew up in their faces last week when Democrats discovered a provision that would have given Members of Congress access to individual tax returns. The intention was apparently to let Congress inspect IRS performance, but the language was so sloppy that it would have allowed the intrusion into taxpayer privacy. Republicans tried to remove the language by voice vote with few Members in attendance last week, but Democrats unsurprisingly demanded a recorded vote to extend the GOP's political embarrassment.

This is what happens when no one but a few staffers really knows what is in a bill that is 3,646 pages and more than a foot high. We remember, circa 1994, when Republicans denounced Democrats for not reading the bills that they passed. Now the GOP is guilty of the same practice, which is a recipe for all sorts of secret pork and mayhem getting into law. Is it too much to ask that every bill get at least three legislative days, after it is in final written form, for the Members to read it?

Democrats have also learned to skewer Republicans for their individual "earmarks," which by one account total 18,000 this year and add up to $22 billion. These pork-barrel classics—e.g., $1 million for a "Wild American Shrimp Initiative"—obscure the larger truth that this year's spending bill is actually the first in years to show some restraint. Domestic non-defense discretionary spending will rise by less than 2% in Fiscal Year 2005. But what many voters will remember instead is that Republican incumbents are as spendthrift as Democratic incumbents.

A solution here is for Republicans to change the current budget rules, which were passed by Democrats in 1974 over a Watergate-weakened President Nixon. Those rules were deliberately designed to obscure the budget process to make it easier to spend, and to reduce Presidential leverage over spending decisions. Republicans denounced them throughout the 1980s, but now they embrace them as tools of incumbent protection.

One alternative would be to give the President enhanced rescission authority, which is the power to send individual spending items back to the Congress for an expedited up-or-down vote. This is a relative of the line-item veto, a long-time GOP campaign staple. But earlier this year GOP chairmen of the Appropriations Committee—aka, the College of Cardinals, or Lords of Lard—twisted arms to defeat the measure on the floor of the House.

Another useful proposal would give the annual budget "resolutions" the force of law, so that the Members couldn't blow out their spending limits at the end of the year. This too would shift the balance of budget power away from the Appropriators and to the broader House and Senate membership.

With control of the House, Senate and White House, Republicans are now going to be held accountable for Congress's decisions. If they talk like conservatives but spend like Democrats, voters may decide to elect the real thing.

The Communist Curse

By David Satter

The confrontation over the Ukrainian presidential election results will determine the future not only of Ukraine but also of Russia. In this sense, the decision that will be made by Ukraine—whether it will be ruled by laws or by men—is the most important that has faced a former Soviet republic since the fall of the Soviet Union.

The Ukrainian election campaign bore absolutely no resemblance to a fair contest. Viktor Yushchenko, the opposition candidate, was denied media coverage and was almost certainly poisoned. Viktor Yanukovich, the prime minister, won because, according to an independent watchdog group, 2.8 million ballots were falsified in his favor. There were impossibly high turnouts recorded in Yanukovich strongholds, for example, 96.3% in the Donetsk district and 88.4% in Lugansk, and all but nine opposition poll watchers were barred from 2,000 polling stations in these regions.

Despite this, Vladimir Putin congratulated Yanukovich on a "convincing victory" and the elections were described as "transparent, legitimate and free" by observers from the Commonwealth of Independent States. The support by Russia for obviously tainted elections has been attributed to Russia's desire to prevent Ukraine from slipping out of Russia's "gravitational field." Mr. Yushchenko, who is pro-Western, supports Ukrainian membership in the European Union and NATO whereas Mr. Yanukovich is against Ukraine's early adherence to either organization and supports instead its participation in a "single economic space" including Russia, Belarus and Kazakhstan.

More important than the blow that a Yushchenko victory would give to Russia's desire to dominate the former Soviet space, however, is the blow it would deliver to the emerging authoritarian regime in Russia. The last three presidential elections in Russia were no fairer than the one in Ukraine, and if the Ukrainians are successful in assuring a peaceful transfer of power, it will give new hope to those who want to see democracy triumph in Russia as well.

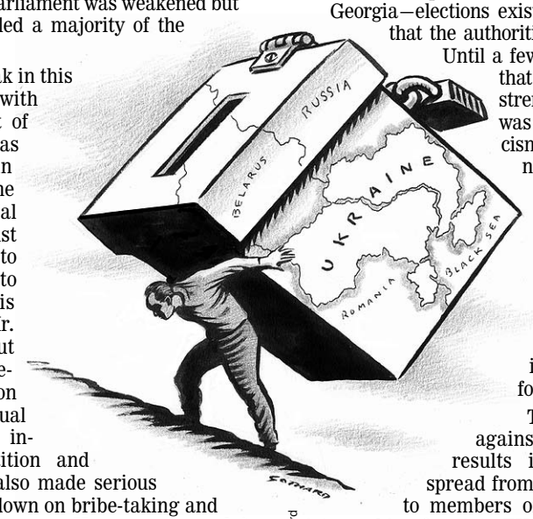
Mr. Yanukovich is the candidate of the government of President Leonid Kuchma, a regime that is corrupt and criminalized even by the unsavory standards of the Commonwealth of Independent States. Mr. Kuchma, the former director of a Ukrainian rocket factory, handed the Ukrainian economy over to a group of communist bureaucrats-turned-businessmen who proceeded, as in Russia, to use their corrupt connections to officials to pillage the country's resources at the expense of its hapless population.

The root of the oligarchs' wealth was Russian gas bought at low prices and sold in Ukraine at a huge markup. The oligarchs enjoyed government-sanctioned monopolies, so their profits were enormous and they often did not even pay for the gas because the government guaranteed their credit. The oligarchic clans expanded into regional conglomerates, taking over steel, energy and chemical production, and insulated themselves against competition with the help of tax exemptions and government subsidies.

The oligarchic system did little good for Ukraine, once, by some measures, the most productive of the Soviet republics. GDP fell by 10% a year in the '90s and Ukraine attracted less foreign investment than even Romania and Moldova. In 1997, the World Economic Forum ranked Ukraine 52nd out of 53 European countries in terms of competitiveness. The system remained in place, however, because the regime controlled parliament, suppressed the media, and, when all else failed, resorted to terror.

Each of Ukraine's three dominant oligarchic clans has its own parliamentary party. The Kiev-based clan of Hryhory Surkis and Viktor Medvedchuk, which has a stake in the gas industry and power utilities, controls the Social Democratic Party, which has 39 seats. The Dnepropetrovsk group, headed by Viktor Pinchuk, who is married to Mr. Kuchma's daughter, controls four big steelworks and directs the Labor Ukraine faction, which has 42 seats. The Donetsk group, a regional conglomerate that became rich on coal subsidies and is headed by Rinat Akhmetov, is represented by the "Regions" faction, with 40 seats. After the March 2002 elections, the grip of the nine oligarchic factions in parliament was weakened but they still controlled a majority of the 450 deputies.

Ukraine's democrats hold a poisoned Soviet chalice.



David Gothard

The only break in this situation came with the appointment of Mr. Yushchenko as prime minister in late 1999, after the Russian financial crash in August 1998 threatened to push Ukraine into default. In his brief tenure, Mr. Yushchenko cut state funding, reducing corruption and creating equal conditions that increased competition and production. He also made serious efforts to crack down on bribe-taking and reform the gas sector. He was removed in a no-confidence vote organized by the oligarchic parties and the communists in April 2001.

Besides controlling parliament, the regime manipulates the press. Hostile newspapers were shut down and independent journalists threatened. Channel 5, the only independent TV station, has been disconnected in one region after another, its managers subject to arrest. At the same time, the non-resisting media has been controlled by secret instructions from the presidential administration. So the four state-controlled national TV stations ignored Mr. Yushchenko during the election campaign while giving saturation coverage to Mr. Yanukovich.

Finally, oligarchic control is enforced with contract killings. In the '90s, Ukraine was the scene of hundreds of such killings, the victims including journalists and politicians. Suspicions that the authorities were themselves behind a large number of these killings were always widespread. The event that, for many, removed all doubt, was the murder of Georgy Gongadze, editor of Ukrainskaya Pravda, an Internet publication that specialized in exposing corruption among oligarchs. In November 2000, his headless body was discovered in the woods outside Kiev. A month later, a leader of the socialist party played a tape in parliament in which Mr. Kuchma is heard suggesting to aides that Gongadze be got rid of: "Deport him. Let the Chechens kidnap him." The tape was provided by a guard who secretly taped Mr. Kuchma's office.

When the Soviet Union collapsed, the republics that emerged as 15 independent states shared an unenviable inheritance. Presented as an economic system, communism, in fact, was an attempt to absolutize political goals for the purpose of destroying morality. This unprecedented attempt to substitute the man-made for the God-given could not but destroy the sense of individual responsibility for millions of people who lived in the former Soviet space.

A result of the absolutization of power in the former Soviet Union is that democracy has taken root only in the Baltic republics. In the other republics—with the possible exceptions of Moldova and Georgia—elections exist to confirm a decision that the authorities have already made.

Until a few days ago, it appeared that Ukraine was about to strengthen this tradition. It was symbolic of the cynicism of the present Ukrainian leadership that the deputy head of Mr. Kuchma's administration reacted to the apparent poisoning of Mr. Yushchenko that has left his face pockmarked and partially paralyzed by suggesting that he should hire a food taster.

The popular revolt against the falsified election results in Ukraine has now spread from Yushchenko partisans to members of parliament, journalists working for state TV, and even members of the security forces. It could, if successful, reverse the relationship between rulers and ruled in Ukraine in a way that is dramatic enough to change the entire political psychology of the former Soviet space. It is for this reason that Mr. Putin has been so adamant in congratulating Mr. Yanukovich on his "victory." The example of a free Ukraine will morally isolate the Russian leadership, making clear that Russia can either join the civilized world or preserve authoritarian rule, but not do both. In this, Ukraine may repay a country that brought it communist enslavement with an example of freedom, and with the preconditions for a new start.

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Currency on a Collision Course

By Christopher Wood

The comments emanating from Washington since the November presidential election, and the related action in the foreign exchange markets, make it clear that "go for growth" will be the preferred Bush strategy. This is an administration driven by ideological supply-siders, not fiscal conservatives. Sure, this suggests a still wider current-account deficit. And America's current-account deficit already accounts for about 77% of the world's total current-account deficits. But this is a game of chicken which Asia will be expected to continue to finance.

In the meantime, the Bush emphasis on growth at all costs means a continuing benign acceptance of a weaker dollar so long as that trend is not precipitous. Dollar weakening is clearly underway again and this is renewing focus on Asia's failure so far to let its own currencies appreciate. The pain of this adjustment is again becoming apparent in Europe, while the Japanese are threatening intervention again. All of this means renewed attention on the renminbi's perceived extreme undervaluation. This is best reflected in China's growing share of world exports. China's share of world exports has risen from 1.8% in 1990 to 6% in the first five months of this year.

The result of the above is renewed focus among the world's community of speculators on the renminbi "revaluation." Courtesy of America's "go for growth" strategy, the Asian asset-reflation story is also back in full swing since if Asian currencies are being artificially held down by central bank intervention, as has been the case, then the only way natural appreciation pressures can be expressed is via higher asset prices. It is, as a result, like early 2003 all over again, with the dollar declining and Asian asset-reflation stocks rising.

The main difference is that, this time, there is much more focus on the inevitable need for Asian currencies to start rising. This growing speculative pressure is clear from the renminbi forward market as well as the strength of other Asian currencies. The renminbi 12-month non-deliverable forward rate has risen by 4% over the past four months to Rmb7.87/$, or a 5.1% premium over the spot rate. Meanwhile, the Japanese yen has risen by 8% against the dollar over the past two months, and the Korean won has risen by 11% in the year to date to a seven-year high. The Singapore dollar has also risen by 5% over the past four months to its highest level since December 1998.

For how much longer will America have the luxury of running its own independent monetary policy?

In financial markets, it is usually better to travel than to arrive. In part, this also applies to the asset-reflation theme in Asia. For the story is largely driven by the seeming inevitability of Asian currency appreciation, which is, in turn, seen to be triggered by the presumed inevitability of a renminbi revaluation. Thus, so long as the Chinese do not move, the story can continue to run. Traditionally, with the notable exception of Sars, the PRC leadership prefers to do nothing when there is external pressure on it to do something. On this point, the market's renewed focus on the renminbi, as reflected in the rising premium on the spot market, would suggest nothing will happen on the revaluation front.

But on this occasion, this writer is no longer quite so sure as before that the old rules apply. China is now at the center, not the periphery, of discussions about developments in the world economy. This massively higher profile on the global stage makes it much harder for the Chinese to ignore external pressures. Their problem is, however, if they only revalue by a marginal amount—by which is meant 10% or less—this is only likely further to fuel speculative pressures as the animal spirits move in for the kill.

All this raises another question: Is it really in America's interests to pressure China for a renminbi revaluation? The U.S. trade deficit is clearly one motivating factor. The U.S. merchandise trade deficit rose by 19% year-on-year in the first nine months of this year to $470 billion, with China accounting for 24% of the total. But this is, to a certain extent, offset by China's trade deficit with other countries, notably those in Asia. Excluding America, China posted a trade deficit of $50 billion with the rest of the world and $62 billion with Asia alone in the first nine months of this year. But U.S. pressure also seems to be driven by other considerations, notably the ideological view that floating currencies are a good thing and that mercantilism is fundamentally unfair as well as misconceived in that it suppresses the purchasing power of Asian consumers.

If this is all true, it also ignores the point that America needs to be careful what it wishes for. The Bush administration can only "go for growth" on the assumption that Asia will keep financing its current-account deficit because it has no choice if the region's exporters want to maintain access to America's domestic markets. This is all very well. But America can only run such a strategy because the dollar holds the privileged position of being the world's reserve currency. The dollar paper standard, which has been in place since Richard Nixon broke the last link with gold in 1971, has meant that America has the luxury of running its own independent monetary policy. That happy situation can continue only for so long as the dollar decline remains gradual and does not turn into a rout.

Another consequence of Asian currency revaluation is that it would increase the inflationary pressure in America, or at least reduce the deflationary bias stemming from the boom in importing cheap Asian goods. American imports from Asia ex-Japan rose by 20% year-on-year in the first nine months of this year. This would raise the risk of an inflation scare. Ironically, this would be ultimately bullish for government bonds in America since any inflation scare in America means significantly higher interest rates, which would likely precipitate a deflationary deleveraging cycle among America's highly indebted consumers—for the consumer-finance driven American economy would prove highly sensitive to higher short-term interest rates.

There are, then, risks, from the narrow U.S. perspective, of pushing China and other Asian governments to revalue since the present "game of chicken" suits the U.S. even if this means increasingly scary macro imbalances which, if they are allowed to continue to grow, will ultimately trigger the demise of the dollar paper stand to the benefit of owners of gold bullion. But from the point of view of the whole world, Asian currency revaluation is required to bring about a more balanced world economy by boosting the dollar purchasing power of Asia's cashed-up consumers. Bring on the Plaza 2 Accord.

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Time for a Kofi Break

By Glenn Harlan Reynolds

Things are going badly for Kofi Annan. The oil-for-food scandal has revealed U.N. behavior regarding Saddam Hussein's Iraq that ranges from criminally inept to outright corrupt. Rape and pedophilia by U.N. peacekeepers haven't gotten the kind of attention they'd get if American troops were involved, but the scandals have begun to take their toll. And the U.N.'s ability to serve its crowning purpose—the "never again" treatment of genocide that was vowed after the Holocaust, and re-vowed after Cambodia and Rwanda—is looking less and less credible in the wake of its response to ongoing genocide in Darfur. And finally, the U.N. has so far played no significant role in defusing the Ukrainian crisis.

Things have gotten bad enough that some are calling for Mr. Annan's resignation, amid talk of former Czech President Vaclav Havel as successor. ("Havel for Secretary General" bumper stickers are on the Web.) But however you assess Mr. Havel's chances of becoming secretary general, for Mr. Annan the comparison is devastating. Mr. Havel, after all, is a hero on behalf of freedom: A man who helped bring about the end of communist dominance in Eastern Europe, despite imprisonment and the threat of death—a man who could write that "Evil must be confronted in its womb and, if it can't be done otherwise, then it has to be dealt with by the use of force." Mr. Annan, by contrast, is a trimmer and temporizer who has stood up for tyrants far more than he has stood up to them.

If the comparison is damning to Kofi, it's even more damning to the U.N. Mr. Havel once wrote Czech dictator Gustav Husak, "So far, you . . . have chosen . . . the path of inner decay for the sake of outward appearances . . . of deepening the spiritual and moral crisis of our society, and ceaselessly degrading human dignity, for the puny sake of protecting your own power." One might say the same of the U.N. bureaucracy.

And that, perhaps, is the only argument against bringing Mr. Havel to the U.N. (Besides the obvious: He probably wouldn't take the job.) The U.N. is losing what shreds of moral legitimacy remain, even among those who were once sympathetic, as the extent of its corruption becomes too obvious to ignore. There's talk of replacing—or, more diplomatically, supplementing—the U.N. with a Community of Democracies that would draw its support from legitimate governments, not thugs and kleptocrats. At the very least, it seems likely that the U.N. will soon come under enormous pressure to reform.

But here's a paradox: It's hard to imagine that Mr. Annan could parry the pressure. But a U.N. headed by Mr. Havel might derive enough reflected legitimacy to resist such changes. According to Mr. Annan's Web site, the secretary general is supposed to serve as a "symbol" of U.N. "ideals." It may well be that he's doing that more accurately than Vaclav Havel ever could.

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