Bloomberg Businessweek
January 13, 2020

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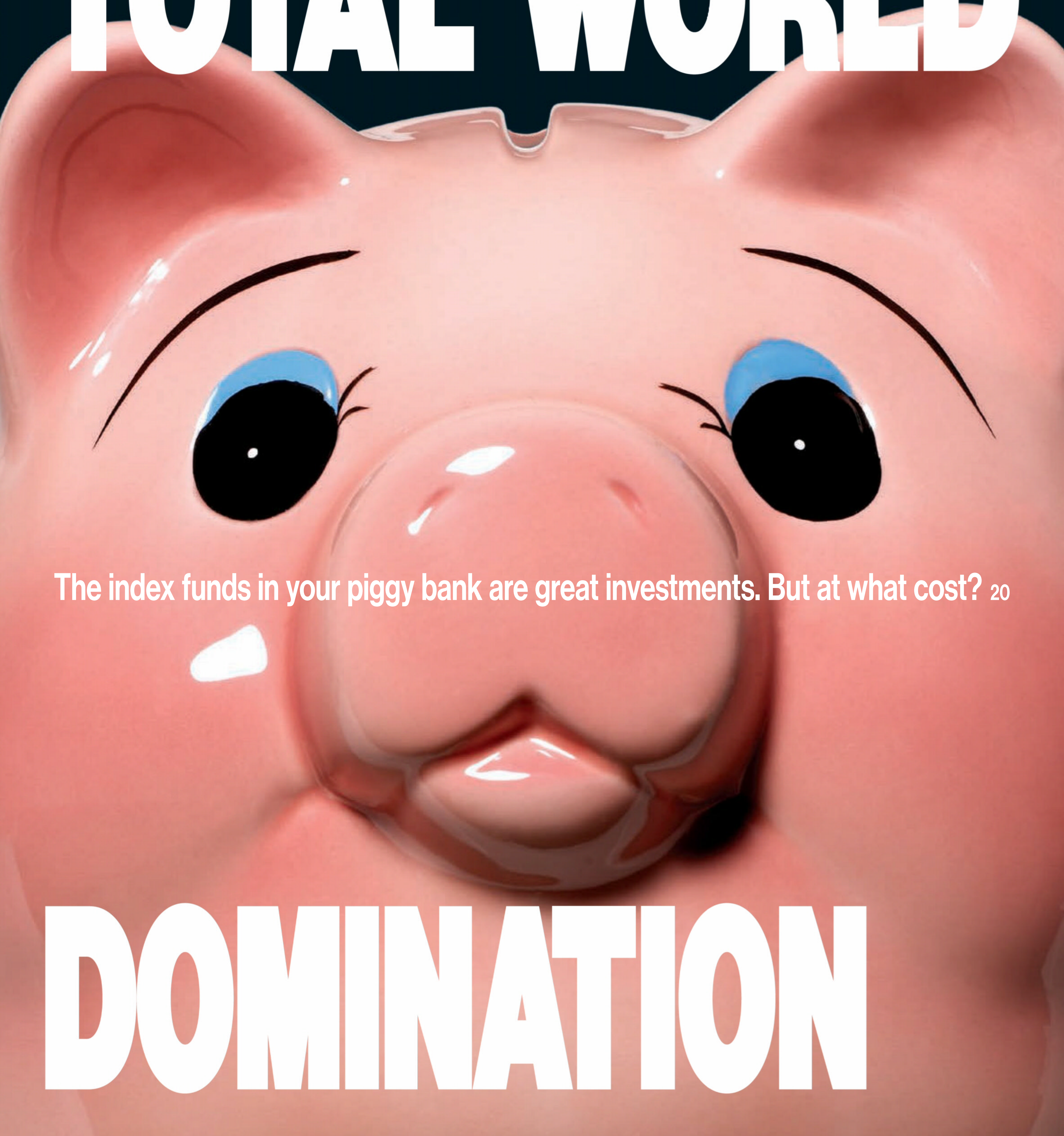
TOTAL WORLD DOMINATION



The index funds in your piggy bank are great investments. But at what cost? 20

◀ Water bottles in Taipei bearing the image of incumbent presidential candidate Tsai Ing-wen before the Jan. 11 election

PHOTOGRAPH BY PUZZLEMAN LEUNG FOR BLOOMBERG BUSINESSWEEK

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The island may soon have to decide between Beijing and Washington

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■ COVER TRAIL

How the cover gets made

❶ "This week's cover story is about the three index fund giants. They own a huge chunk of the market. So they have scary amounts of power."

"The Vanguard 500 brought my $52.74 401(k) to $180.94 over the last decade."

"I'm gonna get you a financial adviser."

❷ "First idea: three really tall guys."

"Cute shoes, but what else ya got?"

❸ "OK, how about three scary dogs?"

"Scary. Maybe too scary?"

"OK, I've got it. All I need to do is sublimate my own financial anxieties into one disarmingly cute image."

Cover: Getty images

VENEZUELA: PHOTOGRAPH BY ADRIANA LOUREIRO FERNANDEZ FOR BLOOMBERG BUSINESSWEEK. DOG COVER: GETTY IMAGES (4)

IN BRIEF

By Benedikt Kammel

● Former U.S. national security adviser John

Bolton said he's willing to testify under subpoena in the Senate impeachment trial of President Trump. Republicans and Democrats are divided on how to proceed, with the GOP seeking a swift trial without witnesses.

● The first made-in-China Teslas began rolling out of a factory near Shanghai, which was built in less than a year. Elon Musk, betting on huge demand from the world's biggest car market, has already cut prices on the Model 3 to win over buyers.

● Flooding and landslides caused by heavy rainfall in and around Jakarta, Indonesia's capital, killed at least 50 people and forced more than 31,000 to evacuate. Authorities said the rain was the most severe in more than a century.

● In governments, two compromises and one deep divide

● Spain's Socialist leader Pedro Sánchez won the narrowest of victories in parliament to take power for a second term with the backing of the anti-austerity party Podemos and a Catalan separatist group.

● Venezuelan President Nicolás Maduro ousted opposition leader Juan Guaidó and his backers from the National Assembly. Guaidó is recognized by the U.S. and dozens of its allies as the country's legitimate president.

● Sebastian Kurz returned as Austria's chancellor, uniting a coalition of his conservative People's Party and the environmentalist Greens. Kurz, 33, is once more the youngest head of government, a distinction held for a short time by Finland's new Prime Minister Sanna Marin, 34.

● The price of gold briefly jumped above

$1,600

an ounce for the first time in almost seven years as investors reacted to rising tension between the U.S. and Iran.

● Former movie mogul Harvey Weinstein appeared in State Supreme Court in New York for his trial on five felony counts, including predatory sexual assault and rape.

● "I'm here to clear my name."

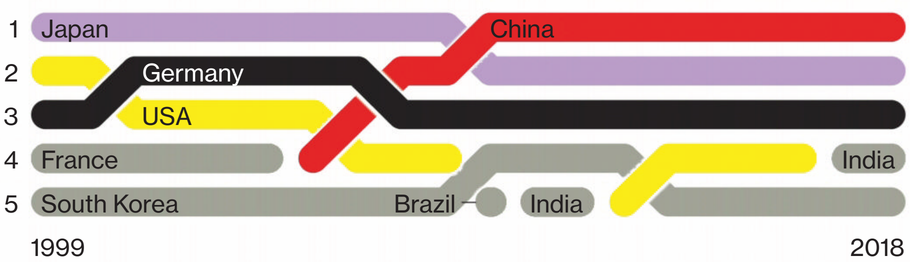
Disgraced former automotive executive Carlos Ghosn spoke for the first time in public in Beirut, after his escape from Japanese detention in late December. The former head of Nissan was arrested at the end of 2018 on allegations of financial misconduct. ▷ 10

● A Boeing 737 bound for Ukraine crashed shortly after takeoff from Tehran, killing everyone on board.

The recently serviced, three-year-old 737-800, a widely used model that predates the grounded 737 Max, went down without a distress call and after its global-positioning transmissions were cut off midflight—unusual for a crash.

● Passenger vehicle production in Germany dipped to 4.7 million last year, the lowest since 1996. BMW, Daimler, and Volkswagen are all grappling with fallout from the global trade war and consumer tastes that are shifting from the combustion engine to battery-powered vehicles.

Top countries in passenger vehicle production



DATA: OICA

● This year's Golden Globes were not kind to Netflix, which had three contenders in the race for best picture, including *The Irishman*. The top award went to *1917*, a World War I epic from director Sam Mendes.

● Sony unveiled a surprise concept car called the Vision-S at the CES tech trade show in Las Vegas.

● Aston Martin's first year as a publicly traded company ended in disappointment for shareholders.

The stock is down 75% since the initial offering in October 2018. Profits have been hurt by lukewarm demand and steep rebates. The carmaker's hopes now rest on the DBX sport utility vehicle it introduced late last year.

● JetBlue wants to offset emissions from all its domestic flights to become carbon neutral by the middle of the year. Pressure is mounting on airlines around the world to do their part for the environment, with "flight shaming" of travelers who book seemingly unnecessary trips becoming more prevalent.

● UBS is shaking up its wealth management division, including the elimination of as many as 500 private-banking jobs. It's part of an overhaul under division co-President Iqbal Khan, the star banker who joined from rival Credit Suisse last year.

UBS

● India's gross domestic product will grow

5%

in the year through March 2020, according to a statement from the Statistics Ministry. That's down from a 6.8% expansion the previous year, and would be the worst annual performance since 2009.

■ AGENDA

▶ A Big Week for Banks

America's largest banks report earnings for the fourth quarter, starting with JPMorgan Chase and Citigroup on Jan. 14, Goldman Sachs and Bank of America on the 15th, and Morgan Stanley on the 16th.

▶ A Chinese government delegation plans to sign the so-called phase one of a trade agreement with the U.S. at a White House ceremony on Jan. 15.

▶ South Korea's central bank sets its interest rates on Jan. 17. The bank cut borrowing costs twice last year to help prop up a slowing economy.

▶ China releases economic data on Jan. 17 that will help gauge the health of the second-largest economy, including fourth-quarter GDP and retail sales.

▶ Saudi Arabia hosts the International Petroleum Technology Conference Jan. 13–15. Participants will discuss the future of fossil energy amid rising oil prices.

▶ The Digital Life Design conference, in Munich Jan. 17–19, features Evan Spiegel of Snap and EU Commission President Ursula von der Leyen as speakers.

▶ Democratic presidential hopefuls meet for their next debate on Jan. 14 in Iowa, whose caucus officially kicks off the primary season on Feb. 3.

ILLUSTRATION BY MINET KIM. BOLTON: AL DRAGO/BLOOMBERG. INDONESIA: AR RAYYAN/AP PHOTO. SANCHEZ: ANGEL NAVARRETE/BLOOMBERG. GUAIDO: CARLOS BECERRA/BLOOMBERG. KURZ: STEFAN WERMUTH/BLOOMBERG. GHOSN: JOSEPH EID/AFP/GETTY IMAGES. SONY: DAVID PAUL MORRIS/BLOOMBERG

Chronicle of a

Vast swaths of Australia are in flames—and the country's plight has put a global focus on climate change

By Edward Johnson

Do you believe in prophecy? More than a dozen years ago, in a report released in July 2007, it was written: "An increase in fire danger in Australia is likely to be associated with a reduced interval between fires, increased fire intensity, a decrease in fire extinguishments and faster fire spread. … In south-east Australia, the frequency of very high and extreme fire danger days is likely to rise 4-25% by 2020." That forecast of a potential effect of the proliferation of greenhouse gases around the world comes about midway through 976 dense pages of scientific citations and assessments by the United Nations' Intergovernmental Panel on Climate Change. Given the countless other statistics and prognoses, you might be excused for overlooking the prediction when it was made.

It's impossible to ignore what's happening in Australia today: Bush fires have charred a combined area twice the size of Switzerland and are continuing to burn. The catastrophe is of Biblical proportions—the chariot of fire that swept Elijah into heaven returning to wreak hellish havoc on Earth. But it's not sufficient to cite Scripture or science. The scale of Australia's agony is beyond celestial or cerebral; it is human.

On Dec. 30, Samuel McPaul, a volunteer firefighter, was battling an inferno in southeastern Australia. The blaze was so large it generated its own weather system, a pyro-convective column thousands of feet high that caused cyclonic winds when it collapsed. McPaul was in a 10-ton firetruck. The storm flipped it over and killed him. The 28-year-old would have become a father in May.

On New Year's Eve in Malua Bay, about four hours south of Sydney, Dan Gocher, his two teenagers, and their friend sheltered on the coastal town's crescent-shaped beach with perhaps a thousand other people as fire raced in. "We had wet tea towels wrapped around our faces, tried to sit under larger towels—wearing them like a cowboy—and put sunglasses on as the smoke began to sting," says Gocher, 41, the director of climate and environment at the advocacy group Australasian Centre for Corporate Responsibility. "We were basically as close to the water as you could go. And it wasn't just people, there were horses, dogs, cats, rabbits. You name it, people were taking the pets that they loved with them."

Australians have long lived with the threat of bush fires

SAEED KHAN/AFP/GETTY IMAGES

Fire Foretold

and have borrowed from indigenous practices to reduce risks through controlled burns during the cooler winter months. But with drought and heat exacerbating tinderbox conditions, fires broke out as early as July. By September, lightning strikes led to out-of-control blazes in remote areas of New South Wales. In early November the state's Rural Fire Service commissioner, Shane Fitzsimmons, warned of an extremely dangerous fire season. On Nov. 11, Sydney was placed under a "catastrophic" fire danger rating for the first time since the warning system was introduced in 2009. Air quality has plunged in the usually pristine city, and choking smoke wafting in from surrounding bush fires blanketed the metropolis for several days in December.

The crisis has built since then. More than a hundred fires are still burning in New South Wales alone, and the Southern Hemisphere summer is barely under way. The devastation will mount as more fires start. "We can't stop those fires," Rob Rogers, the deputy commissioner of the state's largely volunteer Rural Fire Service, said on Jan. 3. "We can't stop the fires we already have." The toll and cost are rising: at least 25 people killed, 25 million acres burned, the colossal estimate of more than 1 billion animals dead. The world has collectively gasped at photographs of Australia's emblematic fauna—kangaroos and koalas—incinerated or asphyxiated.

The fires come as the country is polarized by the debate over global warming. With Canberra, the country's capital, shrouded in smoke, the government has downplayed the link between the fires and climate change. Indeed, Prime Minister Scott Morrison, who advocates expanding the coal industry, Australia's second-biggest export earner last year, cautioned against a knee-jerk response that further curbs carbon emissions at the expense of jobs and growth.

The emergency has put Morrison—only eight months ago lauded as a conservative hero for winning a come-from-behind election victory—on the defensive. The prime minister cut short his Hawaii vacation after two firefighters were killed on Dec. 19 as they battled to contain the Green Wattle Creek blaze, which has consumed 677,000 acres southwest of Sydney. While touring a ravaged community on Jan. 2, he was heckled by locals and filmed turning his back on a pregnant woman appealing for more resources. "People are angry," Morrison, 51, said in a radio interview a day later. "I understand the emotion, I understand the hurt, the anger, the frustration."

He's called up 3,000 army reservists and committed A$2 billion ($1.4 billion) over two years to assist recovery efforts. But he's not bowing to demands from environmentalists for more concerted action against climate ▶

◀ change. Morrison, who once brandished a lump of coal in Parliament in a show of support for the industry, argues that Australia is responsible for only 1.3% of global emissions and is on track to meet its Paris accord commitments. Australia has committed to reducing its CO_2 emissions by at least 26% from 2005 levels by 2030. “Any suggestion that the actions of any state or any nation with a contribution to global emissions of that order is directly linked to any weather event, whether here in Australia or anywhere else in the world, is just simply not true,” he said on Dec. 12.

Critics counter by saying that Australia’s contribution to carbon emissions should include the massive amounts loosed into the atmosphere from the coal it exports to India, China, and other countries. The Australia Institute, a public policy think tank, says the nation is the world’s third-biggest exporter of potential carbon dioxide emissions locked in fossil fuels, behind oil giants Russia and Saudi Arabia. As it is, the current bush fires—which dwarf recent disasters in California, Siberia, and Brazil—have so far pumped out more than half of Australia’s total greenhouse gas footprint last year. Smoke and ash have drifted 1,400 miles across the sea to New Zealand, staining its glaciers.

The fires have contributed one dramatic thing to the debate that scientific arguments and reams of statistics and documents couldn’t. They stand as the most emotional and visible evidence of the impact of a harsher climate. Scientists have toiled on research for decades, but they could never provide a real-life feel for just how bad the exacerbating effects of higher temperatures might make things. In its August 2019 report, the UN’s IPCC reiterated that the global fire-weather season grew almost 20% longer from 1979 to 2013. But only a continent aflame well before the peak of the Southern Hemisphere’s summer could illustrate the reality. That and headlines like “Number of Animals Feared Dead in Australia’s Wildfires Soars to Over 1 Billion.”

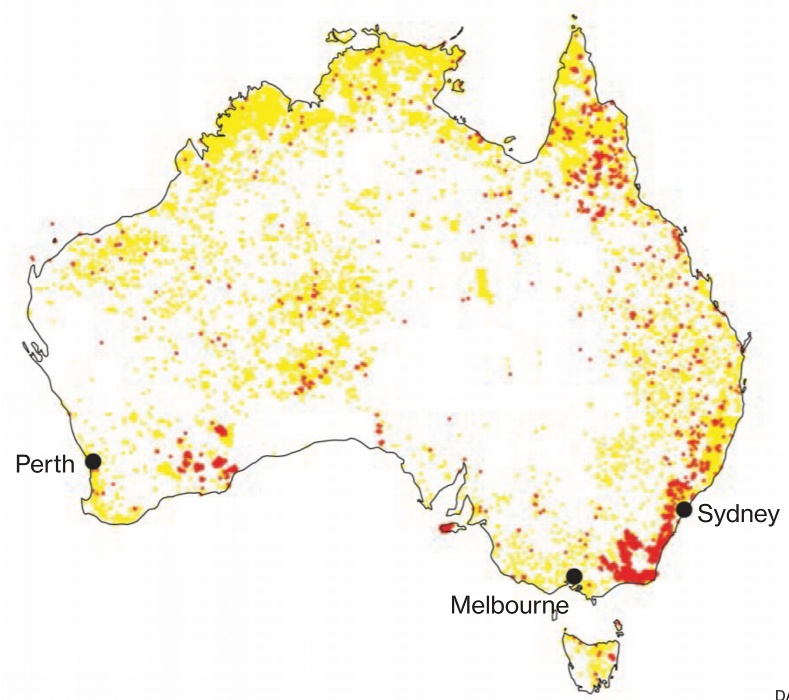
The driest inhabited continent experienced its highest temperatures and least amount of rainfall on record in 2019. Over the Christmas and New Year period—the height of the summer holiday season—states of emergency were declared throughout the country’s southeast as strong winds and temperatures above 45C (113F) created conditions ideal for fire.

“We must expect to see more devastating droughts and fires like the ones we have seen in Australia, California, and the Mediterranean in recent years,” says Matthew Jones, a senior research associate at the University of East Anglia’s School of Environmental Sciences in the U.K. “The impacts on the lives and livelihoods of residents and wildlife make for truly painful viewing, but sadly these scenes are set to become increasingly familiar.”

“Bad” can be motivating, though, and catastrophes can help people viscerally understand the arguments. What the fires may be doing—as hurricanes, heat waves, floods, and droughts have done before them—is demonstrating that humanity is caught in what may be the mother of all dilemmas: We continue to use fossil fuels for 85% of total energy

Scorched Earth

■ Fires in Australia 10/2019 to present ■ Active fires, week of 1/1/2020



DATA: NASA

consumption, but that has increased global heating by 1C. All the tools and technology needed to solve the problem are in hand. The fires are another compelling reason to use them.

For now, the near-term economic cost is mounting. The toxic smoke shrouding Canberra has shuttered businesses and government departments and forced the national carrier Qantas Airways Ltd. to cancel flights. So far, almost 9,000 insurance claims have been filed. These already total A$700 million and will inevitably rise. The country can’t quite bill itself as a travel destination. Tourism Australia—the government agency in charge of promoting the industry—has pulled a campaign featuring Kylie Minogue that showcased Sydney’s azure blue skies and picturesque bush country. The direct impact on the economy from the fires will be A$2 billion to A$3.5 billion in the fiscal year ending June 30, stemming from factors such as lower tourism spending and lost agricultural production, says Terry Rawnsley, an economist at consulting firm SGS Economics & Planning.

Harder to quantify is the emotional impact on Australians. Everyone has stories of anxiety about health. Rawnsley estimates smoke haze in Sydney, Melbourne, and Canberra will cost an additional A$200 million to A$800 million as people reduce outdoor activities and get sick. If the fires linger and cause more damage, Australians may even have to recalibrate their identity: Their huge expanse of the world—once unspoilt, then a penal colony, then a resource-rich refuge from the cuts and thrusts of the world—may ultimately become a parable of paradise lost. “It is deeply devastating. My whole country is on fire,” says Sarah Perkins-Kirkpatrick, a researcher at the Climate Change Research Centre in Sydney. “My children are going to grow up in a world where this is relatively normal, and that is extremely depressing and disturbing to think about. In terms of events like this, we are the canary in the coal mine.” Ⓑ —*With Eric Roston, Emily Cadman, and David Stringer*

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Carlos Ghosn's Great Escape

The auto chief's audacious flight to Beirut isn't the end of his battle with Japanese prosecutors—or Nissan

Throughout his career, Carlos Ghosn portrayed himself as a singular figure, the driving force behind the creation of one of the world's largest automotive groups—and the only person capable of keeping it together. In recent years he was clearly in legacy mode, preparing the groundwork for a deal that would finally bring Nissan Motor Co. and Renault SA together under a single corporate umbrella. Had he achieved his larger goal of incorporating rival Fiat Chrysler Automobiles NV into that alliance, he would have created the world's biggest carmaker and been remembered as one of the handful of business visionaries—such as Lee Iacocca, Jack Welch, or Gordon Moore—whose careers helped reshape their

Edited by
James E. Ellis

industries. For the foreseeable future, however, he will be known above all as something very different: a fugitive.

Ghosn's audacious escape from Japan is the stuff of action movies. He apparently hid inside a large shipping box that airport inspectors in Osaka failed to X-ray and flew on a private jet to Istanbul and then on another to his homeland of Lebanon, which doesn't have an extradition treaty with Japan. But he's not quietly riding off into the sunset as the credits roll. Ghosn still has plenty of scores to settle—especially with Japanese officials who he says wrongly charged him with financial misdeeds with the help of his former Nissan colleagues. "I was brutally taken from my world as I knew it," the former head of Nissan and Renault said in Beirut on Jan. 8, addressing a press conference for the first time since his arrest more than a year ago. "I was ripped from my family, my friends, from my communities, and from Renault, Nissan, and Mitsubishi."

Displaying the energy that helped fuel his rise to the top of the global auto industry, Ghosn attempted to offer a point-by-point rebuttal of the accusations against him while trashing the recent performance of the carmakers and international alliance he formerly ran. Wearing a dark suit and red tie, his hair gone mostly gray, Ghosn took questions from reporters from around the world, shifting easily between English, French, Arabic, and Portuguese.

Throughout the press conference, Ghosn was combative and passionate at the podium, clearly relishing the opportunity to finally tell his side of the story without fear of legal repercussions. He arrived early and tried to start ahead of schedule. He displayed his legendary brashness, at one point attempting to group the reporters packed into the press conference by nationality. Ghosn veered between topics at a bewildering pace, asking repeatedly why his service to the company and Japan had been "repaid with evil." He even compared the unpredictability of his arrest to the Pearl Harbor attack. In all, Ghosn spoke for about 2½ hours, and by the end seemed like he would have happily kept going if circumstances allowed.

The 65-year-old is scrambling to salvage his legacy, blighted by allegations of understating his compensation and raiding corporate resources for personal gain at Nissan. He's also under investigation in France. Proclaiming his innocence, Ghosn accused Japanese prosecutors, government officials, and Nissan executives of conspiring to topple him to prevent a further integration of the Japanese carmaker with Renault. Ghosn named former Nissan Chief Executive Officer Hiroto Saikawa and three other current and former top company officials as among those involved in the plot against him. Saikawa, Ghosn's successor-turned-accuser who lost his job in September because of his own overcompensation scandal, said in November 2018 that Ghosn's ouster wasn't a coup d'état.

Now that Ghosn has slipped from the grasp of Japan's legal system, he's taking his case to the court of public opinion, an arena where he gained a wealth of experience during two decades as one of the world's most prominent business leaders. "I am here to expose a system of justice that violates the most basic principles of humanity," he said at the press conference. "These allegations are untrue and I should never have been arrested."

Ghosn said his lawyers told him he might have had to spend five more years in Japan before his cases would be resolved. So he took the risk of jumping bail. Now he says he's willing to be judged "in any country where I believe I can receive a fair trial," which he doesn't think was possible in Japan. "My unimaginable ordeal over the past 14 months was the result of an orchestrated campaign spearheaded by a handful of unscrupulous, vindictive individuals" at Nissan, its law firm, and the Tokyo prosecutor's office, Ghosn said.

The arrest of Ghosn to face trials that could have landed him in prison for more than a decade has cast an unflattering light on Japan's legal system, where prosecutors can grill suspects repeatedly without their lawyers present and enjoy an almost 100% conviction rate. Under the terms of Ghosn's bail, the court barred him from seeing or even speaking to his wife without a judge's approval—which he received only twice between April and late December. On Jan. 7, Japanese prosecutors said they'd obtained an arrest warrant for Ghosn's wife, Carole, claiming she gave false testimony in court last April. Ghosn said at the press conference that his wife's warrant is just part of Japan's intimidation tactics against defendants. "This is exactly how it works," he said.

Rather than backing off now that its former chairman has fled, Nissan has gone on the offensive. The carmaker has already spent more than $200 million on lawyers, investigators, and digital forensics in its probe of Ghosn and former lieutenant Greg Kelly, people with knowledge of the matter say, asking not to be identified because the information isn't public. Kelly, who remains in Japan, has also denied wrongdoing. In a Jan. 7 statement, Nissan said that its "internal investigation found incontrovertible evidence of various acts of misconduct by Ghosn, including misstatement of his compensation and misappropriation of the company's assets for his personal benefit." ▶

▼ Change in yearend share price since 1998

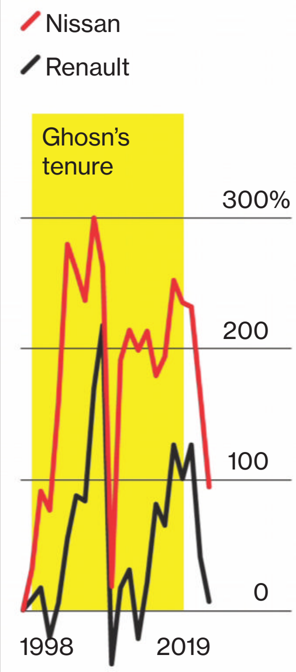


PHOTO ILLUSTRATION BY 731; PHOTOS: BLOOMBERG (1) GETTY IMAGES (2). DATA: COMPILED BY BLOOMBERG

◀ Nissan is also seeking to oust Ghosn from his usual home in Beirut, an elegant $8.75 million pink villa that the Yokohama-based automaker purchased for him and renovated extensively, says one of the people. Nissan views Ghosn's continued use of the house as illegitimate and wants him evicted, the person says. Ghosn's representatives have resisted efforts to dislodge him through the courts, arguing the house was part of a retirement package to which he's legally entitled.

"Ghosn's flight will not affect Nissan's basic policy of holding him responsible for the serious misconduct uncovered by the internal investigation," the company said in the statement. Nissan "will continue to take appropriate legal action to hold Ghosn accountable for the harm that his misconduct has caused."

Japanese officials also seem intent on pursuing the fugitive executive. Prosecutors there said Ghosn's bail was revoked, while the International Criminal Police Organization, or Interpol, has presented Lebanon with a "Red Notice" for his arrest at the request of the Japanese government. And the warrant for his wife, who's now in Lebanon with Ghosn, means she could be arrested if she returns to Japan. Ghosn's inability to see his wife in Japan was the "straw that broke the camel's back" in his decision to flee, Ghosn told Fox Business Network's Maria Bartiromo in a report aired on Jan. 6.

Ghosn has said his wife and other family members played no part in his escape to Lebanon, after reports began to appear suggesting that Carole or other members of his family had helped plan his exit—which, if accurate, could expose them to criminal charges in Japan or elsewhere. On Jan. 2, Ghosn said in a statement that "I alone arranged for my departure." His family, he said, "had no role whatsoever."

This is all a stunning turnabout for Ghosn, who once rubbed shoulders with world leaders and epitomized the term Davos Man. He helped guide Nissan back from the brink two decades ago, following its rescue by Renault. It made him a hero in Japan for a time, complete with a *manga*, or comic series, celebrating his corporate exploits. As the alliance between Renault and Nissan prospered—bringing in Mitsubishi Motors Corp. in 2016—Ghosn became the indispensable man at the center of the partnership.

Yet his compensation led to persistent criticism in Japan and France, and resentment grew at Nissan over the lopsided shareholder structure that left Renault with 43% of the Japanese carmaker, while Nissan owns just 15% of Renault. Given its bigger size and superior earnings in recent years, Nissan has sought more sway in the alliance.

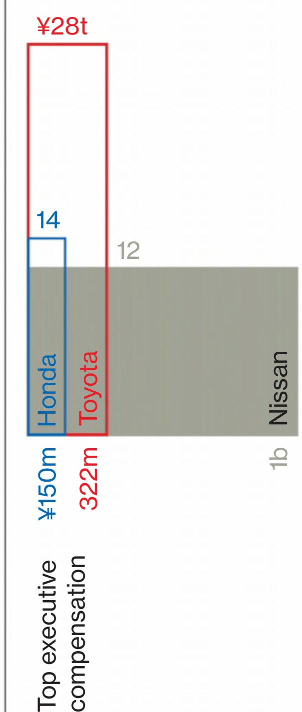
Ghosn had harsh words for the performance of the carmakers and their partnership since his arrest, describing it as "a masquerade of an alliance which is going nowhere." His pledge to "speak freely" has fueled concern his remarks could rekindle the mutual suspicion that has plagued relations between the carmakers.

With its business in jeopardy and shares down almost 40% since Ghosn's arrest, Nissan is already rife with internal divisions over his ouster. Makoto Uchida, who became CEO last month, has a long list of challenges: A top deputy abruptly quit, the company withdrew its dividend guidance in November, and it's under pressure to refresh an aging product lineup. Uchida declined to comment on Ghosn or his escape at a Jan. 7 New Year's reception in Tokyo for Japan's major business groups.

Given those pressures, Nissan doesn't have time to spend more money pursuing Ghosn, says Koji Endo, an analyst at SBI Securities Co. in Tokyo. "Nissan's current focus should be to carry out major restructuring immediately following a sharp earnings fall and a dividend cut," he says. But few expect the automaker—or Ghosn—to return to business as usual anytime soon. —*Matthew Campbell, Kae Inoue, and Ania Nussbaum*

THE BOTTOM LINE Ghosn's clandestine escape from Japan is worthy of a Hollywood script. But his battle to salvage his legacy—from the safety of his native Lebanon—is far from over.

▼ Japanese auto company revenue, fiscal year 2017



The Big Drug That Couldn't

● Sanofi had high hopes for its new cholesterol medicine. Then health-care economics kicked in

For years, drug companies have enjoyed the freedom to charge high prices for their latest products. But when Sanofi and Amgen Inc. each marketed a powerful new cholesterol-lowering medicine, something surprising happened: High prices hurt sales. Sanofi's experience has been especially painful. The French company spent more than five years developing Praluent with Regeneron Pharmaceuticals Inc. before its launch in 2015. But Praluent never caught on. Now Sanofi is cutting its losses, getting out of the U.S. market for the drug, and halting its heart disease research altogether in favor of more lucrative medicines for cancer and other diseases. “We’re proud of our past, but it shouldn’t dictate some poor investment decisions,” Paul Hudson, Sanofi’s new chief executive officer, told a group of investors last month. “We have to draw a line in the sand.”

What went wrong with Praluent? The drug is one of several cholesterol-lowering injections known as PCSK9 inhibitors. It does a better job than earlier drugs of reducing the risk of heart attacks and strokes for some people. Yet this class of new drugs has failed to reach more than a fraction of its intended market. Praluent’s disappointing sales are the result of insurance giants’ reluctance to pay for expensive new pharmaceuticals that treat chronic disease when far cheaper drugs can often get the job done.

Praluent’s disappointing performance shows how consolidation among insurers and pharmacy-benefit managers—the middlemen that handle prescription drug plans for employers and pension plans—has given them much more control over pricing and patient access to medicines.

When Sanofi introduced Praluent, it seemed destined to become a hit. Heart disease remains the top killer in the U.S., responsible for 1 in 4 deaths each year. With its proven ability to dramatically lower “bad” cholesterol, or LDL, Praluent, its promoters argued, would quickly grow into a multibillion-dollar-a-year blockbuster. Biotechnology specialist Amgen thought so, too, and invested in a competing compound, Repatha. The drugs were intended to serve a sizable segment of patients who can’t tolerate or control their cholesterol with widely used statins such as Pfizer Inc.’s Lipitor and for those who have a genetic condition that puts them at risk for early heart attacks and strokes.

The drugmakers badly miscalculated their pricing strategy, however. Sanofi and its partner Regeneron introduced Praluent at $14,600 a year in mid-2015. Amgen priced Repatha at $14,100 annually a month later. Compared to the multimillion-dollar price tags for genetic drugs that cure rare diseases, the cost wasn’t unreasonable, company officials say. But unlike those one-time treatments, the new cholesterol drugs are intended to be taken for a lifetime.

While the companies argued the medicines would provide billions of dollars in savings by keeping patients out of hospitals and reducing the need for more intensive cardiovascular care, insurers balked at the potential cost of these long-term treatments. They pointed to research that suggested giving Praluent and Repatha to all eligible patients would be responsible for about a $120 billion increase in annual health-care spending in the U.S.—a finding the manufacturers doubt. And since generic statins cost as little as $40 a year, insurance companies constructed barriers that made it virtually certain few patients would get the new drugs. “PCSK9s had the potential to be for a very large population,” says Harold Carter, a senior director of value-based pricing solutions at Cigna Corp.’s Express Scripts unit, which manages drug-benefits plans. “We knew it could break the budgets of health plans, so we made sure that only patients that absolutely needed it got access.”

The strategy employed by Express Scripts and its counterparts proved effective. Half of all patients prescribed a PCSK9 inhibitor in their first year on the market were denied approval for coverage, according to the Duke Clinical Research Institute. Many of those who were approved by their plans often found they couldn’t afford their share of the cost.

Things were particularly dire for seniors enrolled in Medicare, who could be on the hook for a quarter or more of the drug’s list price. Debbie Hileman, a patient in Grand Tower, Ill., with a genetic condition known as familial hypercholesterolemia, was forced to pay more than $400 each month for Repatha through her federal drug benefit. “It left me with some difficult choices,” says Hileman, 67, who often did ▶

ILLUSTRATION BY NICHOLE SHINN; DATA: COMPANY FILINGS

◀ without the drug. "I couldn't put my family in the poorhouse."

High-risk patients with the same genetic condition couldn't even get approved for the drug: 63% of their prescriptions were rejected, according to a 2017 study in the medical journal *Circulation*. As a result, sales of the drugs suffered. Sanofi's treatment generated a meager $307 million in 2018, while Amgen's fared better at a still-disappointing $550 million.

That's pushed the manufacturers to take drastic measures. In October 2018, Amgen cut its list price by 60%, to $5,850. Sanofi, which had already offered heavily discounted drugs to certain benefit managers, matched that in March 2019. The companies hoped the sharply reduced prices would encourage insurers to take down their coverage barriers while also lowering seniors' out-of-pocket costs. In other words, they were willing to trade profit margins for scale.

But their more moderate pricing failed to boost sales because of incentives peculiar to the drug industry. Drugmakers provide pharmacy-benefit managers discounts in the form of rebates to win preferred coverage status for their expensive medications. Throughout 2019, many drug middlemen ignored the lower-priced meds in favor of putting the $14,000 versions on their approved lists—which would give heftier rebates.

CVS Health Corp., for example, asked prescribers to provide one of two codes to request access to either the $14,100 product or the $5,850 product. Although it stated "the two products are the exact same and made in the same manufacturing facility," the company required a "documented clinical reason" to access the cheaper drug. Even with such a reason, CVS said it wouldn't make the discounted drug available. So doctors filling out forms essentially had only one choice: request the expensive option.

Troyen Brennan, chief medical officer of CVS Health, says the $14,100 product initially offered health plans the lowest net-cost because the company could pass them the rebate. However, Brennan concedes its demand for a "clinical" justification for the discounted product was inaccurate and unnecessary. "It was a business decision that should have been reviewed more deliberately," he says. After five months, CVS updated the form to eliminate that question and now covers the $5,850 version of Repatha. CVS and Express Scripts say they've since eased restrictions in the wake of new medical guidelines and recent data that show the drugs' effectiveness.

Even so, critics say the drugs are still hard to come by. "A model that prioritizes the more expensive product when a less expensive one is available doesn't serve the patients," says Scott Wright, a cardiologist at Mayo Clinic. "That discount has not changed the way the game is played."

Like Sanofi and Amgen, other drugmakers have struggled to introduce discounted versions of their treatments to improve affordability and patient access. Eli Lilly & Co. created a half-price version of its popular insulin Humalog last year after criticism over the drug's price. But a majority of diabetes patients still haven't gotten insurance coverage for it.

"It's extremely disappointing that that's the outcome we land on," says Lilly CEO David Ricks. "We've done what we can do. I guess insurance companies, pharmacy-benefit managers, and supply chain actors have showed their hand. They prefer the high list price, high rebate, to a low list price, low rebate."

Swiss drugmaker Novartis AG will take a different strategy. Late last year it agreed to buy Medicines Co. and its state-of-the-art cholesterol-bashing drug for $9.7 billion. Unlike Praluent and Repatha, which are self-injected twice a month, Novartis's injection is only needed twice a year. If the company doesn't overreach on pricing, the drug could be a highly attractive alternative.

Calling the battle between Praluent and Repatha for market share "a race to the bottom," Sanofi's Hudson, who became CEO in September, says he's done trying to negotiate with the insurance industry over Praluent. "We're all battle-scarred enough not to go there again." In the U.S., the company will return the cholesterol drug to Regeneron, which will manage commercial operations alone.

Amgen says it's in for the long haul. After more than a year of urging benefit managers to adopt their discounted drug, the high-priced version still accounted for almost half of its volume at the end of 2019. The company removed the more costly version from the market on Dec. 31 in an attempt to force the insurance industry's hand: Pay for our discounted product or don't pay for our product at all. "If you can get an insurer to supply a product, a doctor to prescribe a product, and a pharmacy to carry the product," says Murdo Gordon, Amgen's executive vice president for global commercial operations, "but the patient can't afford the product, then the health-care system is broken." *—Riley Griffin, with James Paton*

THE BOTTOM LINE The latest cholesterol drugs were expected to be blockbusters. But forecasts that they'd add up to $120 billion annually to U.S. health spending cooled insurers' interest.

● Hudson

▼ Share of U.S. drug sales by condition

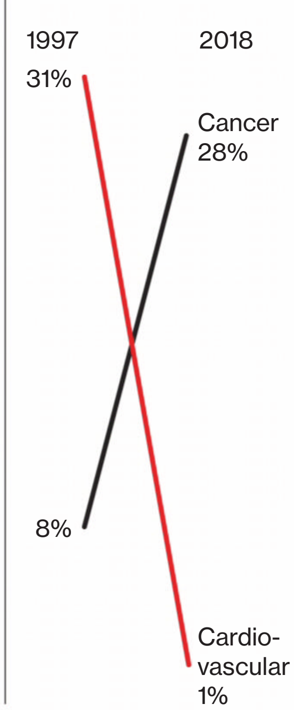


PHOTO: ERIC PIERMONT/AFP/GETTY IMAGES. DATA: BOSTON CONSULTING GROUP

Mushroom Medicine

● Psilocybin is edging toward FDA approval as a treatment for particularly tough cases of depression

Just a few years ago, if you wanted to hear about the benefits of psychedelic drugs, your best bet was to head over to the parking lot outside the local jam band concert and flag down the guy in the tie-dye selling "magic mushrooms." Today there are better options. You could, for instance, fly down to the Waldorf Astoria's gated beachside resort in Boca Raton, Fla., and—between spa appointments and rounds of golf—take in the keynote address at the CNS Summit, an annual Big Pharma conference.

In November, that's where you'd have found George Goldsmith and Ekaterina "Katya" Malievskaia, the conservatively dressed, middle-aged married couple running a mental-health-care company in London called Compass Pathways Ltd. Among other things, they were stumping for their answer to treatment-resistant clinical depression: synthetic doses of the hallucinogen psilocybin, the active ingredient in shrooms. "Our goal is to develop psilocybin therapy—the preparation, the support for the actual dosing, the medicine, and the follow-up," said Goldsmith, a lanky, bespectacled sixtysomething former executive coach. "And then other clinics and so forth will buy and deliver that."

This plan might sound like swirling colors to anyone who lived through President Richard Nixon's crusade against Harvard professor Timothy Leary, the high priest of acid trips. In the decades since Nixon branded Leary and hallucinogens public enemies as part of his "war on drugs," all but a few psychiatrists have avoided publicly testing psychedelics' medical benefits for fear of excommunication from their field. Now, though, attitudes are changing fast. The U.S. Food and Drug Administration has named Compass's experimental treatment a "breakthrough therapy," a designation that comes with extra guidance through a faster review process.

Compass is running a 216-patient Phase 2B clinical trial—typically the second-to-last stage before a drug gets the FDA's nod—and has made enough synthetic

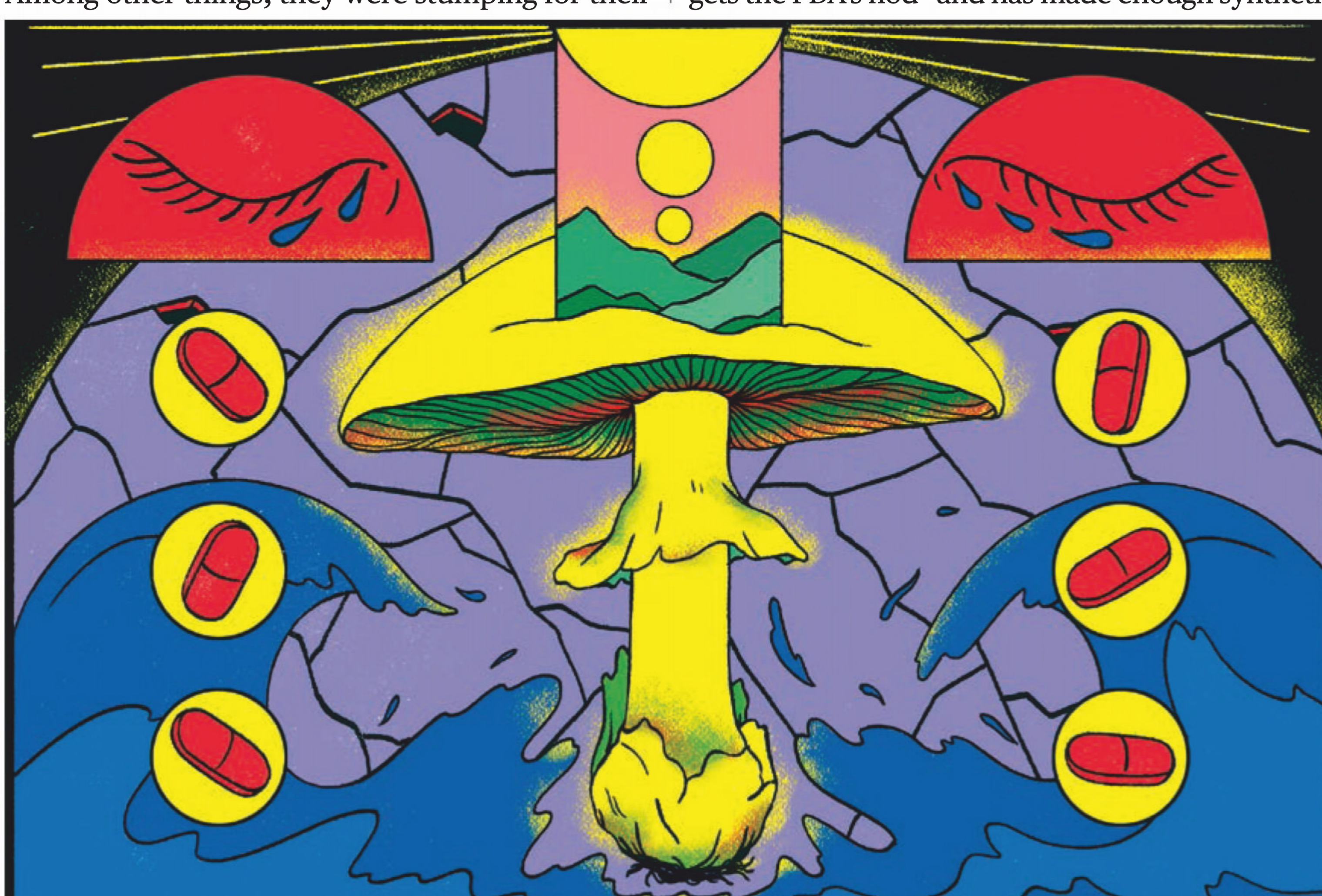


ILLUSTRATION BY CRISTINA DAURA

Edited by Jeff Muskus

doses of the psychoactive ingredient in magic mushrooms to supply more than 30,000 patients. It's raised $58 million in venture funding from powerful tech figures including Trump ally Peter Thiel, investor Christian Angermayer, and Bitcoin booster Michael Novogratz. Thomas Insel, former director of the U.S. National Institute of Mental Health, and Paul Summergrad, former head of the American Psychiatric Association, are on its board of advisers.

The advisers' bona fides are at least as important as the eight-figure funding. For the FDA to say yes to shroom therapy, "you're going to have to be more rigorous, and more risk-averse, and more Catholic than the pope," says Insel, who's also an investor. "You're going to have to do this in a way that is very carefully scientific, with the best scientists, the best clinical trials, the most conservative and rigorous design, and the most careful data analysis."

Scientists can't explain precisely why psychedelics appear to help psychiatric patients make strides in therapy, but in recent years they've gotten closer to the how. Emerging brain-scanning technologies suggest that a person's brain can, over time, begin to malfunction from what are essentially buggy pieces of neural code. Psychedelics seem to act like a hard reboot, restoring the brain to its factory settings. Why that's so remains unclear, says David Nichols, founder of the Heffter Research Institute, which advocates for more research into psychedelics.

If psilocybin proves effective against treatment-resistant depression, patients may be content to leave some whys unanswered. Today's go-to treatments, psychotherapy and selective serotonin reuptake inhibitors, work for only about 70% of patients, leaving as many as 90 million still struggling around the globe, according to the World Health Organization.

Big Pharma is trying to establish medical uses for other recreational drugs. In March the FDA approved the use of Johnson & Johnson's Spravato, a nasal spray derived from the club drug ketamine, for treatment-resistant depression. Eleven U.S. labs are running clinical trials to test the theory that MDMA, better known as ecstasy or molly, can help treat post-traumatic stress disorder. Desperate patients and legalized marijuana use in many states have broken down old stigmas, says Rick Doblin, executive director of the advocacy group Multidisciplinary Association for Psychedelic Studies. "The rise of the for-profit psychedelic pharma efforts are a sign of our success over the last 33 years in changing the political dynamics at the FDA, changing the public attitudes toward this," Doblin says.

Yet ketamine and MDMA lack the layers of social and political baggage around psilocybin (and LSD). The mild-mannered Goldsmith, who founded several successful startups, and the no-nonsense Malievskaia, a Russian-born physician who says she never so much as puffed on a joint pre-Compass, still have lots of work to do.

The Compass founders say they first encountered psilocybin after Malievskaia's son developed acute depression and obsessive-compulsive disorder in 2012 during his first semester of college. Months of $960-an-hour psychiatric appointments didn't seem to help, nor did pills or an inpatient OCD program. "He was getting worse and worse," she says. "They were just sitting there shaking their heads."

One sleepless night in 2013, she read a Heffter-funded study that concluded psilocybin use had helped ameliorate symptoms among a small group of OCD patients at the University of Arizona. Goldsmith and Malievskaia contacted Nichols, who invited them to the next Heffter board meeting. The couple were so impressed with the discussion that they wrote Nichols a check for $100,000. By 2014 therapist-supervised use of psychedelics and ketamine had helped Malievskaia's son recover, and the couple thought about how they could make similar treatment available to a much wider audience. Why not start asking regulators what it might take?

● Therapy and SSRIs don't work for about

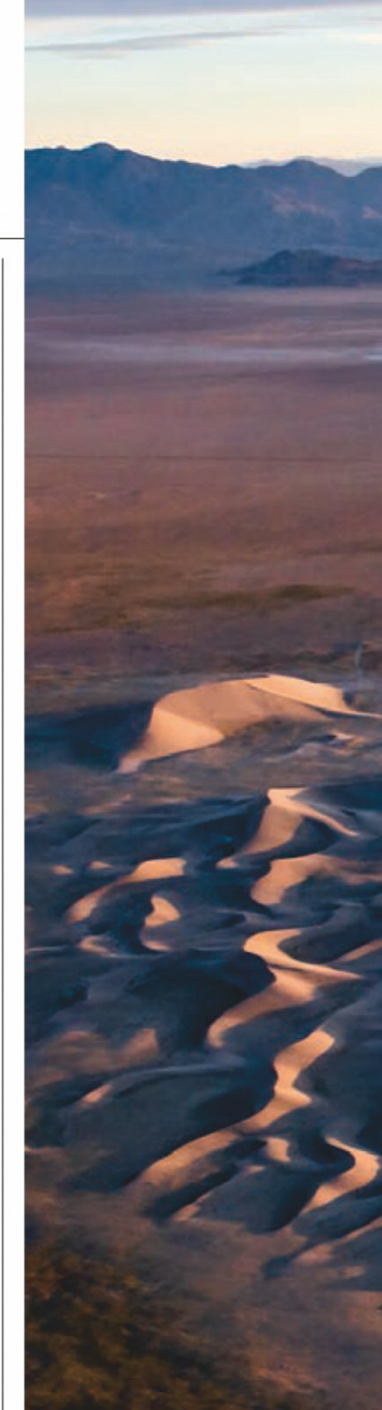
30%

of patients with clinical depression

Nichols and his collaborators "freaked out," Malievskaia says. They worried if they moved too fast, the feds might shut down psilocybin research altogether. So she and Goldsmith began to search carefully for test-case patients and set up a nonprofit to help finance clinical trials for terminal cancer patients. In the north of England they spent hundreds of thousands of dollars from their savings to make a synthetic psilocybin standardized and controlled to comply with European regulations.

Negotiations with local authorities stalled, but by then Compass had drawn interest from other researchers in the U.K. and the European Union. In late 2016 regulators at the EU's equivalent of the FDA recommended they focus on treatment-resistant depression. To finance the added expenses, the couple patented their manufacturing technique, founded the for-profit version of Compass, and began soliciting backers.

Despite investor confidence and positive FDA signals, lots of questions remain. "There's nothing else on the market like it," says Walter Dunn, a professor of clinical psychiatry at the University of California at Los Angeles, who advises the FDA on drugs that affect the brain. "Nothing previously approved where you require someone to stay in a room with a patient for six hours to help them process a psychedelic experience." Dunn says he expects the treatment eventually will be approved. But Compass ▶



◀ will have to show that results in a greater number of patients are more than a placebo effect and that its clinicians are trained to handle comedowns and bad trips and help protect against abuse.

Some old-school psychedelics advocates say they're also worried that for-profit Compass will bring sketchy Big Pharma legal tactics to a market that's always been more touchy-feely and that the incentives to crowd other people out of the nascent market could work against patients. These were among the strongest warnings, in a highly critical 2018 report by the news site *Quartz*, sounded by experts who'd worked with Compass founders when the enterprise was a nonprofit.

Goldsmith says the cost of the clinical trials forced him and Malievskaia to go for-profit to protect their specific techniques as intellectual property and give potential investors the confidence to write checks. Doblin, the nonprofit psychedelics advocate, says Compass's patent applications are narrow enough that they won't threaten a nonprofit effort in the U.S.

For now, Compass says it's focused on the 216 patients in its Phase 2B trials, meant to help perfect the dosage. Initial dosing is supposed to end by summer, with follow-up and results by early 2021 to put the treatment on track to seek FDA approval a couple of years later, Goldsmith says. However it ends, it's certain to be a long, strange trip. —*Adam Piore*

THE BOTTOM LINE Imitation shrooms won't be over-the-counter drugs for at least a few years, but the tentative backing of the FDA marks an astonishing shift given the drug's longtime political toxicity.

The $1 Billion Solar Relic

● By the time the massive Crescent Dunes plant came on line, it was already outdated

The Crescent Dunes solar plant looks like something out of a sci-fi movie. Ten thousand mirrors form a spiral almost 2 miles wide that winds around a skyscraper rising above the desert between Las Vegas and Reno. The operation, a kind of thermal/solar power plant, soaks up enough heat from the sun's rays to spin steam turbines and store energy in the form of molten salt.

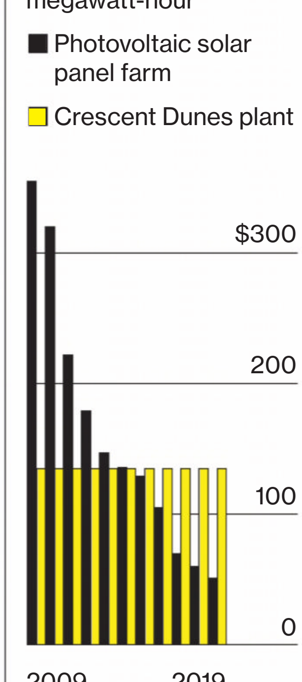
In 2011 the $1 billion project was to be the biggest solar plant of its kind, and it looked like the future of renewable power. Citigroup Inc. and other financiers invested $140 million with its developer, SolarReserve Inc. Steven Chu, the U.S. Department of Energy secretary at the time, offered the company government loan guarantees, and Harry Reid, then the Senate majority leader and senior senator from Nevada, cleared the way for the company to build on public land. At a Washington celebration of SolarReserve's public funding, Chief Executive Officer Kevin Smith told the assembled politicians, "We're proud to be doing our part to win the future."

SolarReserve may have done its part, but today the company doesn't rank among the winners. Instead, it's mired in litigation and accusations of mismanagement at Crescent Dunes, where taxpayers remain on the hook for $737 million in loan guarantees. Late last year, Crescent Dunes lost its only customer, NV Energy Inc., which cited the plant's lack of reliability. It's a victim, ironically, of the solar industry's success over the past decade. The setup at Crescent Dunes requires custom parts and a staff of dozens to keep things humming and to conduct regular maintenance. By the time the plant opened in 2015, the increased efficiency of cheap solar panels had already surpassed its technology, and today it's obsolete—the latest panels can pump out power at a fraction of the cost for decades with just an occasional hosing-down.

NV Energy, owned by Warren Buffett's Berkshire Hathaway Inc., had to wait months to cut ties with SolarReserve. Crescent Dunes has been shut down since April, and the Energy Department took control of it in August, according to a lawsuit SolarReserve filed in Delaware Chancery Court seeking to reverse the takeover. The plant's technology was designed to generate enough power night and day to supply a city the size of nearby Sparks (population 100,000), but it never came close. Its power cost NV about $135 per megawatt-hour, compared with less than $30 per MWh today at a new Nevada photovoltaic solar farm, according to BloombergNEF, which researches fossil fuel alternatives.

Almost no one associated with Crescent Dunes will talk about it anymore. That includes the once-friendly politicians and regulators, the financiers, and the executives who've been in place during its failure. (SolarReserve didn't respond to repeated requests for comment for this story, and a lawyer representing the company said he wasn't authorized to comment.) One exception is Bill Gould, a SolarReserve co-founder who retired as its chief technology officer last year. He blames the contractor. "It was a tragedy of mismanagement,"

▼ Cost of solar technology per megawatt-hour



JAMEY STILLINGS. DATA: BLOOMBERGNEF

▲ Crescent Dunes has been shut down since April and has lost its only customer

he says. Spanish company ACS Cobra, he says, delayed necessary work on Crescent Dunes and designed a salt tank that leaked, crippling the plant. SolarReserve doesn't appear to have filed any legal claims against the contractor, however. Grupo Cobra, ACS Cobra's parent company, didn't respond to requests for comment.

The Energy Department estimates that losses represent only 2.9% of its $28 billion in loan guarantees for renewable energy projects, which also funded such successes as the massive farms of thin-film solar cells from the biggest American manufacturer. Advocates of public investment say flops are an inevitable part of seeding a carbon-neutral future, just as they are for venture capitalists seeking the next Google. "You should probably have more than one or two high-profile failures," says Yale economics professor Kenneth Gillingham, who studied energy issues as part of President Barack Obama's White House Council of Economic Advisers. "Otherwise, you haven't invested aggressively enough."

Under the Trump administration, which has mocked the push for fossil fuel alternatives, it's easy to imagine Crescent Dunes being used as a talking point if the White House proposes to eliminate federal subsidies for renewable power, says Timothy Fox, a vice president at researcher ClearView Energy Partners LLC. Chris Edwards, the director of tax policy studies at the libertarian Cato Institute, says the feds shouldn't invest in alternative energy. "There's a long and growing list of failed government projects," says Edwards, a former senior economist on the Republican staff of the U.S. Congress Joint Economic Committee. He points to the familiar example of Solyndra LLC, a solar company backed by $535 million in loan guarantees that filed for bankruptcy in 2011.

A buyer might try to bring Crescent Dunes back on line, or its owner could sell it for parts. For now, the plant is mostly a punchline in a part of Nevada that's seen its share of booms and busts. The nearest town, Tonopah, was the site of a silver rush in the early 1900s. It's now home to 2,400 people, a motley collection of saloons and casinos, a mining museum, and the Clown Motel, which calls itself "America's scariest motel" because it's close to a cemetery and filled with creepy red-nosed tchotchkes. The solar plant's workers don't boost business like they used to, says Linda Taylor, the motel's manager. "It took our money," she says of the giant mirror matrix up the road. "It's dead. But real pretty, though. You can see it for miles." —*Chris Martin and Nic Querolo*

THE BOTTOM LINE Cheap solar panels have grown wildly more efficient in recent years, but that's a disaster for such plants as Crescent Dunes that can't easily upgrade their dated components.

The Great Index Fund Takeover

The Big Three—BlackRock, Vanguard, and State Street—may be the most important players in corporate America. Whether they like it or not

If you hold a stock market index fund, congratulations. The S&P 500's total return was a thumping 31.5% in 2019, and a fund that passively tracks that benchmark delivered almost all those gains, minus a tiny fee—perhaps just 0.04% of assets. Now here's something you probably weren't thinking about when you clicked on the box to choose an index fund in your 401(k) or IRA: You were also part of one of the biggest shifts in corporate power in a generation.

The index fund is one of a handful of unambiguously beneficial financial innovations. Before it caught on, investors routinely paid sky-high fees to active stockpickers who often delivered subpar returns. The near-universal popularity of index funds puts them up there with Social Security, Stevie Wonder, and streaming TV.

Indexing also has been a runaway success for some fund companies. The largest asset manager in the world, BlackRock Inc., best known for its iShares brand of exchange-traded index funds, has $7 trillion under management. Index pioneer Vanguard Group Inc. has $5.6 trillion. The No. 3 indexer, State Street Corp., manages $2.9 trillion. These companies also run active funds, but together they hold about 80% of all indexed money. They've come to be known as the Big Three.

Their success has had a weird and unintended consequence. As millions of investors have done the most sensible thing financially, they've also concentrated shareholder power in the Big Three. Some 22% of the shares of the typical S&P 500 company sits in their portfolios, up from 13.5% in 2008. Their power is probably greater, given that many stockholders don't bother to vote their shares.

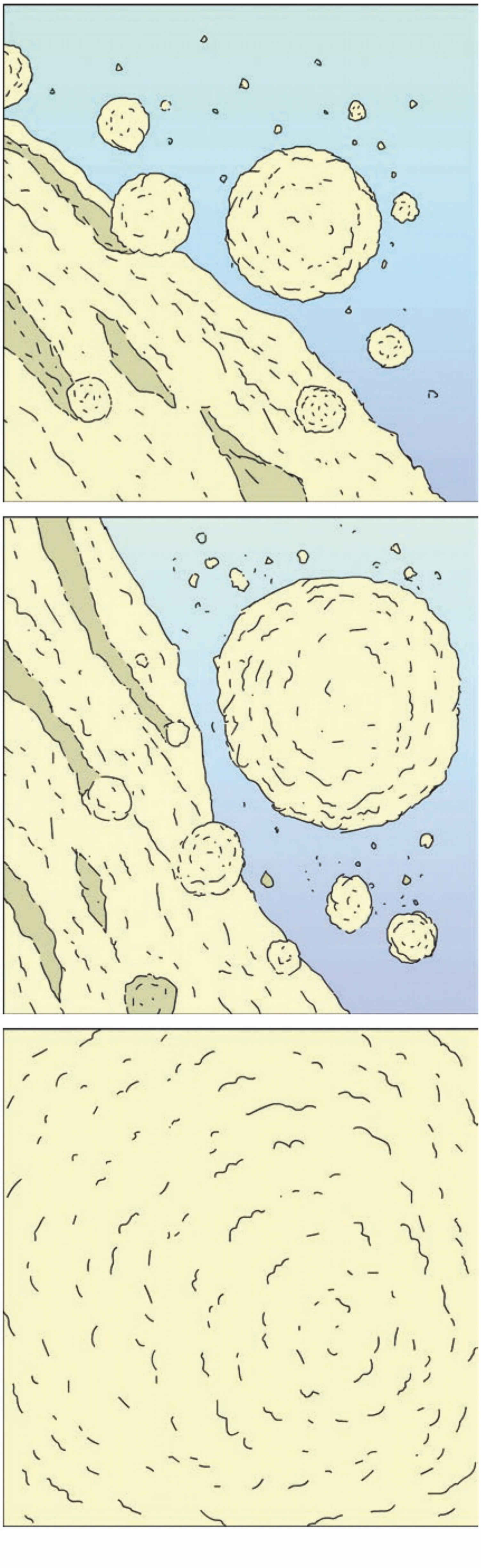
BlackRock, Vanguard, and State Street combined own 18% of Apple Inc.'s shares, up from 7% at the end of 2009. Of the four largest U.S. banks, the fund companies together own 20% of Citigroup, 18% of Bank of America, 19% of JPMorgan Chase, and 19% of Wells Fargo. The phenomenon can be even more pronounced for smaller companies. The Big Three own 28% of Cabot Microelectronics Corp., an Aurora, Ill., seller of materials to semiconductor manufacturers that has a market value of $4 billion.

The fund companies say there's nothing to worry about because they don't vote as a bloc. And index funds don't buy shares to pursue any special agenda—they just buy whatever's in the index, usually in proportion to its market value. If passive managers weren't grabbing up all these shares, similar power would likely be in the hands of active funds, which haven't served investors nearly as well. Index fund managers are more technocrat than robber baron.

And yet voting power is voting power. The fund companies' combined votes and back-channel jawboning, in which they make their views known to directors and chief executive officers, could swing the outcome of important matters such as mergers, major investment decisions, CEO succession, and director elections—even if no fund house has the ability to decide the outcome of such matters alone. They're potentially the most powerful force over a huge swath of America Inc. Alarm bells have begun to go off with some regulators, as well as with an ideologically diverse array of academics and activists.

Environmental and consumer groups, for example, accuse index managers of shirking their broader social responsibilities, such as by not divesting the shares of fossil fuel companies or by not blocking lavish CEO pay. BlackRock CEO Larry Fink was met by protesters at an October black-tie gala at the Museum of Modern Art, where he sits on the board. (The fund companies say the passive investment model means they can't divest from companies listed on indexes.) Other detractors say companies

Edited by
Pat Regnier and
Paula Dwyer



may not be competing aggressively because their common owners—the funds that hold them all—don't want or need them to.

Where the critics agree is that index funds, as good as they are for investors, may be also indirectly harming consumers and workers. And, of course, many of us are all three. "When you see a small handful of players with ever-growing share and ever-growing clout affecting the trajectory of the largest public companies in the world, that's going to raise a lot of eyebrows," says Ben Johnson, a Morningstar Inc. analyst. "The question is whether their influence will be wielded for better or worse."

Even Vanguard founder Jack Bogle—a tireless advocate for indexing—warned just before his death in January 2019 that there may be too many shares in too few hands. Index funds are so successful, he wrote in the *Wall Street Journal*, that they could one day effectively control the U.S. stock market. "I do not believe that such concentration would serve the national interest," he said.

The debate threatens to put the giants of passively managed money under the same harsh light as Big Tech, where rising market concentration is blamed for the disappearance of small businesses, fewer startups, lower wages, and the loss of privacy.

The antitrust worries about index funds involve common ownership, when the same large investors own a big chunk of the shares in the major corporations in the same industry. Academics have long theorized that common ownership might encourage coordinated behavior among companies linked by the same set of owners. And recently researchers have made some surprising findings, including that high levels of common ownership can lead to higher prices and lower levels of investment, innovation, and output. Harvard Law School professor Einer Elhauge calls common ownership the greatest anti-competitive threat in the economy today. Index funds "are great for investors," says Elhauge, "but part of the reason they're great for investors is exactly because of the anti-competitive effects." Elhauge says the trusts of the late 19th century that gave rise to today's antitrust laws also involved a form of common shareholding.

Index fund managers aren't meeting with companies to secretly carve up markets in smoke-filled rooms. The process critics imagine is more subtle. It starts with the idea that passive funds seek only to match an index's return and not outperform it. Thus the fund managers lack financial incentives to ensure the companies in their portfolios are competing fiercely with one another. Compare ▶

"The question is whether their influence will be wielded for better or worse"

ILLUSTRATION BY SAMMY STEIN

◀ this to an active manager who holds, say, shares of Coca-Cola Co. but not PepsiCo Inc. She might want Coca-Cola to take big risks to crush Pepsi, and invest capital in new products and markets to do so. An investor who holds both, on the other hand, would prefer that Coke and Pepsi avoid price wars.

Such going along to get along may not always be benign. A 2018 study found that, when the same institutional investors are the largest shareholders in branded drug companies and generic drugmakers, the generic companies are less likely to offer cheaper versions of the brand-name drugs. Consumers could be paying higher drug prices as a result. “The potential effects on anti-competitive conduct are really serious,” says Melissa Newham, a Ph.D. candidate at KU Leuven in Belgium and a co-author of the study. It isn’t clear whether funds are somehow pressuring management or management just knows that competing hard isn’t in the interest of their key shareholders.

This line of research began with a 2014 paper about competition among U.S. airlines that quietly shook the fund industry and the antitrust world. José Azar, an economist at the University of Navarra in Barcelona, along with Martin Schmalz and Isabel Tecu, showed that airline ticket prices were 3% to 7% higher because big funds owned stakes in so many airlines.

Azar says he first became interested in common ownership in late 2010 as a Princeton graduate student. It led to his dissertation on the issue, but it wasn’t until he was working at economic consulting firm Charles River Associates that he and Tecu decided over lunch to look at airlines, partly because the industry produces reams of data on fares.

The research prompted BlackRock to hire an economic consulting firm to do its own study. It concluded that Azar and his co-authors had overestimated the effects of common ownership on ticket prices by not accounting for periods when the major airlines were in bankruptcy. (When a company is bankrupt, its shares are removed from indexes, and the index funds usually sell.) Azar says that he did account for bankruptcies in the paper and hasn’t seen any research that invalidates his key findings.

The fund management companies reject any notion that their ownership is anti-competitive. They point to studies that back them up, and say that higher air fares, for example, would hurt the hotel stocks they also own. Besides, they say their sway over companies is vastly overstated. Being the largest shareholder of a company is not the same thing as holding voting control over it. “For the overwhelming majority of proxy votes, the data shows that index managers’ votes do not determine the outcome,” says BlackRock spokeswoman Tara McDonnell. “Any assertion otherwise is not based in fact.”

The Big Three are paying close attention to this research because it’s beginning to have an impact beyond the ivory towers. On Nov. 15, Rohit Chopra, a Democratic member of the Federal Trade Commission, cited overlapping ownership in Bristol-Myers Squibb Co. and Celgene Corp. as one reason to vote against the pharmaceutical giants’ $74 billion merger. His point was that incentives for the merger might be distorted since many of the same investors owned both the buyer and the seller.

While Chopra lost the vote, FTC Chairman Joe Simons said at an antitrust conference three days later that his agency is considering conducting an in-depth study of common ownership. “Serious people have raised these issues, and there’s empirical work, and it’s definitely worth looking into,” he says. The Justice Department’s antitrust chief, Makan Delrahim, in May said the department was closely following common-ownership research.

The European Union has gone further. When competition officials reviewed the proposed merger of DuPont Co. and Dow Chemical Co., they looked into the high levels of common ownership, including by index funds, already in place across the agricultural chemical industry (not only in Dow and DuPont). The EU found it potentially threatened innovation. In part to allay these concerns, the EU in 2017 forced DuPont to offload large parts of its global pesticide business to win approval for the deal.

The Investment Company Institute, the fund industry trade group, has arranged for members to meet with lawmakers to reassure them that common ownership isn’t a problem. Separately, BlackRock Vice Chairman Barbara Novick began a flurry of emails and phone calls with the FTC in October 2018, according to documents obtained through the Freedom of Information Act. Some of the outreach was triggered by Fiona Scott Morton, an economics professor at the Yale School of Management, who voiced concerns about common ownership. In December 2018 the FTC devoted a hearing to the issue.

The potential impact of common ownership reaches beyond antitrust matters to questions about how companies are run. Index fund managers may follow passive investment strategies, but they don’t blindly choose stocks and sit back, says John Coates, a Harvard law professor. Fund companies have multiple tools to influence corporate behavior, such as developing preferred policies on executive compensation, carbon footprints, gender diversity, and other governance matters. ▶

● Assets in U.S. equity index funds as of August 2019

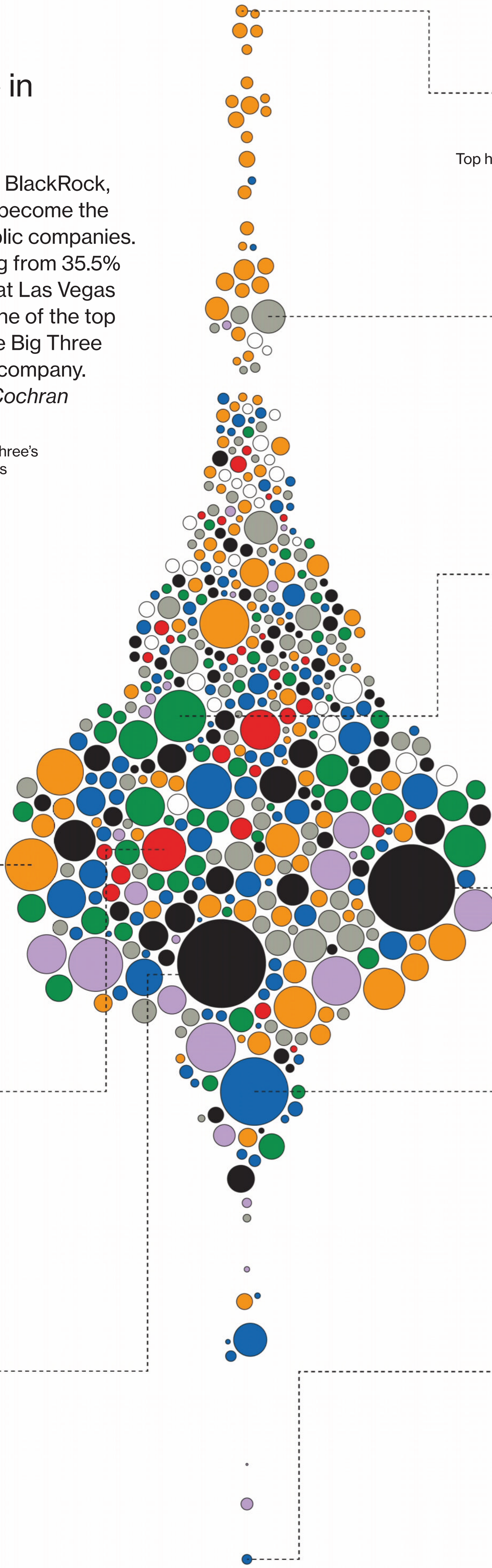
$4.3t

The Big Three's Stake in Corporate America

As investors pile into index funds, BlackRock, Vanguard, and State Street have become the leading shareholders in many public companies. With combined ownership ranging from 35.5% at Host Hotels & Resorts to 6.1% at Las Vegas Sands (where State Street isn't one of the top five shareholders), on average the Big Three own 22% of the typical S&P 500 company.
——*Mark Glassman, with Denise Cochran*

Sector
- Energy
- Financials
- Health care
- Consumer discretionary and staples
- Communications
- Industrials and materials
- Technology
- Utilities

Value of the Big Three's combined holdings
$100b
50
10



Big Three share ▶ 35%
30
25
20
15
10

Host Hotels & Resorts

Top holders ▶

Vanguard	17.0%
BlackRock	11.6
State Street	6.9
Franklin Resources	3.9
Northern Trust	2.1

Lockheed Martin

State Street	15.4%
Capital Group (American Funds)	8.8
Vanguard	7.8
BlackRock	6.4
Wellington Mgmt.	4.1

Johnson & Johnson

Vanguard	8.6%
BlackRock	7.2
State Street	5.8
Capital Group	1.5
State Farm Mutual Auto Insurance	1.4

JPMorgan Chase

Vanguard	8.0%
BlackRock	6.7
State Street	4.7
Capital Group	4.3
Berkshire Hathaway	1.9

Microsoft

Vanguard	8.1%
BlackRock	6.7
Capital Group	4.9
State Street	4.1
FMR (Fidelity)	3.2

Exxon Mobil

Vanguard	8.3%
BlackRock	6.7
State Street	4.7
Capital Group	2.8
Geode Capital Mgmt.	1.4

Amazon

Jeff Bezos	11.6%
Vanguard	6.4
BlackRock	5.3
MacKenzie Bezos	4.0
State Street	3.4

Apple

Vanguard	7.6%
BlackRock	6.4
Berkshire Hathaway	5.8
State Street	4.2
FMR	2.2

Las Vegas Sands

Sheldon Adelson	51.7%
Capital Group	5.5
T. Rowe Price	3.1
Vanguard	3.0
BlackRock	2.1

OWNERSHIP STAKES AS OF SEPT. 30, 2019, OR, FOR INDIVIDUALS, MOST RECENTLY REPORTED PRIOR TO SEPT. 30, 2019. MARKET VALUE OF THOSE STAKES AS OF JAN. 3, 2020. DATA: COMPILED BY BLOOMBERG

◀ They often do this in coordination with other industry leaders, Coates says. "A small number of unelected agents, operating largely behind closed doors, are increasingly important to the lives of millions who barely know of the existence much less the identity or inclinations of those agents," Coates wrote in a widely cited 2018 paper. The agents, in this case, are the managers of fund companies—and the most important of those are the index giants.

The surprising thing about all this is that index funds began so modestly. They were a niche product aimed at investors who took the then-radical position that paying close attention to individual companies wasn't worth the effort and expense. In the decades after Bogle launched the first retail index fund in 1976, that idea would be proven right again and again. For example, only 10% of actively managed U.S. large-cap funds outperformed the market in the 15 years through June 2019, according to S&P Dow Jones Indices data.

Investors caught on, and money piled in. Vanguard, now led by CEO Mortimer "Tim" Buckley, boasts more than 30 million investors globally. The original Vanguard 500 Index fund now has about $405 billion in assets; there are about 380 U.S. mutual funds that follow indexes. Add to this list exchange-traded funds that track indexes and can be bought and sold instantly just like stocks. In 1993, State Street's investment management arm, State Street Global Advisors, launched the first of these in the U.S., the SPDR S&P 500 ETF Trust, or SPY for short. BlackRock got into the business when it acquired iShares in 2009 from Barclays Plc. The U.S. now has more than 1,400 equity index ETFs. In August 2019 the industry reached a milestone when the $4.27 trillion in passively managed stock funds outflanked the $4.25 trillion run by stockpickers.

The Big Three represent the key votes on matters such as mergers and shareholder activist campaigns. The fund companies also hold what they call "engagements" with companies through meetings and phone calls. But perhaps unsurprisingly, because the rise of index funds is relatively new, academics who study common ownership have different ideas about how the fund managers' influence might be felt. Some, such as Coates, think they could emerge as key power players, perhaps joining their votes with hedge funds that push for deals or corporate restructurings. Such deals can boost share prices but may also lead to layoffs.

Others worry that index funds, mainly by keeping quiet, will simply enhance the power of CEOs. In a 2018 paper, New York University professors Ryan Bubb and Emiliano Catan found that the Big Three were unlikely to oppose management on hot-button issues such as executive pay and likely to support management proposals to merge or make large acquisitions. BlackRock supported such M&A proposals 79% of the time and Vanguard, 85%. BlackRock and Vanguard overwhelmingly favored election of incumbent company directors, according to another analysis of proxy voting records at 25 global asset managers.

Lucian Bebchuk, a Harvard law professor, says index fund managers don't have incentives to invest the time into actively supervising companies. That's because any effort to increase the value of a company would also increase the value of the index, which in turn benefits every fund that tracks the index. As a result, the fund that pushes management can't stand out from its peers and attract more money—yet it incurs higher stewardship costs. The concern is that such deference will "result in insufficient checks on corporate managers," Bebchuk says.

In a 2019 paper, he writes that the Big Three spent minuscule amounts on stewardship. According to Morningstar, Vanguard employed 21 people to do the work of corporate oversight at a cost, by Bebchuk's estimate, of about $6.3 million—a drop in the bucket considering Vanguard's trillions of dollars under management.

The Big Three all claim to be good stewards of the companies whose shares they own. Vanguard, for example, said it engaged with 868 companies in the 2019 proxy year and voted on more than 169,000 proposals. BlackRock reported more than 2,000 engagements with 1,458 companies in its 2019 global investment stewardship report. BlackRock's McDonnell says the fund company takes its role "as a shareholder seriously" and that it dedicates more people to overseeing the companies whose shares it owns "than any other investment management firm in the world." BlackRock employs about 45 full-time people globally to work on stewardship issues. State Street spokesman Marc Hazelton says the company uses its "voice and vote to influence companies on long-term governance and sustainability issues." He says State Street has seen "companies respond to our calls to action across a range of important topics."

Novick, the BlackRock executive, has called the competing theories over how fund companies wield their power the Goldilocks dilemma: "Do asset managers do enough? Do they do too much? Or are they doing just the right amount?" she said at a Harvard roundtable on corporate governance.

The power of the index funds is also becoming a concern of social activists. One study found that

"The potential effects on anti-competitive conduct are really serious"

BlackRock and Vanguard voted against at least 16 climate-related shareholder proposals in which their support would have given the measures a majority of votes. The study, conducted by the nonprofit Majority Action, looked at 41 climate change-related proposals ranging from setting greenhouse gas emission targets to disclosing environmental lobbying activity. BlackRock and Vanguard were less likely than their fund company peers to back the resolutions, supporting them less than 15% of the time. State Street voted in favor of climate-related resolutions more often—about 27% of the time—but still less often than its peers did. “I think the large passive managers have a real difficult decision to make,” former Vice President Al Gore told the *Financial Times* in December. “Do they want to continue to finance the destruction of human civilization, or not?”

Leo Strine Jr., an influential corporate law jurist who recently retired as chief justice of the Delaware Supreme Court, thinks index funds ought to be doing more to check the political influence of the companies they own. In a paper, he castigates BlackRock and Vanguard for failing to curb campaign contributions, lobbying expenses, and other political spending by their portfolio companies. He calls this “a huge fiduciary blind spot.” Although the companies’ political spending might be good for each individual business, Strine argues that asset managers should bear in mind the broader interests of their own fund shareholders, who are often workers investing in 401(k) retirement plans. Political spending to elect lawmakers who favor giving companies more leverage over pay and benefits, for example, can result in lower wages.

The role of fund companies in Americans’ retirements may pose another conflict. The corporations in their portfolios may be clients, too. Vanguard, for example, administers 1,900 retirement plans with about $1.4 trillion in assets under management. The worry is that fund houses might cast votes as shareholders that appease executives “even when voting with management—the client—is not in its investors’ best interests,” wrote Sean Griffith, a Fordham School of Law professor, and Dorothy Lund, a law professor at the University of Southern California, in a recent article. Carolyn Wegemann, a Vanguard spokeswoman, says Vanguard keeps a clear separation between its stewardship efforts and its retirement plan business.

Is there any way to limit the potential downsides of the Big Three’s dominance? It’s possible that competition from other fund managers could chip away at it. Fidelity Investments, known for its stable of actively managed funds, intensified a price war among indexers when it introduced four no-fee index mutual funds in 2018. But such competition may only change things marginally. Cost-cutting tends to entrench big players. Tiny management fees add up when they’re spread over trillions of dollars, and larger companies can more easily offset any loss of fee revenue with advisory and other services.

State Street CEO Ron O’Hanley has suggested having individual fund managers vote the shares in their portfolios, rather than the parent fund company voting all the aggregated shares. “My view is we should be open to change on this,” he told the *Wall Street Journal* in December.

In his op-ed, Bogle discussed other remedies floated by experts and rejected most of them. Barring index funds from owning the shares of more than one company in an industry, he said, would destroy the index fund model—breaking one of the best investment tools ordinary people have. Only one suggestion—more transparency—won the endorsement of Bogle and BlackRock. BlackRock already discloses its engagement priorities, voting guidelines, actual votes cast annually, and other summary statistics. Bogle wanted to take the idea further by requiring index funds to publicly disclose each engagement with corporate managers.

If the problem is that companies’ key shareholders have a tangle of conflicting interests, a more radical fix could be to get new voices into the room. Companies could add employee representatives to boards. Politicians from the Left (Democratic presidential candidate Elizabeth Warren) and the Right (former U.K. Prime Minister Theresa May) have proposed as much. German companies already include workers on their supervisory boards.

Perhaps the most immediate solution comes from Anat Admati, a Stanford finance and economics professor. Fund companies, she says, should use their leverage to make sure corporations are managed in the true interests of a fund’s clients. “Start with the basics, such as ensuring better controls to prevent fraud, deception, reckless practices, and political activities against the public interest,” Admati says, “and it’s just possible that competition will improve and costly scandals, such as the opioid epidemic, Boeing Co.’s 737 Max failure, Wells Fargo & Co.’s fraudulent checking accounts, and Facebook Inc.’s repeated privacy breaches, might have been avoided.” *—David McLaughlin and Annie Massa, with Aoife White, Denise Cochran, and Bruce Johnson*

THE BOTTOM LINE About 22% of the voting shares of a typical S&P 500 company are held by fund companies that built their businesses on passive investing. Passive doesn’t mean powerless.

● Vanguard’s Buckley

● BlackRock’s Fink

● State Street’s O’Hanley

BUCKLEY: COURTESY VANGUARD; FINK: SIMON DAWSON/BLOOMBERG; O’HANLEY: DANIA MAXWELL/BLOOMBERG

Saudi Arabia

The “Clash on the Dunes”

Steps Into the Ring

● The kingdom sees racing, boxing, and soccer as a way to boost its profile and soften its image

On Jan. 5 the Saudi port of Jeddah echoed with the roar of hundreds of cars, motorcycles, and trucks in the Dakar Rally, a grueling two-week trek through the mountains and deserts of the kingdom—the first time the event is being held in the Middle East. That came just four weeks after the “Clash on the Dunes,” a heavyweight boxing title bout near the ancestral home of the Saudi ruling family, which was billed as a worthy successor to Muhammad Ali’s “Rumble in the Jungle” and “Thrilla in Manila.” And on Feb. 29, 14 thoroughbreds will take to a dirt track in Riyadh for the inaugural Saudi Cup, the world’s richest horse race, with $20 million up for grabs.

The run of big-ticket events marks a sharp turnaround for the kingdom, which barely registers on the global sporting map. It’s part of a push by Crown Prince Mohammed bin Salman, the 34-year-old de facto ruler, to modernize the economy and reduce the influence of puritanical Islam. The prince says opening up to tourists and allowing Western-style entertainment and concerts that Saudis have long been denied can create much needed jobs and attract investment beyond oil—though the risk of wider conflict after the U.S. killed Iranian General Qassem Soleimani could threaten his ability to achieve that. The Saudis aim to raise non-oil revenue more than sixfold annually, to $266 billion by 2030.

Edited by
Cristina Lindblad

Critics call the effort "sportswashing"—an attempt to deflect attention from the kingdom's role in the war in Yemen, now in its fifth year, and the 2018 murder of *Washington Post* journalist Jamal Khashoggi by Saudi agents. "It's a soft-power strategy to project a kinder face," says Madawi Al-Rasheed, a frequent government critic working as a visiting professor at the London School of Economics. "They're using it to cover up some serious shortcomings."

The plans echo those of Middle Eastern rivals, which have long seen sports as a way to boost their profile. Dubai has hosted international golf, tennis, and rugby tournaments for decades. Bahrain and Abu Dhabi have Formula One races, and the latter in 2010 opened a Ferrari-linked theme park with a marina and luxury hotels next to the circuit. Qatar is investing $200 billion in stadiums and other infrastructure for the 2022 soccer World Cup.

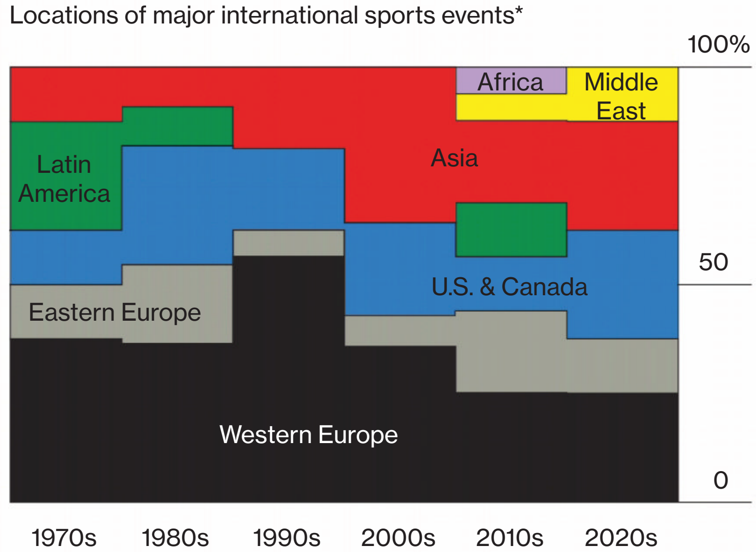
The strategy risks attracting more scrutiny than the Saudis are accustomed to. Human Rights Watch called on the Dakar Rally organizers to use the event to highlight the mistreatment of female activists. Former players have slammed the Royal Spanish Football Federation for a $130 million deal that will see Barcelona, Real Madrid, and two other teams play in the kingdom on Jan. 8-12. Citing the Saudis' record on human rights, Spain's state broadcaster refused to show the tournament, to be held annually for the next three years. Golfer Phil Mickelson has come under fire for competing in the Saudi International tournament in January (unlike Tiger Woods, who declined an offer of $3 million just to show up, and Rory McIlroy, who said "morality" was part of his decision to skip the event). "I'm excited to go play and see a place in the world I've never been," Mickelson wrote on Twitter.

Still, the experience of other rising nations suggests sports investment pays off. The 1988 Seoul Olympics and the Beijing Games two decades later presented a softer side of those countries, and the Chinese are seeking a repeat with the winter version in 2022. While Qatar has taken flak over its treatment of immigrant workers building World Cup stadiums and allegations of corruption in the bidding for the tournament, its reputation as a center of tourism and culture is growing. "The Saudis don't want their political record in the spotlight," says Anoush Ehteshami, director of the Institute for Middle Eastern & Islamic Studies at Durham University in England. "But it's committed to getting the world's interest economically. You can't do that without opening up."

The push comes as Saudi Arabia's isolation following Khashoggi's killing starts to ease. Many Westerners skipped the 2018 Future Investment Initiative, a Davos-like conference hosted in Riyadh, but the 2019 meeting in October was attended by the likes of U.S. Treasury Secretary Steven Mnuchin and the heads of Citigroup Inc. and BlackRock Inc. A few weeks later, Citi joined Goldman Sachs Group

Sweat Equity

Locations of major international sports events*



*OLYMPIC GAMES, WORLD CUP, WOMEN'S WORLD CUP, AND WORLD ATHLETICS CHAMPIONSHIPS. DATA: ORGANIZATION WEBSITES

Inc. and other global financial houses to manage energy giant Saudi Arabian Oil Co.'s $26 billion initial public offering. "Some sports or institutions will decide they just can't do business in Saudi Arabia, but they'll be in the minority," says Ryan Bohl, who analyzes the Middle East for Stratfor, a political advisory firm in Texas.

The country's sports drive may dovetail with big-name sporting acquisitions abroad, says Simon Chadwick, a professor of sports enterprise at the U.K.'s Salford Business School. Saudi Arabia has so far stayed out of the race for soccer teams and naming rights that other Persian Gulf countries have engaged in. Qatar in 2011 paid $140 million for France's Paris Saint-Germain and has since invested more than $1 billion in the club and A-list players such as Brazil's Neymar. And Abu Dhabi, which effectively owns English champions Manchester City through a senior member of the emirate's royal family, has named the club's stadium after its national airline, Etihad. With some $160 billion in oil revenue this year, Saudi Arabia has the clout to catch up. It will be hard for any business—including sports—to ignore, Chadwick says. "The thing that speaks most loudly is money," he says. "If the money's in Saudi Arabia, sport will go there." —*Paul Wallace*

THE BOTTOM LINE Big-ticket events may create jobs and investment in Saudi Arabia, but critics call the idea "sportswashing," deflecting attention from the kingdom's human-rights record.

"It's a soft-power strategy to project a kinder face"

RICHARD HEATHCOTE/GETTY IMAGES; DATA: BLOOMBERG CAFÉ CON LECHE INDEX

The Dollar Is Conquering Venezuela

● The country is awash in semi-illicit greenbacks that threaten to spark a crime wave

U.S. dollars are everywhere in Venezuela, and suddenly that's a problem.

The greenback is steadily gaining ground in this inflation-wracked country, where a single dollar buys about 70,000 bolívars on the black market. That's creating challenges for local businesses, because Venezuelan banks are barred from offering foreign currency accounts.

For safekeeping, an insurance saleswoman in the western town of San Cristóbal tapes stacks of dollars from clients to the inside of a toilet tank in her office bathroom. A general contractor, unable to wire cash into his accounts in the U.S., flew his elderly mother and wife from Caracas to Miami with $9,900 of cash each, just under the limit required for reporting money to U.S. customs authorities.

"This is money earned through legal means yet in a currency that exists entirely outside the country's constitutional order. This isn't money laundering," says Luis Godoy, a former deputy chief of the judicial police who now works as a security consultant. "You have to wonder how many people right now have money stacked inside their homes like Pablo Escobar."

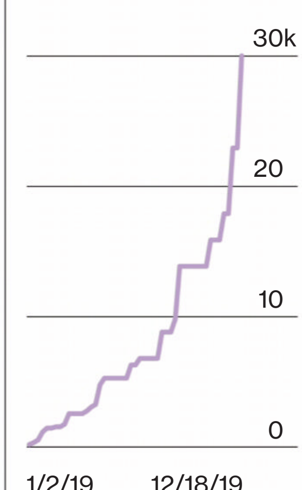
The collapse of the bolívar, which shed 99% of its value against the dollar in 2019, mirrors that of the Venezuelan economy, which has endured 21 consecutive quarters of decline. The crisis has been aggravated by international sanctions that prohibit exports of oil to the U.S. and cut access to external financing. While inflation has abated somewhat, largely through severe restrictions on lending, it remains the highest in the world, at an estimated annual rate of 6,567%, according to Bloomberg's Cafe Con Leche Index. A year ago a cup of coffee cost 450 bolívars; at the end of last month it was 30,000 bolívars.

Increasingly, the national currency is used mostly to pay for a few subsidized goods, such as subway tickets and gasoline, which costs less than a penny a tank in the former petrostate. The dollar has crept in for almost everything else. Hairstylists and window washers quote their prices in dollars. Juice and hot-dog stands in Caracas are adorned with signs advertising that they accept payment in greenbacks or via Zelle, the U.S. peer-to-peer payment system.

José Gómez runs a corner store in a working-class Caracas neighborhood that's stocked with Brazilian sweets and liquor. About 70% of his sales are in dollars. "We don't know for how long the tax authorities will ignore us," he says. Juan Carlos, who asked that his last name be withheld for security reasons, says there's about $3,000 in the register at his shop in the capital's Chacao district that sells imported luxuries such as Nutella and gluten-free flour. He pays suppliers in dollars and takes his profits home at the end of the day. "We've turned back to the 1920s, to keeping cash under our mattresses," he says.

Banks in Venezuela can't offer dollar checking or savings accounts. Several institutions allow clients to stash their greenbacks in safe deposit boxes, and some charge a steep 2% fee on withdrawals. Venezuela's bank regulator, Sudeban, declined to comment.

▼ Price of a cup of coffee in Caracas, in bolívars



◀ Dollars being stored in a box at a kiosk in Caracas

The ascendancy of the dollar has stoked fears about another wave of violent crime like the one that swept the country in the late 1990s, when gun-toting bandits on motorcycles preyed on drivers waiting at red lights and so-called express kidnappings—daylong abductions for ransom—skyrocketed. In December, Andrés Gutierrez was robbed at gunpoint outside his home in the Caracas neighborhood of Macaracuay as he was coming back from a party. “He took my phone and was pointing his gun at me as I lay on the sidewalk. He told me to close my eyes if I didn’t want to die,” he says. Gutierrez later managed to make a deal, offering the pair of thieves $100 to get back his phone. “If I hadn’t had dollars, they would have never given it back,” he says. “I don’t think they would have accepted a bolívar transfer.”

While crime figures aren’t readily available, robberies and kidnappings are believed to have decreased in recent years as the bolívar lost value, ammunition increased in price, and the rich—and poorest—left Venezuela in an exodus of 5 million people. With more dollars in circulation, there’s once again something valuable to steal. “Any moment, we will see crime blow up, because we’re facing a huge problem with how to move cash. It’s chaos,” says Jorge Barrios, who owns Caracas-based Gallery Security. “Stores and homes are becoming cash deposits.”

While President Nicolás Maduro railed against the idea of officially swapping the bolívar for the U.S. dollar last year, equating it with a surrender of sovereignty, he thanked God for greenbacks in a November interview, crediting their increased use with an economic recovery and resurgence of production.

If the regime were to follow in the footsteps of countries such as El Salvador and Ecuador that have formally adopted the dollar as their currency, Venezuelans would turn in their bolívars, which would be destroyed, and exchange them for dollars from the government’s remaining reserves at a determined exchange rate. That would go a long way toward ending hyperinflation and restoring incentives to save and invest.

For now, though, the dollar remains in a dangerous gray area: heralded by the president, yet mostly outside the rule of law. “The government has turned a blind eye to this,” says Gómez, the store owner. “Now we’re living with ropes around our necks like fugitives.” —*Patricia Laya and Nicolle Yapur, with Alex Vasquez*

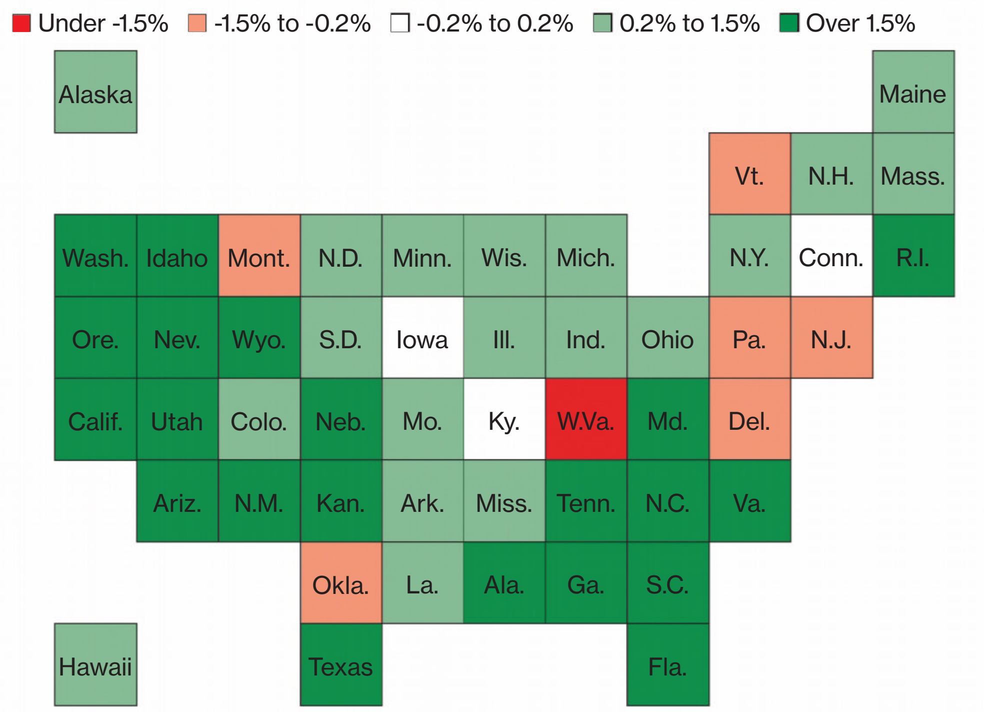
THE BOTTOM LINE The greenback is edging out Venezuela’s national currency, the bolívar, in business and everyday commerce, but President Maduro has nixed the idea of full dollarization.

ADRIANA LOUREIRO FERNANDEZ/BLOOMBERG

Tracker U.S. States

A Philly Fed index sees the economies of several states stalling in the next six months.

Change in coincident index



DATA: FEDERAL RESERVE BANK OF PHILADELPHIA

The economies of nine U.S. states are expected to slip into contraction within six months—the most since the financial crisis ended more than a decade ago, according to the latest projections from the Federal Reserve Bank of Philadelphia.

West Virginia’s economy is forecast to shrink the most, while a decline in neighboring Pennsylvania is anticipated to be the most severe since May 2009, figures released on Dec. 31 show.

The Philly Fed’s coincident index, which is updated on a monthly basis, analyzes state data including housing permits, unemployment insurance claims, and order delivery times from a manufacturing survey, along with the interest-rate spread between the 10-year Treasury bond and the three-month Treasury bill, to come up with six-month growth predictions.

While the index predicts growth of 1.4% for the U.S. economy as a whole, the expanding list of poor performers may have political consequences for President Trump, who’s staked claim to the longest expansion in American history. The early caucus and primary states of Iowa (Feb. 3) and New Hampshire (Feb. 11) are expected to see marginal growth over the next few months. —*Alex Tanzi*

Takeaway Weak state economies may cast a shadow over President Trump’s bid for reelection.

How Far Will It Go?

● Trump says he struck hard to prevent a war with Iran, but he may still get trouble

The drone killing on Jan. 3 of Iranian General Qassem Soleimani, the bloody-handed leader of Iran's elite Quds Force, was an expression of President Trump's lifelong philosophy: "Get even with people. If they screw you, screw them back 10 times as hard," as he said in a 2011 speech. The question is whether what works against other real estate developers will work as well against Iran.

Iran's immediate response to the killing of Soleimani—a Jan. 7 missile attack on joint U.S.-Iraqi military bases that caused no deaths or injuries—seemed symbolic. But that doesn't mean it won't strike again, and in the long run, the president's gambit could provoke escalation and damage America's standing in the region.

Trump is running into a dilemma other U.S. presidents have faced: How do you fight a foe who pokes and prods using asymmetric warfare, including guerrilla tactics, terrorism, and proxy forces, but against whom the use of catastrophic force would be reckless? President Nixon complained in 1970 that North Vietnam, an impoverished nation supplied militarily by the Soviet Union, stood to make the U.S. into a "pitiful, helpless giant" in Southeast Asia.

Like North Vietnam, Iran has played a weak hand expertly. The U.S. blames Soleimani for the deaths of 603 U.S. service members killed in Iraq since 2003. He's also suspected to be behind a drone attack on Saudi oil installations in September, a Dec. 27 drone attack in northeast Iraq that killed an American contractor and wounded four service members, and the invasion of the U.S. Embassy in Baghdad by Shiite militias on New Year's Eve. In addition, Iran has supplied money and weaponry to forces fighting against U.S. allies, including the Houthis in Yemen, Hezbollah in Lebanon and Syria, and the Popular Mobilization Forces in Iraq.

Edited by Jillian Goodman

▲ In Iran's parliament on Jan. 7, lawmakers chanted and held posters of General Soleimani, killed in Iraq by the U.S. days earlier

VAHID SALEMI/AP PHOTO

Soleimani seems to have crossed Trump's red line with the embassy invasion. It revived memories of the 444-day occupation of the U.S. Embassy in Tehran in 1979-81, which made Jimmy Carter a one-term president. By killing Soleimani, the U.S. signaled that Iran will face consequences for its actions even if it tries to cloak its responsibility for them.

Threatening to hit back hard, even to overreact, isn't always a bad idea. It can work against a foe who's perfected the art of "salami slicing," i.e., carrying out attacks and advances that always fall just short of the threshold for serious retaliation. Israel, Trump's favorite ally in the region, has made a practice of sending a message to its enemies by hitting back hard when attacked. Exasperated by repeated rocket attacks from Hamas fighters in Gaza, Prime Minister Benjamin Netanyahu ordered an invasion in December 2008 that killed more than 1,000 Palestinians. Tzipi Livni, then the foreign minister, said, "Israel is not a country upon which you fire missiles and it does not respond. It is a country that when you fire on its citizens it responds by going wild—and this is a good thing."

Ray Takeyh, an Iranian-born senior fellow at the Council on Foreign Relations, argued in a conference call with council members and journalists on Jan. 6—before Iran's retaliatory missile strike—that the hit on Soleimani will eventually work out well for Trump. "I think what the United States did was sensible and did restore American deterrent power," he said.

But the killing of Soleimani created new threats and revived old ones. Iran abandoned limits on the enrichment of uranium, one of the last vestiges of its 2015 nuclear agreement with the U.S. and other world powers. Iraqis who were only recently protesting Iran's presence in the country have pivoted to protesting the U.S. On Jan. 5, the parliament in Baghdad held a nonbinding vote calling on American troops to withdraw from the country. And the U.S.-led coalition against Islamic State paused its training and operations against the jihadi group in Iraq so it could redirect resources to protecting Iraqi bases hosting its troops.

Iran may find other ways to get back at the U.S., such as cyberattacks on American infrastructure. In 2016 the U.S. Department of Justice indicted seven Iranian hackers who it said had paralyzed some American banks and tried to seize control of a dam in the New York suburb of Rye.

Trump's one clear blunder was his Jan. 4 ▶

"If you paid any attention to Iran in the last 40 years, you know they will never buckle to that kind of pressure"

The Extent of Iran's Influence

Nurturing regional proxies has been a key part of the country's defense strategy

LEBANON

The Quds Force was formed to spread proxy militias throughout the region, beginning with Lebanon's militant Hezbollah group. U.S. Secretary of State Mike Pompeo has tried with little success to persuade the Lebanese government to reject Iran's influence.

IRAQ

Under Soleimani's leadership, the Quds Force trained and equipped Shiite militias against U.S. forces in the early 2000s. More recently, Soleimani commanded Iraqi units in the successful battle against Islamic State.

SYRIA

The country signed a mutual defense treaty with Iran after the start of the U.S. war with Iraq. Soleimani's forces provided crucial support to President Bashar al Assad during Syria's protracted civil war.

YEMEN

Iran has abetted the Houthi rebel group in its conflict with Yemen's Saudi-backed government. While U.S. intelligence indicates that the Quds Force was involved in a September Houthi attack on Saudi oil facilities, Iran has denied involvement.

◀ Twitter threat to attack sites important to Iranian culture. That would be a crime under the Law of Armed Conflict, which is based on international treaties and customs. While laws of war sometimes fall by the wayside when shooting starts, they benefit all combatants by making certain actions—such as harming prisoners of war—taboo. Attacking Iranian cultural sites would put the U.S. on the same level as the Taliban, which dynamited 1,700-year-old sandstone statues of Buddha, or the Islamic State group, which has blown up mosques, churches, Sufi shrines, and Roman monuments.

"Reckless and unprecedented words from a Commander-in-Chief," wrote Brett McGurk, the former U.S. special envoy for fighting Islamic State under Obama and Trump, on Twitter. After Secretary of State Mike Pompeo said the U.S. would not hit Iranian cultural treasures, Trump—in keeping with his "screw them back 10 times as hard" philosophy—insisted to reporters that he still considered cultural targets to be legitimate. That left Defense Secretary Mark Esper to reassert that the U.S. would indeed obey the laws of war.

But Trump may have done lasting harm simply by floating the idea. "The United States has spent decades building an international legal order and now risks being branded as a rogue nation," Jens David Ohlin, the vice dean of Cornell Law School, wrote in an email.

Trump rejects the notion that he's the one who's escalating. "We took action last night to stop a war. We did not take action to start a war," he told reporters shortly after the hit on Soleimani.

But escalating in order to de-escalate is risky business, because the foe may not fold. As game theory explains, escalatory strategies that succeed in convincing an opponent to back down once can fail when the combatants meet many times, giving the enemy time to absorb blows and mount a counteroffensive. The theocratic leadership of Iran, for one, is playing a long game.

"If you paid any attention to Iran in the last 40 years, you know they will never buckle to that kind of pressure. It's just the opposite," says retired Army Lieutenant Colonel Daniel Davis, a senior fellow at Defense Priorities. Soleimani's replacement—his longtime deputy, Esmail Qaani—was close to the general, and has been subject to U.S. sanctions for his own role in funding Iranian proxy forces.

It's impossible to predict how any given strategy will play out, says Anthony Cordesman, who's carried out diplomatic missions on the part of the U.S. in Iran and elsewhere in the region and now holds a chair in strategy at the Center for Strategic and International Studies in Washington. Trump's escalation may have worked. Or it may precipitate the exit of U.S. forces from Iraq, leaving a power vacuum that would likely be filled by Iran. "In that case," Cordesman says, "the people who were assassinated end up winning the biggest victory." *—Peter Coy, with Nick Wadhams*

THE BOTTOM LINE Trump has positioned his moves against Iran as an attempt to scare it into a more submissive stance toward the U.S., but they could have the opposite effect.

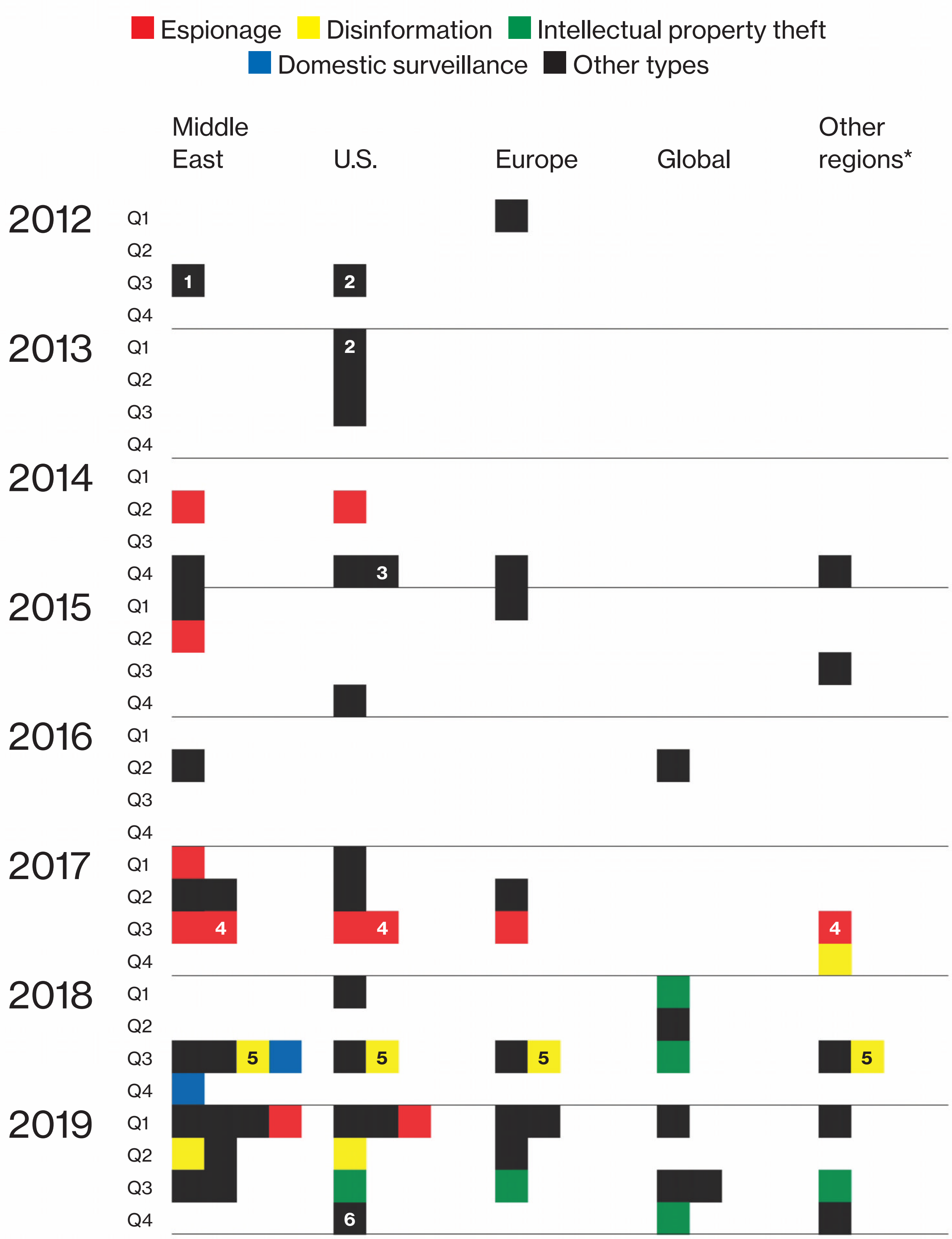
● Qaani

TASNIM NEWS AGENCY/REUTERS. DATA: INTERNATIONAL INSTITUTE FOR STRATEGIC STUDIES

Security | Iran's Cyberweapons

Trump has vowed that Iran will never join the nuclear club, but that hasn't stopped it from developing powerful weapons of a different sort. Unlike conventional warfare, cyberwar has no Geneva Convention or other rules limiting harm to civilians. —*Minh-Anh Nguyen and Alyza Sebenius*

Reports of significant Iran-attributed cyberattacks since 2012



❶ A group known as Cutting Sword of Justice, thought to be sponsored by Iran, used a virus called Shamoon to destroy data at Saudi Arabia's state oil company.

❷ A series of distributed denial-of-service attacks crippled the websites of major U.S. financial institutions.

❸ An attack on one of billionaire Sheldon Adelson's Las Vegas casinos was later deemed the first harmful use of cyberweapons on the U.S. by a nation-state.

❹ Another Iran-linked hacking group known as APT33 targeted Saudi, U.S., and South Korean businesses in the defense and oil industries.

❺ Iran has tried to sway elections in the U.S., U.K., and multiple Latin American and Middle Eastern countries.

❻ Microsoft announced that an Iran-linked group tried to hack email accounts associated with journalists, U.S. government officials, and a U.S. presidential campaign.

DATA: CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES. *SOME ATTACK LOCATIONS NOT SPECIFIED

Frayed in Taiwan

A pro-independence flag flies in the Ximending district of Taipei

As Hong Kong boils, Taiwan chooses between two visions of its future

By Matthew Campbell and Debby Wu
Photographs by Puzzleman Leung

As seats of state power go, Taiwan's Legislative Yuan is jarringly humble. The parliament building, erected a century ago as an all-girls high school, occupies a rectangle of low-rise buildings in the center of Taipei, set back from the street behind a low fence. It was renovated only lightly for its current use: Aides work in what were once classrooms, and the former principal's office now belongs to the parliamentary speaker. There are far too few offices for all 113 members, so many work out of even more utilitarian buildings nearby.

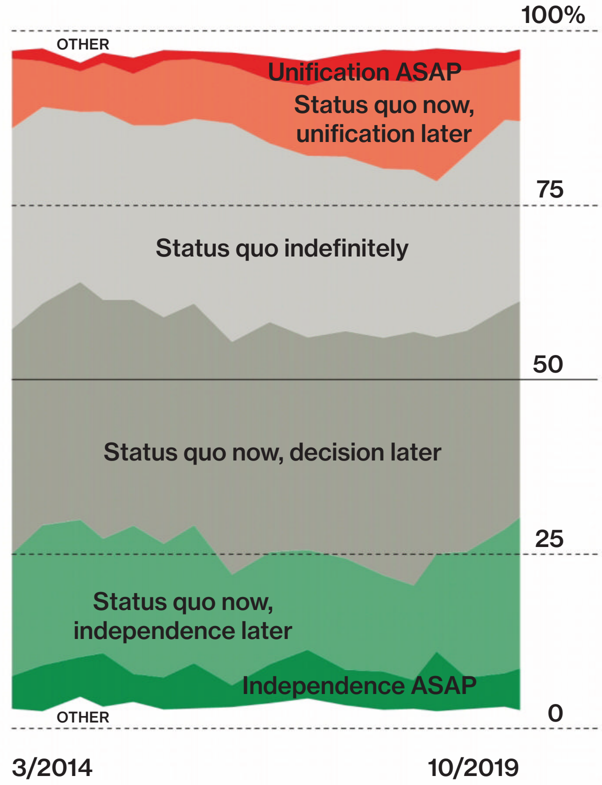
Taiwan is hardly a modest polity. Its population of approximately 23 million is roughly equal to Australia's, and, with almost $600 billion in gross domestic product, its economy is comparable to Argentina's. Neither of those countries, though, had a foundational figure quite like Chiang Kai-shek, who reigned as a virtual dictator from 1949 until his death in 1975. The Generalissimo, as he was often called, arrived on the island once known as Formosa under duress, thrust from China after Communist armies led by Mao Zedong defeated the forces of Chiang's Nationalist Party, or Kuomintang. The civil war never officially ended, and for the rest of his life Chiang considered the Taiwanese state—which is still officially known as the Republic of China—to be a government in exile, waiting for the inevitable day it would reconquer the mainland. There was no point in building anything grand for Taiwan's legislators: That could wait for Chiang's triumphant return to Nanjing, the Nationalist capital.

Much has changed in Taiwan since Chiang's day, but this liminal quality has never really gone away. By almost any functional standard, it's a sovereign country, with a president, a military, a central bank, passports, and all the other trappings of a state. But almost nobody who matters in international politics officially recognizes it as one. Taiwan isn't a member ▶

◀ of the United Nations, the International Monetary Fund, or the World Bank. Its formal diplomatic relations are mostly limited to a smattering of microstates in the Pacific and the Caribbean. Even the U.S., its primary ally, has no embassy in Taipei, instead funding an arm's-length American Institute that happens to issue visas and employ Marines.

While this arrangement is undoubtedly awkward, it's served Taiwan well. By treading carefully on the subject of formal independence, the island has been able to develop deep economic ties with the mainland—which officially considers it a rogue territory—and turn China into by far its largest trading partner. At the same time, Taiwan has maintained close business, political, and military relations with the U.S., which serves as the ultimate, if only semiformal, guarantor of its autonomy. With one foot in each of the world's biggest economies, local companies such as Hon Hai Precision Industry Co., the manufacturer better known as Foxconn, essentially built the modern technology supply chain, setting up the factory networks in China that made devices like the iPhone possible. Along the way, these companies helped Taiwan become one of Asia's most sophisticated societies: high-tech, prosperous, and, since Chiang's Kuomintang (KMT) relinquished its monopoly on power in the 1990s, raucously democratic.

Taiwanese Views of Cross-Strait Relations



DATA: MAINLAND AFFAIRS COUNCIL, REPUBLIC OF CHINA

"The situation has changed.... Taiwan has to choose a side"

Yet as Taiwan prepares for elections on Jan. 11 that will pit the pro-independence incumbent, Tsai Ing-wen of the Democratic Progressive Party (DPP), against Han Kuo-yu, a China-friendly populist representing the KMT (which, improbably, has aligned itself with China in recent years), this model is under unprecedented strain. In Beijing, President Xi Jinping has signaled impatience with Taiwan's unwillingness to accept Chinese rule, stepping up efforts to isolate the island from international institutions and suggesting it could be forcibly integrated. In Washington, meanwhile, the Trump administration has been working to sever China's technology industry from the rest of the world, with a set of policies that represents an enormous challenge to Taiwan and could upend the business model that underpins its economy.

The campaign was unusually bitter even before the violence surrounding pro-democracy protests in Hong Kong escalated in the fall, riveting many Taiwanese and becoming a central election issue. The Chinese government openly reviles Tsai, who's been targeted by online trolling and disinformation campaigns her government blames largely on Beijing. Her supporters accuse Han of harboring dangerous sympathies for China and being willing to sacrifice Taiwan's de facto independence in exchange for economic gains. In November, Han's campaign had to deny allegations, made by a Chinese defector to Australia who claims to be a former spy, that Han had received millions of dollars from the Communist government for a previous political campaign.

Voters now have an unusually stark choice to make—one reflecting the broader national dilemma as Chinese pressure intensifies. "I think many people in Taiwan realize the situation has changed," says Jou Yi-cheng, a Taipei businessman and founder of a pro-independence political party. Eventually, he says, "Taiwan has to choose a side."

Taiwan has been politically severed from the mainland for all but a few years since 1895, when the Qing dynasty, weakened by war and internal decay, was forced to cede it to Japan, which ruled it as a colony until the Second World War ended. Attitudes toward China remain the fundamental political cleavage. The DPP, which traces its roots to 1970s protests that opened the first cracks in one-party rule, is explicitly pro-independence and implicitly pro-Western; many of its senior officials were educated overseas and advocate closer ties to the U.S. and its allies.

Tsai was raised in Taipei by parents who ran an auto repair shop, attended law school at Cornell, and earned a doctorate at the London School of Economics. She worked as a trade negotiator for KMT governments early in her career, then joined the DPP in 2004 and was elected to parliament during the administration of Chen Shui-bian, the first DPP president of Taiwan. She first ran for the top job in 2012, losing narrowly to the KMT incumbent, Ma Ying-jeou. (Tsai declined to be interviewed for this story.)

The DPP gained new energy over the next several years, in particular from the Sunflower Movement, a student-led 2014 campaign to halt a proposed trade pact with China. Tsai won the presidential election two years later in a landslide, thanks in large part to support from young voters, who polls indicate are much more likely to identify as Taiwanese than Chinese. She also delivered the DPP's first-ever majority in the parallel parliamentary election, and the party used its control of domestic lawmaking to implement a series of progressive policies—passing legislation, for instance, that made Taiwan the first place in Asia to legalize same-sex marriage.

Even the most passionate DPP leaders act cautiously in their dealings with China, however, and Tsai has sought to avoid outright confrontation. Beijing has nonetheless refused official communications with her government and condemned her policies, which also include diversifying Taiwan's economic relationships and building up its military. Last January, Xi took the podium at the Great Hall of the People, in Beijing, to signal a hard line on Taiwan, declaring that “China must and will be united” and that the task “cannot be passed from generation to generation.” As to how this might occur, he said that while “Chinese will not fight Chinese,” the government would “make no promise to abandon the use of force” to stop what it deems separatism. A few months later, People’s Liberation Army fighter jets crossed the midpoint of the Taiwan Strait for the first time in years, an especially provocative move in a series of military maneuvers there. Next, China placed restrictions on tourism from the mainland, drastically curtailing an important flow of visitors.

Tsai refused to change course, writing in *Foreign Policy* that “the people of Taiwan have not given in to the fearmongering of authoritarian regimes and never will.” She soon made a high-profile trip to the U.S.—technically a long layover on the way to see formal allies in the Caribbean, since Washington tightly restricts official visits by Taiwanese leaders. Not long after, the Trump administration signed off on one of her main defense initiatives, an $8 billion deal for advanced F-16 jets, over furious Chinese objections.

The KMT’s relationship with China is more complex. At the core of its philosophy is an informal compromise with Beijing that it calls the 1992 Consensus, which, unhelpfully, is neither from 1992—the name first came into use much later—nor really a consensus. It stipulates that Taiwan is part of China but doesn’t specify what “China” means, allowing each side to retain its own definition. This ambiguity is critical to the internal semiotics of the KMT, which has never renounced its claim to being the legitimate government of China even as its prospects of assuming power have grown remote, to say the least.

In practice, the party long ago made peace with its erstwhile Communist enemies. Its hostility to China’s rulers began to ease in the 1980s, and its leaders now espouse a policy of nonconfrontation, prioritizing cross-strait economic exchanges over political issues and laying the groundwork, however gradually, for unification. The strategy has yielded important results. Ma, who led Taiwan from 2008 to 2016, finalized a landmark deal to allow regular commercial flights to the mainland for the first time since the 1940s and also reached a broad economic agreement with Beijing. Not surprisingly, the KMT enjoys the support of many powerful businesspeople, whose investments in Guangdong, Fujian, and other regions depend on a reasonably stable relationship.

One of the most prominent advocates of this business-driven attitude is Terry Gou, the founder of Foxconn and Taiwan’s second-richest man. A longtime KMT backer with strong networks in the U.S. and China, Gou announced in April that he would seek the party’s presidential nomination, citing as his priorities “peace, stability, economy, and future”—a list critics were quick to note omitted democracy or human rights.

It turned out, however, that KMT’s voters weren’t looking for factory-friendly pragmatism. Han defeated Gou easily in the primary, presenting his presidential run as Taiwan’s last chance to avoid a calamitous rupture in relations with Beijing. “The election is a choice between a peaceful Taiwan Strait or a Taiwan Strait filled with crisis,” he said in accepting the nomination. At stake was nothing less than “the life or death of the Republic of China.”

A few years ago, Han, a former member of parliament from a military family, was running an obscure government agency, the Taipei Agricultural Products Marketing Corp., which acts as a wholesaler for farmers. In 2017 the KMT approached him to see if he’d be willing to run for mayor in Kaohsiung, Taiwan’s third-largest city. A number of more plausible candidates had passed on the chance: Kaohsiung is the DPP’s heartland, and the campaign looked doomed.

But to the astonishment of almost everyone, Han won, leveraging a knack for baby-kissing retail politics and resentment over a local economic slump. The political elite in Taipei still had trouble taking him seriously. At one point, Tsai’s spokesman referred to Han as a *tubaozi*—a slur for a country yokel that translates literally as “dirt meat bun.” Han responded by holding a competition to find Kaohsiung’s best meat buns. He officially entered the presidential race in June, after a long period of informal campaigning that included a Taipei rally attended by tens of thousands. (He remains mayor of Kaohsiung.)

A campaign ad for Tsai in a shopping district of Taipei...

Han has an angular jaw, a thickly muscled neck, and a bald bullet of a head. He’s more polished than he once was—as a young lawmaker engaged in one of the Taiwanese parliament’s notoriously rowdy debates, he punched the DPP’s Chen so hard that the future president had to be hospitalized—but he retains a rumpled air. For an interview in November, he wore a mismatched blue blazer and ill-fitting black trousers over leather shoes that resembled slippers. A baseball fan, he opened with a joke about the Taiwanese team, which was vying to finish a tournament ahead of South Korea—*Han-kuo* in Mandarin. “I’m Han Kuo-yu,” he said, punning on his full name. “I hope Korea loses.”

He turned quickly to more serious matters. One of Han’s core beliefs is that Taiwan is an inextricable part ▶

◀ of Chinese civilization, and he argues that it forgets this historical relationship at great peril to its economy and security. "There has been a calculated decrease in the connection our young people feel toward Chinese culture," he complained, partly blaming textbook changes that emphasize the island's distinct history. "Cutting off these connections to China does a great deal of damage." In an odd extended metaphor, he likened Taiwan's neighbor to the genie in the story of Aladdin, powerful and capable of delivering great riches. Compared with "the big genie," he said, Taiwan "is very weak."

Han was even more deferential to China before he became a presidential candidate, making comments suggesting, among other things, that independence was a prospect "scarier than syphilis." In March he met with the head of the Liaison Office, which represents the Chinese central government in Hong Kong, as well as the director of the Taiwan Affairs Office, the mainland body responsible for encouraging unification. It's almost unheard of for a sitting Taiwanese politician to hold discussions with the Liaison Office, in particular, and some observers interpreted Han's moves as a signal of openness to adopting Hong Kong's "one country, two systems" model, which permits limited autonomy under an umbrella of Beijing control. Such an outcome would please Xi, who in his January 2019 speech endorsed exactly that approach for Taiwan.

Events since have forced Han to explicitly reject the possibility. The Hong Kong protests, which began last spring in response to a bill before the territory's legislature that would have allowed extradition to China proper, are one of the biggest topics in the Taiwanese campaign. During the interview, Han tried to straddle the debate, expressing concern about the potential loss of "economic power" in Hong Kong while urging Beijing to respect citizens' desire for more say in their own affairs. "Many Hong Kong problems will be solved as long as true universal suffrage is implemented," he said, referring to protesters' demands to open up the city's elections, which are held under a complex system dominated by government-friendly business lobbies. Free votes, he suggested, "will calm down Hong Kong people."

The protests are clearly a more comfortable issue for Tsai, who presents them as evidence that Taiwan's democratic values could never survive closer integration with China. They're a big part of why most analysts view her as the clear front-runner, despite a slow start to her campaign. Such assessments don't tell the whole story, however. A senior adviser to Tsai, who asked not to be identified discussing internal deliberations, expressed concern about turnout, predicting that Han's enthusiastic supporters will make it to the polls in large numbers. There's also the matter of the legislative contest, in which the KMT stands a decent chance of regaining parliamentary power.

...and one for Han in the same spot

Han's campaign has been fairly light on policy specifics. His economic proposals center on boosting Taiwan's exports to China, along with establishing free-trade zones and creating a sovereign wealth fund. But he wants voters to be clear on one point: "Independence is the red line," he said. "If the 23 million people of Taiwan came to a consensus and voted for independence in a referendum, they would have to deal with the military and political consequences." In such a situation, "we don't have any resources. We have nothing. All we have is talented people and a diligent fighting spirit."

Rather, Han argued, Taiwan should seek to prolong the status quo for as long as possible. "I support the 1992 Consensus," he said. "If you don't agree with me, then don't vote for me."

For now, Tsai's argument that Taiwan can thrive while distancing itself from China is being borne out. During a recent visit to Taoyuan, a city that's home to many electronics manufacturers, a pair of bright-yellow excavators chipped away at an asphalt parking lot while workers directed a cement truck between stacks of foundation piles. They were building something Taoyuan hasn't seen many of in the past few decades: a new factory, to be operated by Quanta Computer Inc., a Taiwanese company that makes hardware for Apple Inc. and others. After decades of rapid expansion in China, Quanta is reshoring production of some servers, pricey laptops, and additional premium products.

Although Tsai has sought to develop tourism, green energy, and other less established industries, the heart of her economic strategy is persuading Taiwanese tech companies to bring back production, especially of complex items for which China's cost advantage is less of a factor. Her administration is helping manufacturers find space and providing cheap financing for advanced production facilities, promising, for example, to cover bank fees on more than $22 billion in loans. So far the effort seems to be paying off. The government says companies with overseas operations have promised almost $24 billion in domestic investment; in one recent example, Innolux Corp., a Foxconn affiliate, announced a $2.3 billion expansion of its Taiwanese production.

Some manufacturers haven't needed much convincing, and not just because goods made in Taiwan aren't subject to Trump administration tariffs targeting China. On Nov. 26 the U.S. Department of Commerce unveiled proposed rules that would allow it to block the import of any technology it deems a security risk, one of several measures designed to shrink China's role in the technology supply chain. Although the agency said it planned to evaluate products on a case-by-case basis, it's a safe bet that goods produced on the mainland will be subject to intense scrutiny. Nor have many Taiwanese companies' experiences in China been unequivocally positive, particularly when it comes to protecting intellectual property. At home, says Taoyuan Mayor Cheng Wen-tsan, "they don't have to worry that their technology will be stolen or pirated." Other reasons for China's declining appeal are more conventional. Rising wages and real estate prices have made it a much more expensive place to operate than in the past, and foreign producers now compete for workers with a large number of innovative local companies.

Tsai's government holds that Taiwan's manufacturing expertise could let it become the hub of a restructured global technology industry, keeping advanced electronics flowing to the U.S. and Europe without much, if any, input from the traditional workshop to the world. "Before the trade war, the world had a centralized supply chain based in China," says Kung Ming-hsin, a government minister responsible for future economic strategy. "But now it's breaking up." Taiwan, he argues, "can absorb these resources" if it moves fast. "We will only have three to four years to reshape our industries, and the outcome will decide our future for the next decade or two."

"In Hong Kong, universities have become battlefields.... That's 'one country, two systems' for you"

It's not clear, however, that this new strategic geography will be as kind to Taiwan's economy as the old one. Taiwanese businesspeople were uniquely positioned to benefit from China's economic opening, thanks to a common language, cultural similarities, and sometimes family ties—advantages they don't enjoy in Vietnam or Cambodia, which are increasingly the destinations of choice for lower-end manufacturing.

There's also the matter of Taiwan's growing political isolation. In September the minuscule number of governments that recognize its sovereignty dropped to just 15, thanks to decisions by two Pacific island states, the Solomon Islands and Kiribati, to switch their relations to Beijing. Taiwan has trade deals with fewer than a dozen countries, the bulk of them tiny economies in Central America. (Singapore and New Zealand are also on the list.) Tsai has sought to take Taiwan into the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, the recent trade pact that includes Australia, Canada, Japan, and Mexico, but a successful campaign of Chinese pressure on any of its 11 signatories would make that impossible.

Taiwan does, however, still have its economic deal with the mainland, which many in the KMT would be delighted to expand. Doubling down on the cross-strait relationship and becoming a key player on the Chinese side of what could become a global economic cold war would in some ways be the path of least resistance, albeit one that could jeopardize relations with the U.S. It would also leave Taiwan exposed, even more than it already is, to a government in Beijing that will never accept a level of independence many Taiwanese view as fundamental.

In 2018 reports appeared in the island's press about shipments destined for Chinese consumers being rejected by customs inspectors or pulled from shelves. The issue wasn't that they were illegal or unsafe. Rather, the products were deemed unacceptable because their labels described them as "Made in Taiwan," rather than the Communist Party's preferred nomenclature: "Made in Taiwan, China."

On a late-autumn afternoon in Kaoshiung, thousands of Tsai supporters streamed into an open field for a DPP rally. The party seemed intent on making a statement on Han's home turf, busing in activists from other cities and bringing Tsai, Premier Su Tseng-chang, and a host of other notables onstage. Campaign staffers passed out little green flags with Tsai's oddly prosaic campaign slogan, "Let's Win," written in English, while a rap crew warmed up the crowd and vendors dished out oyster omelets, pork dumplings, and huge skewers of deep-fried squid.

No one would accuse Tsai of possessing excessive charisma. She's unassuming to a degree that can seem startling in a high-level politician, with a neat bob, ovoid glasses, and a strict uniform of black or gray blazers over light blouses. She delivers speeches in a near-monotone, as though delivering a trade-law lecture. But she sparks surprising ardor in her fans, some of whom mobbed her in search of selfies as she made the rounds of the food stalls. The reaction to her address, which began shortly after darkness fell, was similarly rapturous.

"Faced with pressure, our economy has to be strong, people have to feel confident in their ability to maintain their livelihoods, and our defense and diplomatic relations have to be maintained," she said from the podium, waving her right hand up and down for emphasis. "We don't aim to conquer the universe. Taiwanese people just want to use their own power to protect sovereignty and safeguard democracy." The danger to both, she argued, is evident in Hong Kong. "China is promoting a Taiwan version of the 'one country, two systems' policy. But now in Hong Kong, universities have become battlefields, some people have suddenly gone missing, some people have died." She continued: "That's 'one country, two systems' for you. Can you accept that? Can you accept that? We will state very clearly: We will never, ever accept that."

Even if Tsai wins a second term, there's little chance she'll end Taiwan's 70-year political limbo. But for many of her supporters, especially the young, the argument over the island's identity is already settled. That was the case for Sunny Lin, a 26-year-old auto parts worker who drove an hour to the rally. "It will take time to reach formal status, but we need to at least try," she said, standing on the edge of the crowd. "We will never belong to China. For me, Taiwan has been a country for a long time." Ⓑ *—With Samson Ellis and Adela Lin*














CHURCHES IN THE ARCHDIOCESE OF SANTA FE ARE EXCLUDED FROM THE BANKRUPTCY ESTATE THAT'S AVAILABLE TO CLERGY ABUSE VICTIMS

THE CATHOLIC CHURCH'S BANKRUPTCY DEFENSE



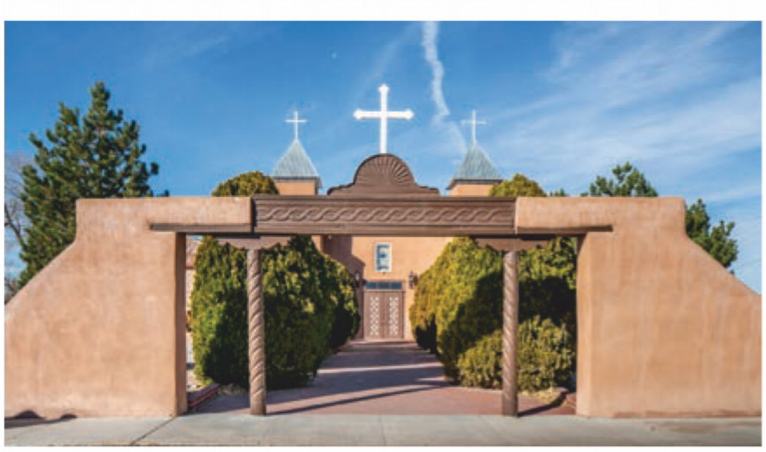













BESIEGED BY SEX ABUSE CLAIMS, AMERICA'S CATHOLIC CHURCHES ARE SHIFTING ASSETS AND FILING FOR CHAPTER 11

BY
JOSH SAUL

PHOTOGRAPHS BY
WILLIAM LeGOULLON

FOR MOST OF THE 20TH century, the Catholic Church in the U.S. minimized the damage wrought by pedophile priests by covering up the abuse. When the bishop of the Davenport, Iowa, diocese was told in the mid-1950s that one of his priests was sexually abusing boys at a local YMCA, he kept it secret. "It is consoling to know that no general notoriety has arisen, and I pray none may result," he wrote to a priest, capturing the strategy of the era.

Cover-ups worked when victims and their families could be intimidated or shamed into silence. But in the 1980s and '90s, victims started filing civil lawsuits against the dioceses where the alleged incidents took place. Church leaders across the country kept these suits quiet by settling out of court and demanding nondisclosure agreements in return. Church leaders paid out about $750 million from the early '80s through 2002, according to BishopAccountability.org, a nonprofit that tracks clergy sex abuse.

The veil of secrecy on these transactions was pierced when the *Boston Globe* published its investigations into church sex abuse in 2002, sparking public outrage at how clergy had protected their own. From 1950 to 2002, 4,392 priests were accused of abuse, according to a study by John Jay College of Criminal Justice.

The pace of lawsuits escalated as public awareness grew, and besieged church leaders looked to a new option: bankruptcy. When a church district that's been sued files for Chapter 11 and then reaches a bankruptcy settlement, a percentage of its assets are divvied up by victims. Like Fortune 500 executives—and more recently the Sacklers, the family that owns OxyContin maker Purdue Pharma LP—church leaders see bankruptcy as an attractive solution because it provides a controlled process for settling a large number of lawsuits while holding on to as many assets as possible.

Another benefit is secrecy. Lawsuits and trials lead to testimony and publicity. Bankruptcy ensures a quieter mass settlement that forces an end to existing lawsuits and blocks new ones. "It provides a clean slate," says Robert Kugler, a lawyer who represented abuse victims in the bankruptcy of the St. Paul and Minneapolis archdiocese. Dioceses have gone this route more than 20 times since 2004, when the Archdiocese of Portland, Ore., declared itself insolvent.

More dioceses are filing for bankruptcy now that rules are changing about how much time a victim has to sue over abuse. Seven states and the District of Columbia passed laws in 2019 that suspend the statute of limitations on civil sex abuse suits, and at least three other states are considering them. Known as "window statutes," they've become popular in the wake of the #MeToo movement and public outcry over abuse by men in power. Until recently, only a half-dozen states had them. Window statutes caused churches to declare bankruptcy in San Diego, Wilmington, Del., and cities throughout Minnesota.

A STATUE AT OUR LADY OF GUADALUPE IN SANTA FE

After New York state's law went into effect in August, almost 430 sex abuse victims immediately filed lawsuits, most of them against dioceses. The diocese of Rochester declared bankruptcy in September; bishops in Brooklyn and Buffalo announced that theirs may soon follow.

In many cases, churches precede bankruptcy by transferring and reclassifying assets. The effect is to shrink the pot of money available to clergy abuse victims. That and Chapter 11's universal settlements and protections from further claims have been an effective one-two punch for limiting payouts. A *Bloomberg Businessweek* review of court filings by lawyers for churches and victims in the past 15 years shows that the U.S. Catholic Church has shielded more than $2 billion in assets from abuse victims in bankruptcies using these methods. "The survivors should have gotten that money, and they didn't," says Terry McKiernan, president of BishopAccountability.org. "The Catholic Church has behaved like a business. It hasn't behaved like a religion that lives by the rules it espouses."

THE UNFOLDING OF ONE diocese's bankruptcy provides a road map for what may come as more go this route. The Chapter 11 filing of the archdiocese in Santa Fe shows how easy and routine it is to rejigger a balance sheet.

The archdiocese was facing a few dozen clergy abuse suits when it filed in December 2018, saying it was too poor to defend itself. The number rose to about 375 by the June 2019 deadline that the bankruptcy court had set for victims to file claims. New Mexico doesn't have a window statute.

In court papers, the archdiocese reported owning $49 million in real estate, cash, and investments. That figure included its Albuquerque headquarters, corporate and municipal bonds, a half-dozen cars and pickup trucks, and an unspecified amount of gold and silver. By contrast, the church's 1951 incorporation papers put its estimated value at $40 million, or $396 million in today's dollars.

To arrive at that $49 million figure, church leaders said at least $178 million in cash and property associated with the archdiocese was owned by parishes or held in a trust or foundation and thus wasn't eligible for inclusion in the estate. Lawyers for victims, saying there's no real separation between the archdiocese and its parishes, argue that the $178 million should be included in the available funds. That would raise the value of the estate to as much as $227 million.

The church in Santa Fe began reorganizing in 2012. In November of that year, the business managers for the 90 or so parishes across northern New Mexico gathered in Albuquerque to be addressed by Tony Salgado, chief financial officer for the archdiocese. Salgado had called the meeting to explain to the managers how to incorporate their parishes separate from the archdiocese. "We got step-by-step instructions," says

Christine Romero, then the business manager for St. Anne parish in Santa Fe. The legal change would let the archdiocese assert that each parish was a distinct organization that owned its own property. Around the same time, records show, church leaders created the Archdiocese of Santa Fe Real Estate

OWNERSHIP OF THE SAN JOSE CEMETERY IN ALBUQUERQUE WAS TRANSFERRED TO A TRUST

Corp. and began transferring hundreds of properties into it.

Romero says that when she raised her hand and asked how the separate incorporations would affect the parishes, Salgado said the move wouldn't change day-to-day operations. "It's just to protect us from the pedophile lawsuits," he said, according to Romero. Salgado declined to comment.

Incorporating parishes separately allowed the archdiocese to take about $91 million off its books. The first $34 million came from moving 120 properties in Santa Fe, Taos, and other areas into a trust it says it holds on behalf of its parishes. The properties include churches, cemeteries, and a building with a cafe and a yoga studio. (The real value of the properties is likely much higher: The archdiocese assigned a value of zero for many of them, and for others it used the assessed value the local authorities assign for tax purposes instead of the appraised value, or what the property could be expected to command in a sale.) The next $57 million worth of property owned by the parishes, including cemeteries in Santa Fe and a mobile home in Taos where a priest lives, is held in a separate trust.

James Stang, lead lawyer for the alleged clergy abuse victims in the bankruptcy, wrote in a June court filing that the incorporations and transfers were made with the intent to "hinder, delay, or defraud" the claimants. J. Ford Elsaesser, an archdiocese lawyer, disputes accusations that the archdiocese shuffled assets to keep money from claimants. The relationship between the church and its parishes is like that between an adult child and an elderly parent who can no longer handle his affairs, he says: "The property is yours in name, but it's not your money." He says that bankruptcy is the best venue for settling large numbers of abuse claims in part because it makes for a fairer distribution of finite church assets, with all victims sharing the money in an orderly way instead of it being quickly scooped up by victims who file claims first.

Church officials also put close to $37 million in cash and investments into a Wells Fargo account that it says it controls but doesn't own. Yet another pot of funds sits in the Catholic Foundation, which accepts donations to the archdiocese. The foundation has almost $50 million and dispersed about $1.8 million in ▶

◀ 2019 to Catholic causes, including the training of new priests and the retirement of older ones. Church lawyers say the foundation is not part of the bankruptcy estate.

But victims' lawyers say the foundation is listed as a "subordinate organization" of the archdiocese with the Internal Revenue Service, a designation it needs to be exempt from federal taxes, and its holdings should be included in the estate. "Let's be very clear what this foundation is," Stang said at an August hearing. "It's the fundraising arm of the archdiocese."

Incorporation documents for four parishes *Businessweek* reviewed show that the archdiocese has kept tight control. Salgado is listed as the point of contact for the parishes, and half of the board of directors for some parishes are listed as archdiocese staff. The articles of incorporation for each parish, which lay out corporate and tax information, can't be changed without the archbishop's approval.

Parishes continue to pay 12.5% of their Sunday collection plates to the archdiocese, according to a 2018 deposition from Father John Daniel, who at the time worked in archdiocese administration. Parish payments provided the vast majority of the archdiocese's $6 million annual income, with the payments checked by auditors who report to Salgado, according to the deposition, which was taken as part of a sex abuse suit prior to the bankruptcy.

THE LARGEST BANKRUPTCY settlement from an archdiocese came in the Chapter 11 filing of St. Paul and Minneapolis. The smallest was in Milwaukee.

When the Archdiocese of St. Paul and Minneapolis filed for bankruptcy in 2015, it said it didn't own the parishes, the schools, or the 10 cemeteries within its territory. "They took a paintbrush and went to every cemetery and painted over the name 'Archdiocese of St. Paul-Minneapolis,'" Jeff Anderson, a lawyer who represented abuse victims in that bankruptcy, said in a news conference at the time. Church leaders,

A ROADSIDE CRO

SS IN ESPAÑOLA

claiming they'd fully disclosed all assets and cooperated with the bankruptcy court, said the archdiocese owned assets worth less than $50 million; lawyers for victims said the number was closer to $1.7 billion. The court never reached a consensus, but about 450 people got a total of $210 million—an average of about $467,000 each. Some of it came from church assets and some from insurance.

In Milwaukee, then-Archbishop Timothy Dolan sent a letter to the Vatican in 2007 asking for permission to shift almost $57 million into a trust fund earmarked for maintaining cemeteries. The letter appeared to acknowledge that the purpose of the move was to shield the assets. "By transferring these assets to the Trust, I foresee an approved protection from any legal claim and liability," Dolan wrote. The Vatican approved the transfer, levying a tax of $100 for itself without explaining why. When Milwaukee's church leaders declared bankruptcy four years later—Dolan was by then cardinal of New York—they claimed assets of $10 million to $50 million. Victims' lawyers didn't make their own estimate, but they fought successfully to include the cemetery trust in the estate's assets. After a nearly five-year fight in which the Milwaukee archdiocese tried to get virtually all of the claims dismissed by a judge, about 350 victims got an average of $60,000 each.

As a very rough guide, an archdiocese will settle with clergy abuse victims for roughly half the value of its estate. If the Santa Fe archdiocese settles for half the value of the $49 million it says it owns, the 375 victims will each get roughly $65,000, about one-fifth of the $300,000 they would get if the archdiocese hadn't taken $176 million off its ledger.

The difference matters. Victims of childhood sexual abuse face increased mental and physical health problems and lower lifetime earnings. The cost to a victim can be more than $280,000 over a lifetime, according to a 2018 study by the Johns Hopkins Bloomberg School of Public Health. (The school is supported by Michael Bloomberg, founder and majority owner of Bloomberg LP, the owner of *Businessweek*.) ▶

A TREE OUTSIDE SAN ISIDRO CHURCH IN SANTE FE

◀ High rates of poverty and devout obedience to local priests left some New Mexico children particularly vulnerable. Mary, who asked that her full name not be used to protect her privacy, lives in Las Vegas, N.M. She says she was raped by Sabine Griego, a priest at Our Lady of Sorrows when she was 10. Griego pleaded not guilty to eight counts of child sex abuse and has a jury trial scheduled for June. The archdiocese has settled with at least 30 people who said he abused them as children, according to the *Albuquerque Journal*. Mary isn't among them, but she's listed as a creditor in the bankruptcy. The public defender representing Griego says the priest maintains his innocence.

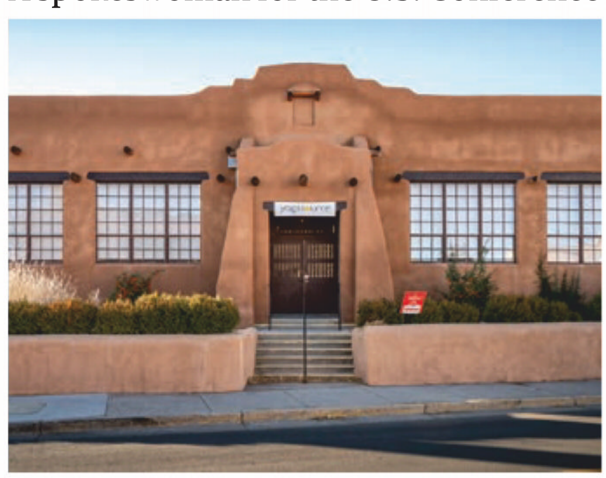
The area around Our Lady is poor, with ramshackle trailers and yards full of junked cars, shopping carts, and firewood. Now 51, Mary lives not far from Our Lady in a home with a tall fence, a surveillance camera, and three pit bulls. "I'll probably be seeing a therapist for the rest of my life," she says. "What amount of money is going to give me my life back?"

Isaac Casados, another creditor, grew up in the small town of Española wanting to be a priest. Casados says that when he was a 10-year-old altar boy, fresh off his first communion at Holy Cross Catholic Church, Father Marvin Archuleta molested him. Archuleta was charged in February with raping a first-grade boy at Holy Cross in the mid-'80s; a jury trial is slated to begin in January. His lawyer denies that allegation and those of Casados.

Living now in Santa Fe, where he owns a small medical technology company, Casados, 38, suffered in the decade after he was abused from alcoholism and depression. He says he attempted suicide. "Money would have helped me find the resources to rectify the internal issues I was dealing with," he says. After decades of listening to sermons about responsibility and honesty, he views the archdiocese's financial restructuring as hypocritical. "They teach us not to lie," he says. "Why are they willing to lie about their assets?"

Multiple victims' lawyers say the Vatican guides the dioceses in both their financial reorganization and their positions regarding settlements. "All financial decisions, all strategic decisions, all decisions are made by the Vatican," says Anderson, who's represented clergy sex abuse victims for 37 years. "I'm in constant communication with lawyers who represent churches, and I know they are in touch with the Vatican." John Manly, a lawyer who's represented victims in 15 church bankruptcies, says he's been in settlement negotiations in which bishops have told him they're in touch with the Holy See. "I've had bishops say, 'I can't do this without Vatican permission,'" Manly says.

In late December, in a nod toward greater transparency, Pope Francis abolished the "pontifical secrecy" rule, which church officials had used to withhold information about sexual abuse from civil authorities. The Vatican didn't respond to a request for comment for this story. A spokeswoman for the U.S. Conference of Catholic Bishops wrote in response to questions, "A decision on whether to seek Chapter 11 protection in a given case is the diocese's alone."



A SANTA FE CHURCH PROPERTY HOUSING A YOGA STUDIO AND OTHER BUSINESSES

The Archdiocese of Santa Fe and victims' lawyers started court-ordered mediation in September. Every church bankruptcy so far has ended in a settlement, but the aggressiveness of the archdiocese's asset shielding has increased the possibility that there won't be one this time.

At a court hearing in early December, the federal judge overseeing the case asked Stang if he was satisfied with how the mediation was going. The lawyer would only say he was committed to attending the next session, which is scheduled for early February. "A solution at present still appears elusive, and progress is slow," the mediator wrote in a December progress report. Church leaders and lawyers across the country are watching the negotiations for guidance on how to approach their own potential bankruptcies.

If the archdiocese refuses to budge on its asset pool, then victims could refuse to settle, says Paul Linnenburger, another lawyer who represents clergy abuse victims. If that happens, there's a risk for the archdiocese that the judge could lift the shield protecting it from lawsuits. That would open it up to trials and the possibility of enormous jury awards. Other possible scenarios include the archdiocese dragging out the fight until exhausted victims agree to a low settlement, as they did in Milwaukee, or the judge assigning an outside financial expert to untangle the archdiocese's accounting and pressuring church leaders into a more generous settlement, as happened in San Diego.

However the fight in New Mexico concludes, nobody can bring new cases against the archdiocese for clergy abuse that happened before the bankruptcy. Many victims didn't come forward in time to make the June deadline, say victims' lawyers. "That will leave out a significant portion of people who are still too ashamed, too wounded, too fearful to come forward," says Robert Weisz, a Santa Fe psychologist who's treated clergy abuse victims for 15 years.

That doesn't mean the archdiocese will necessarily be done with the issue. Hector Balderas, New Mexico's attorney general, is disturbed about the archdiocese's history of paying off victims and making them sign nondisclosure agreements to stay silent. In late 2018 his office demanded personnel and financial records related to clergy abuse, and his agents served search warrants at archdiocese headquarters. The investigation is ongoing, and Elsaesser says the archdiocese is cooperating.

One focus of the probe is whether church leaders paid off individuals to preserve their ability to raise money, Balderas says. He's disturbed by church leaders who may have prioritized the wealth of the archdiocese over making victims whole. "The bankruptcy code should not be used to revictimize victims," says Balderas, himself a former altar boy. "They are really just trying to shield assets." Ⓑ

Gellert spa bath in Budapest

Where to Go in 2020

The best way to plan a trip is to think about what you love to do and when you need a break—not which destination you have yet to check off some list. With these key points in mind, we found 24 inspiring spots that are especially enticing right now. *Photograph by Federico Ciamei*

January 13, 2020

Edited by Nikki Ekstein

Businessweek.com

An overwater bungalow at Antigua's Royalton Resort

If You Want the Bea

Antigua

DECEMBER–APRIL

Overwater bungalows, a rarity in the Caribbean, are shaking up Antigua's bland reputation. So will direct flights from four major airlines and a smattering of fresh five-star hotels. The biggest splash comes courtesy of Royalton Luxury Resorts, which planted its flag on the island's northwestern shore last summer. Its stilted thatched-roof pavilions have plunge pools, and hammock nets jutting out above the ocean. Access is increasingly easy from New York, Miami, and the U.K.—to an airport that's especially efficient and modern. And if sleeping above the surf isn't your thing, there's Carlisle Bay, an island institution that's been freshly renovated, or the just-opened, all-inclusive Hammock Cove, where the bathrooms are larger than many Manhattan apartments.

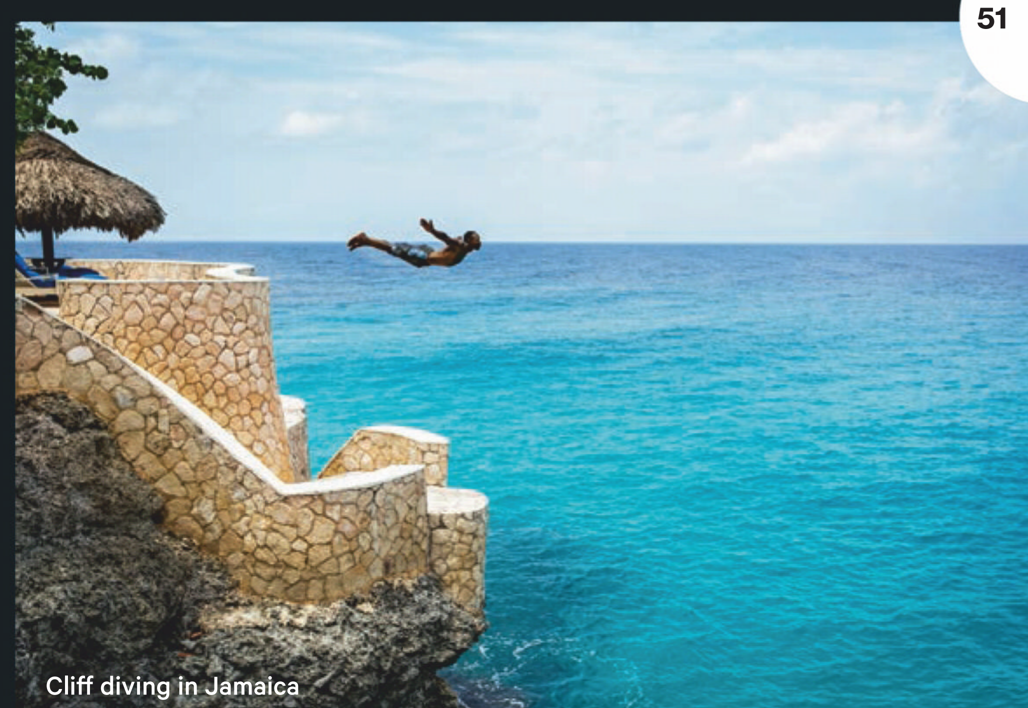
For each destination, we've recommended the very best time to go. For more detailed data, including luxury hotel room rates, visit bloombergpursuits.com

Riviera Nayarit

DECEMBER–MARCH
Mexico's next go-to vacation spot is across the Sea of Cortez from Cabo and feels worlds away. Instead of rugged shores and desert landscapes, Riviera Nayarit has 200 miles of tranquil coast and verdant jungle. Golf clubs trump nightclubs in Punta Mita, where the St. Regis and Four Seasons just got face-lifts. But Cabo and Nayarit will eventually have one thing in common: hotels from every conceivable luxury brand, including Rosewood and Auberge. Conrad opens first, in May, with seven restaurants and a Mexican steam bath, or *temazcal*; June will welcome a One&Only with a polo club and zip line.

Jamaica

APRIL–MAY
Jamaica's powerful tourism industry will get extra buzz after the April release of *No Time to Die*, Daniel Craig's last James Bond movie, which was filmed partially in Port Antonio. That's where owner Jon Baker has expanded the beloved Geejam Hotel to include a sea-facing infinity pool, a stage for live music, and 12 "studio" rooms each designed by a different emerging artist. Meanwhile, an offshoot of Half Moon resort, which the fictional spy patronized in 1973's *Live and Let Die*, will open in Montego Bay in March. The 57-room Eclipse at Half Moon will have hammocks slung on coconut trees outside its casual restaurant, Spice—perfect for sleeping off a mai tai or piña colada. Even Dr. No would say yes to that.



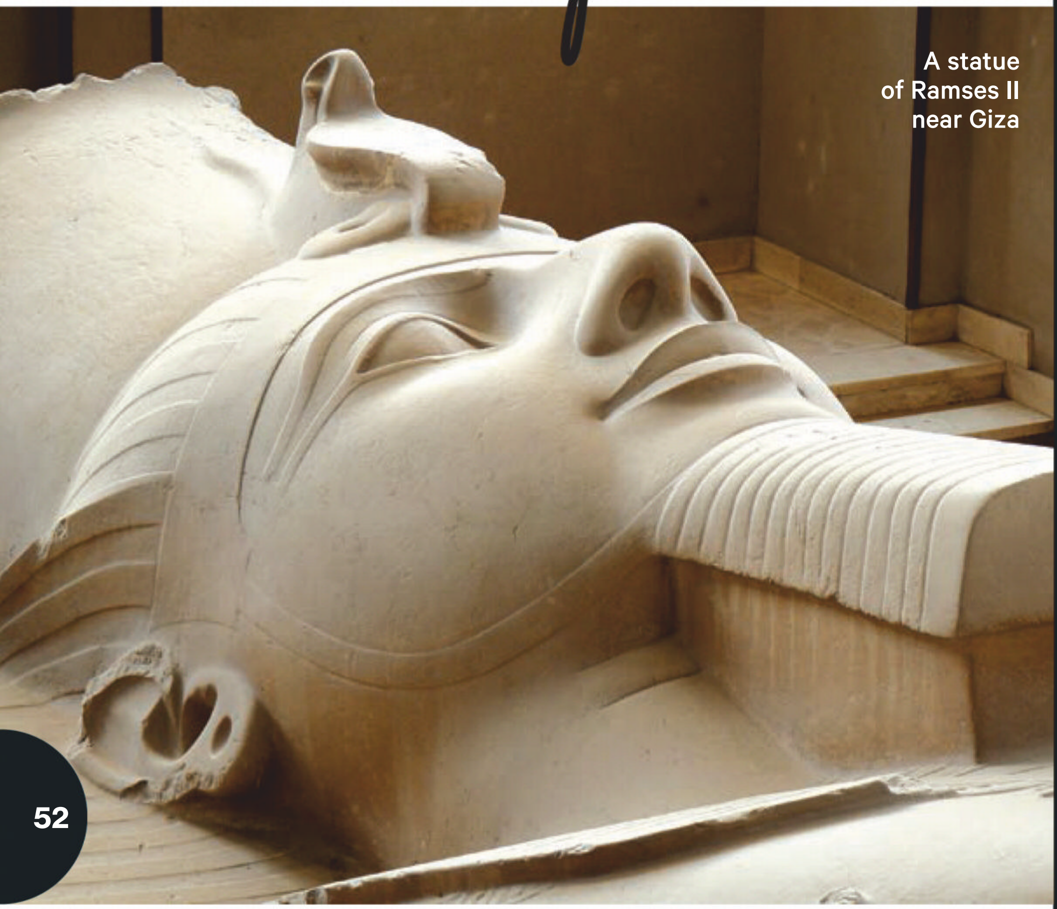
Cliff diving in Jamaica

Mozambique

MAY–SEPTEMBER
With dozens of white-sand islets ringed by vibrant marine life, Mozambique is Africa's under-the-radar answer to the Maldives. Despite weathering back-to-back cyclones last year, the country is more enchanting than ever. Its most impressive newcomer, Kisawa Sanctuary, will command rates of $5,500 a night when it opens this summer; each of its 12 rooms sits on a full acre of sand on Benguerra Island. The resort is purportedly the first in the world to (at least partly) 3D-print its structures, combining sand and seawater to make mortar. Better yet, its nonprofit arm, the Bazaruto Center for Scientific Studies, will use the technology to help propagate local coral reefs.

PHOTOGRAPH BY JOYCE LEE FOR BLOOMBERG BUSINESSWEEK (ANTIGUA), COURTESY ISLAND OUTPOST (JAMAICA)

Ruins to Explore



A statue of Ramses II near Giza

Cairo

OCTOBER–NOVEMBER

Ancient history never looked so fresh. When the Grand Egyptian Museum finally opens in the fall, the entire collection of precious objects from the Upper and Lower kingdoms will be showcased together for the first time with the respect it deserves—in a half-billion-dollar space near the Giza pyramids. More forthcoming draws include renovated historic Jewish synagogues such as the 116-year-old Sha'ar Hashamayim and a sumptuous St. Regis by Michael Graves Architecture & Design. Book through Abercrombie & Kent, and you'll have access to flexible flights on private jets to get around the country—a relief from EgyptAir's strict early morning schedules.

Guatemala

OCTOBER–NOVEMBER

Channel your inner Indiana Jones at newly accessible Mayan sites such as Holmul, a buried city so large it's taken two decades to excavate. On private trips with Big Five Tours & Expeditions, you can even meet the archaeologists currently at work. Meanwhile, Black Tomato is bringing beautiful mobile tents to the turquoise lakes of Semuc Champey; they're like a series of desert oases surrounded by thick jungle instead of sand. Dust off in the colonial capital of Antigua, where Villa Bokeh, opening in September, will be the city's first design hotel. The 16-key mansion, formerly owned by acclaimed Guatemalan photographer Lissie Habie, is being meticulously reimagined as a throwback to the city's glory days.

Vibrant Culture

Kyrgyzstan

MAY–SEPTEMBER

It's a logistical challenge to hit this destination's nomadic villages, picturesque mosques, and Brutalist architecture on one luxury trip. But Steppes Travel, which has led vacations in Kyrgyzstan since the '90s, now offers en suite yurts along the mystical shores of Song Kol Lake and helicopter service to sidestep bumpy back roads to see the country's three 23,000-foot-plus mountains. Voygr, another high-end adventure operator, offers your best chance at sighting a snow leopard with guided walks in the Tien Shan mountain range. And for the easiest (and plushest) CliffsNotes introduction, Golden Eagle Luxury Trains will inaugurate its Republics of the Silk Road route in the spring.

Ethiopia

OCTOBER–FEBRUARY

The first step to getting on travelers' bucket lists is to have a tourism ministry that cares, and few care like Ethiopia's. In 2015 it set out to make the country a top five African destination by 2020; in 2018 tourism grew 48.6% from the previous year, faster than any other country. Its formula is a mix of history (the rock-hewn churches of Lalibela), cultural experiences with the tribes of the Omo Valley, and wildlife viewing in the Bale and Simien mountains. Plus, Ethiopian Airlines is offering new routes from Houston and Chicago, and Journeys by Design has added helicopter safaris in the north with an anthropological twist. Travelers see species such as walia ibex and gelada baboons as well as religious sites and 1,000-year-old fortresses—with expert guides including one of the paleontologists who discovered Lucy.

Church of St. George in Lalibela

COURTESY ABERCROMBIE & KENT (EGYPT); CHRIS TINKLER (ETHIOPIA)

Europe Unexpected

Biogradska Gora National Park

Montenegro

SEPTEMBER–OCTOBER

Move over, Croatia: This tiny Balkan nation has slowly positioned itself as the new jewel of the Adriatic with a mix of centuries-old villages, aristocratic mansions, and activities beyond its pebbly beaches. Local adventure outfit Black Mountain is beginning conservation-centric journeys to see the brown bear, gray wolf, Eurasian lynx, and other threatened species in Durmitor and Biogradska Gora national parks. Connect those destinations with the coast, where Iberostar, Melía, and Karisma Hotels & Resorts have opened properties in the past year. And don't miss Portonovi, a billion-dollar, 60-acre yachting playground on Boka Bay. In June its marina will welcome Europe's first One&Only resort and an Espace Chenot spa. Cruise right in, or fly Lufthansa to the port town of Tivat. Either way, you'll bypass hectic Dubrovnik.

Ionian Islands

MAY–SEPTEMBER

Free from the high prices and tempestuous winds that plague Mykonos and Santorini, the island chain where Odysseus set sail is emerging as a slower, more peaceful, and—dare we say—more epic twist on Grecian summer. For those spoiled by the Cyclades' famed resorts, Kanoni Estate on Corfu can be booked via Red Savannah for groups of 18; it featured as Hector Gonzales's mansion in yet another James Bond movie, *For Your Eyes Only*. On Meganisi, villa rental agency Thinking Traveller offers the stunning Galatea, whose wraparound floor-to-ceiling windows face the sea. But best of all might be climbing aboard the fully staffed *Alexa J*, a 38-meter schooner yacht with just one opulent cabin.

Galleria Vik

Northern Italy

APRIL–JUNE

Sicily and Puglia will continue to trend, but 2020 is the year to head north. Start in Milan, where the owners of Galleria Vik have adorned 89 stuccoed rooms with their fabulous contemporary art. One of the world's best chefs, Massimo Bottura, and his wife, Lara, have done the same at their new 12-room country estate, near Modena—Casa Maria Luigia has Warhols and Hirsts to spare. Even further up, the Dolomites region is busily preparing for the 2026 Winter Olympics in Cortina. Depending on your interests, you can book into Lefay Resort & Spa, a wellness retreat with thermal pools, fitness trails, and a medicinal garden in Trento; Castel Hörtenberg, with 24 elegant rooms in medieval Bolzano; or the Adler Lodge Ritten, a hypermodern chalet kissing the Austrian border.

AutoCamp Yosemite

When You Crave the Great Outdoors

PHOTOGRAPH BY AARON LEITZ

Yosemite

SEPTEMBER–NOVEMBER

Sleeping in the shadow of El Capitan never fails to send a chill up your spine. Unfortunately, that's been due in part to a lack of comfortable accommodations. Thankfully, plush (and low-impact) digs are sprouting up: Since April, AutoCamp has offered "rooms" in converted Airstreams—each with a private patio, fire pit, and walk-in shower—outside the gateway town of Mariposa. In the park, Camp'd Out has added pop-up glampsites, complete with mud-cloth throw pillows, s'mores kits, and butler service. And Under Canvas Inc., which pioneered lifestyle camping in U.S. national parks, will open in the fall. Its 90 wood-platformed tents will be set on 85 acres just 15 minutes from Yosemite's entrance.

A seaplane lands in Queensland

Queensland

JUNE–SEPTEMBER

The Great Barrier Reef is in a precarious state, but eco-friendly ways to see it are flourishing. In April artist Jason deCaires Taylor will unveil his Museum of Underwater Art, a multisite installation that includes a greenhouse on the ocean floor. Local outfit Cruise Whitsundays just opened Reefsuites, Australia's first underwater accommodations, built under a floating platform. For daytrips, the private Hamilton Island resort choppers guests to a wind- and solar-powered pontoon near the previously inaccessible Heart Reef lagoon. Divers often pit-stop in Brisbane, which will soon accept flights from San Francisco and Chicago. The workaday state capital is suddenly cool with a 50,000-square-foot exhibition space, a craft brewery, and an art-inspired hotel called the Fantauzzo lining its formerly derelict shipping port. A Rosewood and Ritz-Carlton are on the way, too.

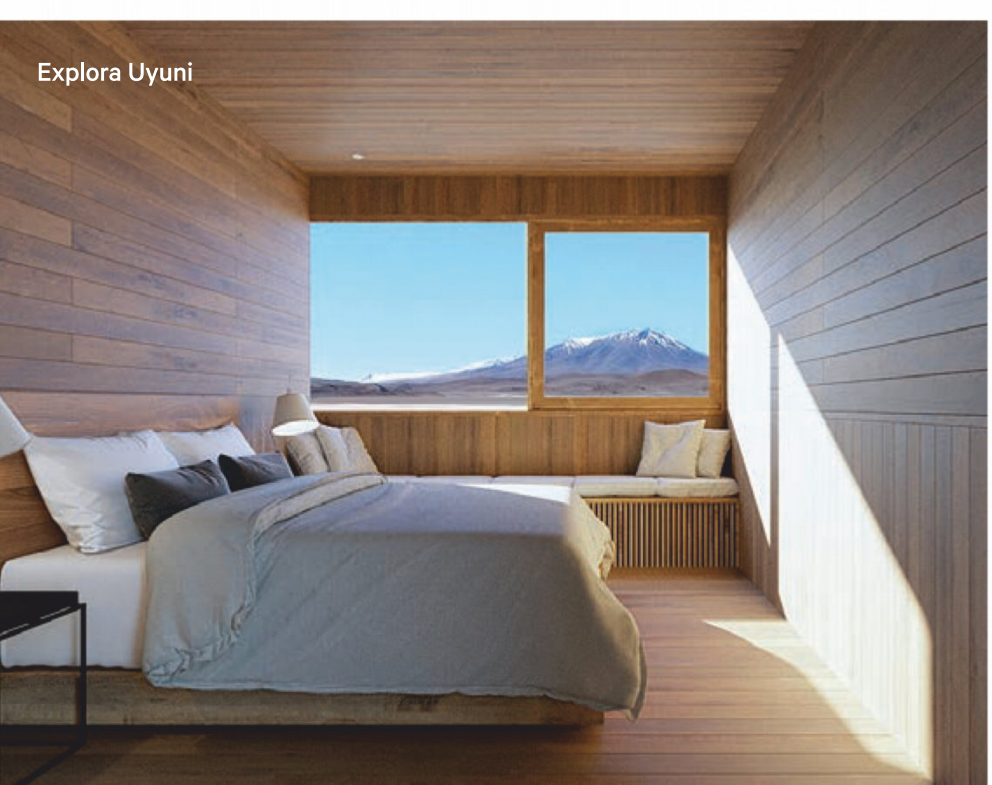
COURTESY TOURISM AND EVENTS QUEENSLAND (QUEENSLAND). LENA SAUGEN (ANDALUCIA). COURTESY EXPLORA (BOLIVIA)

Andalucía

OCTOBER–MARCH

Outside perennially popular Seville, the countryside still holds many secrets. Its carefully safeguarded *pueblos blancos*—all-white villages nestled in the mountaintops—and rural estates are among Europe's most unspoiled spots. Explore them on horseback with George Scott, a professional rider and second-generation co-owner of the bohemian estancia Trasierra. His three-day circuits, starting and ending at the property, visit rugged corners of the outback. Another family-owned Andalucían destination, Hacienda de San Rafael, is being taken over by the next generation with a focus on hiking and culinary excursions. Bookend your trip in charming Málaga, where you can now stay at the Palacio Solecio in an 18th century Moorish-inspired palace.

Exploring Andalucía on horseback



Explora Uyuni

Bolivia

JUNE–OCTOBER

While Bolivia has been in crisis, its citizens have been busy taking tourism into their own hands. What they've created is impressive: an all-in-one luxury vacation circuit spanning mountains, desert, jungle, and city. La Paz, already recognized for its surprising dining scene, is getting a hotel to match. The 10-room Altu Qala in the capital's colonial core opens midyear with meticulous artisan tile work and Murano glass fixtures. Around the same time, South American luxury operator Explora will begin welcoming guests in three spare lodges along the salt flats of Uyuni. Then there are Hershey's Kiss-shaped glamping tents from Bolivia Milenaria, a husband-and-wife-run outfit. They set up shop in Torotoro National Park, where dinosaur footprints are baked into the clay earth, and the so-called Valley of the Condors—one of the only places in the world to view the enormous birds.

West Hollywood

SEPTEMBER–NOVEMBER

Within its 1.9 square miles, WeHo has always claimed an unfair number of attractions, whether the Troubadour or Chateau Marmont. Now it's making a push for even more stars—Michelin stars, that is. A pair of them were awarded to the 16-seat Sushi Ginza Onodera and more may go to Wolfgang Puck's two restaurants, coming in the spring to the Martin Brudnizki-designed Pendry West Hollywood hotel on Sunset. Likewise, the kitchen of the nearby Edition is run by New York chef John Fraser. Find more conventional cinematic stars at the 1 Hotel West Hollywood and San Vicente Bungalows—the latest project from Sunset Tower's Jeff Klein—or memorialized just beyond the district's borders, at the long-delayed Academy Museum of Motion Pictures.

Bangkok

NOVEMBER–FEBRUARY

Even if you're one of the 20 million visitors that made it the world's most visited city in 2018, for the fourth year running, chances are you'd return to find the Thai capital reborn. IconSiam, a $1.8 billion shopping complex, has revitalized the Chao Phraya River's western bank with an indoor floating market, a fancy bistro by Alain Ducasse, and an illuminated fountain as long as the Empire State Building is tall. On the other shore, the 143-year-old, newly renovated Mandarin Oriental has two glitzy neighbors: the Capella Bangkok, with its Mauro Colagreco restaurant, and the Four Seasons Hotel Bangkok, with a pool large enough to host yoga classes on stand-up paddleboards. Plus, a fleet of electric ferries will zip passengers to the Grand Palace by summer.

Omakase at Sushi Ginza Onodera

PHOTOGRAPH BY ROZETTE RAGO FOR BLOOMBERG BUSINESSWEEK

The Gellert spa bath

assic City

Budapest

APRIL–JUNE

Stop thinking about the Queen of the Danube as just a way station for backpackers and river cruisers. Budapest will welcome no fewer than seven five-star hotels in the next two years. They include a 162-room W that will occupy the long-dormant neo-Renaissance Drechsler Palace, opposite the Hungarian State Opera house. In July, Marriott's Luxury Collection will unveil the Matild Palace, once home to Princess Clotilde of Saxe-Coburg and Gotha, which will have a glassed-in "sky bar" and a brasserie lined with traditional Zsolnay porcelain tiles. (It's within walking distance of the city's famous Gellert spa bath.) Bonus: There are new flights on a half-dozen airlines from Chicago, New York, Seoul, and Shanghai—plus a dining scene that's shedding its humble reputation.

PHOTOGRAPH BY FEDERICO CIAMEI FOR BLOOMBERG BUSINESSWEEK

If You Want Quiet Time...

Lombok

APRIL–OCTOBER

Bali's unsung neighbor may lack Hindu temples, but it has pristine, undeveloped beaches and waterfalls to spare. Following the expansion of Lombok's airport (and a major earthquake) in 2018, resorts such as the garden-shrouded Oberoi and the antique-filled Hotel Tugu have lured sun seekers to a tiny peninsula facing the Gili Islands. Nearby, in March, the Legian Sire will add 46 suites and 15 pool villas along with boat service to explore pearl farms, markets, and brilliant coral reefs. Farther afield, Aqua Expeditions is now sailing in the eastern archipelago, with chef Benjamin Cross (of Spain's three-Michelin-starred Can Fabes) drawing inspiration from the Spice Islands.

Israel

FEBRUARY–MAY

Biblical landscapes will get a modern edge this April, when Six Senses Shaharut opens on 46 acres of desert dunes. It'll have saunas and hammams, camel rides through the Negev, minimal artificial lighting, and a tented restaurant featuring a traditional Bedouin sand oven. Get there via the recently completed (and architecturally dazzling) Ramon Airport, only an hour's drive away. Upgrades continue in Jerusalem and Tel Aviv as well—where Brown Hotels, the local authority for stylish stays, is working on a major expansion. Prioritize JLM, near the new Museum of Tolerance, and Hotel BoBo, with a funky aesthetic that accentuates the Mediterranean Sea views.

The Oberoi Lombok

PHOTOGRAPH BY FEDERICO CIAMEI FOR BLOOMBERG BUSINESSWEEK

Six Senses Shaharut

… or Wine Time …

Finger Lakes

MAY–JUNE
Named for its 11 digit-shaped lakes, this bucolic region in central New York counts more than 100 wineries—of which Red Tail Ridge was the first to win a coveted James Beard nomination last year. It's roughly an hour south of the wine-centric new-American restaurant Redd, an offshoot of the Michelin-starred Redd Wood in Napa Valley. For sophisticated accommodations, American Girl founder Pleasant Rowland owns five inns in Aurora, and the Brooklyn-based design wizards at Studio Tack will open the Lake House on Canandaigua this summer, complete with a spa and timber-framed event barn. The area is also the birthplace of the women's rights movement and will commemorate the 19th Amendment's centennial with parades, museum exhibits, and a new home for the National Women's Hall of Fame.

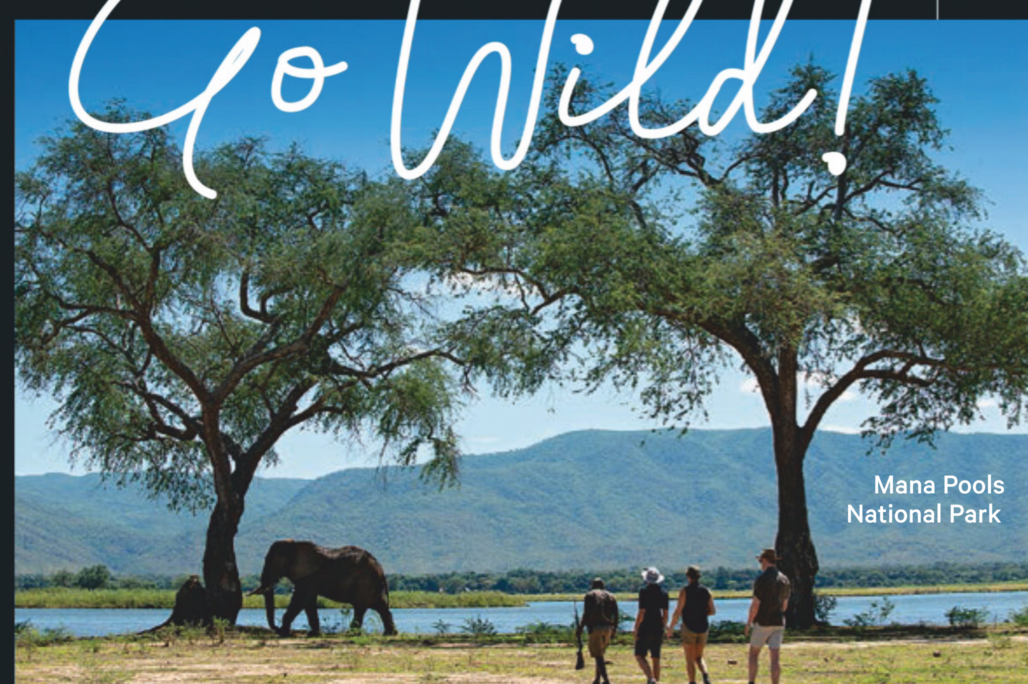
Inland Alaska

FEBRUARY–MARCH
The cruise crowds are racing against climate change to see this northernmost state, where glaciers are shrinking at record clip. That shouldn't discourage anyone; instead, it's reason to delve deeper inland, where the landscapes are (still) frozen in time and insulated from the coastal traffic. Mother Nature has a strong year in store for Alaska's dark skies; the practically inaccessible Sheldon Chalet, a glamorous oasis inside Denali National Park & Preserve, has planned a year of programming around celestial events, including some penumbral eclipses. If daytime explorations are more appealing, Tordrillo Mountain Lodge—fresh off a multimillion-dollar renovation—now includes the state's only *via ferrata* (protected climbing route) and heli-biking trails.

Hawaii

SEPTEMBER–OCTOBER
Hotels on the Hawaiian Islands are getting ever more serious about the health factor that luxury travelers increasingly crave. Auberge Resorts' reboot of Mauna Lani—one of the oldest and most beloved hotels on the Big Island—will open in January with a sports program designed by surf legends Gabby and Laird Hamilton. It'll focus not on cutbacks and foam climbs, but on breathing—a hot trend. On the tiny island of Lanai, where Four Seasons already runs a best-in-class resort founded by Oracle billionaire Larry Ellison, the same company just opened its first Sensei Retreat, a 96-room, all-inclusive getaway with a high-tech spa and farm-to-table restaurant by Nobu Matsuhisa.

… or Just to Go Wild!



Mana Pools National Park

Zimbabwe

JUNE–NOVEMBER
It's a wonder so many travelers never make it past Victoria Falls when some of Africa's biggest concentrations of wildlife, most qualified guides, and best all-around values are just beyond its roaring depths. Now that the Robert Mugabe era is over, though, Zimbabwe is a better bet—and laws that encourage hunting in next-door Botswana are driving some adventurers here instead. An hour from the falls, in Mana Pools National Park, Wilderness Safaris' Chikwenya Camp has seven tents at the confluence of the Sapi and Zambezi rivers. Nearby, the Zimbabwean-owned Nyamatusi Camp offers canoeing, walking safaris, and the chance to catch the famously ferocious tigerfish.

By Eleni Chrepa, Sara Clemence, Lisa Fleisher, Naureen Malik, Jen Murphy, Brooke Porter Katz, Brandon Presser, Chris Rovzar, Antony Sguazzin, Zoltán Simon, Randy Thanthong-Knight, Hailey Waller, and Gisela Williams

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Cable Lost—But Streamers Aren't Celebrating Yet

By Shira Ovide

People have been talking about the streaming era for so long that it's hard to imagine the tipping point just happened. In 2019 the rate of Americans quitting cable went from steady slide to avalanche. TV ratings continued to tumble. The three biggest U.S. entertainment titans made the jump into original streaming video, as did Apple Inc.

It's time to really, truly declare that streaming won. Winning, though, has never looked this bad.

No major subscription provider generates reliable profits from streaming video. The king, Netflix Inc., has borrowed $13 billion as the cash it spends on programming exceeds the fees it gets from subscribers. (Netflix is profitable on a noncash basis.) Walt Disney Co. says that Hulu, which it took over last year, won't turn a profit until 2023 or later. HBO Max, which is launching this year, is forecast to be unprofitable through 2024. By most outsiders' estimates, Disney+, Prime Video from Amazon.com, CBS All Access, Apple TV+, and YouTube TV aren't paying for themselves.

For now this streaming red ink doesn't matter. Some companies such as Amazon and Apple care less about profits than selling shoes or smartphones. Plus, there's no point in trying to maximize profits if a company is going to die in the streaming war.

The economics could eventually work. For the first time, companies control everything from words on a script page to pixels on a TV screen–and all the revenue they generate–vs. having to pay a distributor. Maximum control lets companies glean maximum profits from their creations. It also increases the risk if things go badly. Enjoy that *Friends* binge while you still can. Ⓑ

—*Ovide is a former tech columnist for Bloomberg Opinion*

● TOUGH COMPETITION
Given the financial commitment required to be competitive in a marketplace this crowded, success could be as fleeting as the image on a smartphone screen. Liberty Media CEO Greg Maffei predicted in November that the new streamers will "drain each other in a circular firing squad."

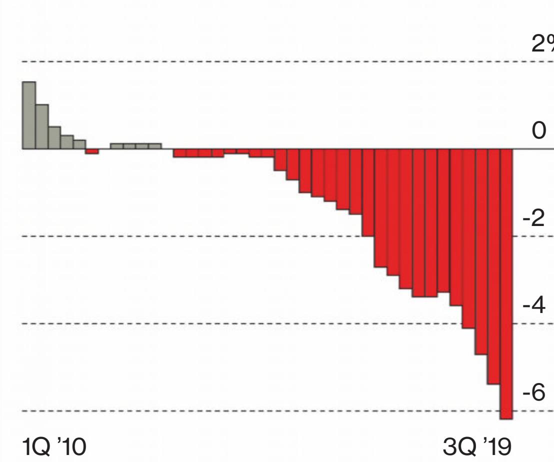
● THE BINGEING BINGE
In 2015, FX Networks LLC Chief Executive Officer John Landgraf famously said, "My sense is that 2015 or 2016 will represent peak TV in America."

● TOO MUCH OF A GOOD THING
Landgraf was off by at least three years. In 2015 there were

422

original scripted English-language series in the U.S. The number likely topped 500 in 2019.

● U.S. TV subscribers, year-over-year change*



● CONSCIOUS UN-CABLE-ING
The pace of cord-cutting last year turned "even worse than freaking ugly," wrote media analyst Michael Nathanson in a research note. The rate of people quitting cable- and satellite-TV network packages reached a high in 2019.

ILLUSTRATION BY GEORGE WYLESOL. *INCLUDES CABLE, SATELLITE, AND CABLE-LIKE ONLINE SERVICES SUCH AS SLING. DATA: MOFFETT NATHANSON LLC

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