

## Bloomberg Brief

# QuickTake

*Explainers for a world in flux*

# FEBRUARY 2017

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# Trump's Executive-Action Deluge

By Laurence Arnold

**As often happens at the start of a presidency, Donald Trump is making full use of the unilateral powers he now wields. By the end of his first full week in office, he had issued 14 executive actions — including orders and memoranda — which can instantly change the course of American governance without any involvement by Congress. Use of such presidential directives ballooned in the early- to mid-20th century. Some critics worry they can be overused, even abused, by the inhabitant of the White House.**

## 1. What's an executive action?

It's a signed directive from the president that can guide operations of the federal government and carry the force of law. The most formal and best known is the executive order. Presidents also can issue memoranda, to direct administrative matters, and proclamations, which can address ceremonial matters (like federal observances) or substantive ones (like trade policy).

## 2. What gives the president this power?

"The U.S. Constitution does not define these presidential instruments and does not explicitly vest the president with the authority to issue them," according to the Congressional Research Service. "Nonetheless, such orders are accepted as an inherent aspect of presidential power."

## 3. What directives has Trump issued?

The 13 he personally signed in his first full week (through Jan. 27) include the executive order closing the border to certain immigrants; a memorandum directing the U.S. trade representative to withdraw from the Trans-Pacific Partnership; memoranda reviving construction of the Keystone XL and Dakota Access pipelines; and an executive order cutting federal funds to "sanctuary cities" that decline to enforce certain U.S. immigration laws. His chief of staff, Reince Priebus, also signed a memorandum, upping the administration's total to 14. Trump's very first directive, an executive order stating his desire "to seek the prompt repeal" of the Affordable Care Act, left many scratching their heads; it and a few others were more reiterations of promises than plans for concrete actions.

## 4. Are there limits on presidential directives?

Yes. An executive order or memorandum carries the force of law only if it's "based on power vested in the president by the U.S. Constitution or delegated to the president by Congress," according to the Congressional Research Service. So a directive that "implements a policy in direct contradiction to the law will be without legal effect" unless it's "justified as an exercise of the president's exclusive and independent constitutional authority." Already, some predict Trump's immigration order will be struck down by courts as discriminatory for focusing on majority-Muslim nations.

## 5. Who can change an executive action?

Only the sitting president can overturn one, by issuing another one. That's what Trump did with his Jan. 23 memorandum forbidding international nonprofit organizations that receive federal money from providing abortion services. Specifically, Trump revoked a 2009 Obama memorandum that in turn had revoked a 2001 George W. Bush memorandum. Executive actions don't require approval from Congress, and Congress can't overrule them if they are rooted in the president's constitutional authority. What Congress can do to undermine any executive action is to pass legislation that makes carrying out the order impossible, such as denying funding to a position or office the president creates.

## 6. Are Trump's 14 actions a lot?

He's off to a torrid pace. According to the Pew Research Center, Barack Obama issued 277 executive orders during his eight years in office, or 35 per year, down slightly from 36 per year by George W.

# 14

Number of executive actions issued in President Trump's first week

Bush and 46 per year by Bill Clinton. The executive-action champion was Franklin D. Roosevelt, who issued 3,721, or an average of 307 a year.

## 7. Why did FDR issue so many?

To say he had a broad sense of presidential power would be an understatement, since he tried to reshape the Supreme Court and broke an unwritten two-term limit on the presidency by seeking and winning four terms. There also was the matter of being the nation's leader during the Second World War. Among his orders was a notorious one, in 1942, granting the War Department broad powers to create military exclusion areas that resulted in more than 110,000 Japanese Americans being forced from their homes into internment camps.

## 8. What's the concern?

As might be expected, the party not in power often expresses concern about the president's use of executive actions. So can people or businesses affected by such actions. Steel companies challenged a 1952 executive order by President Harry Truman giving the commerce secretary possession of most steel mills to avert the effects of a strike. In *Youngstown Sheet & Tube Co. v. Sawyer*, the Supreme Court struck down Truman's action as an improper intrusion onto Congress's turf.

# Trumponomics

By Brendan Greeley

**Early in his first press conference as president-elect, Donald Trump said he would make pharmaceutical companies bid for U.S. business because they were “getting away with murder” on drug prices. Indexes that track pharmaceutical stocks plummeted. It was classic Trump, doing what economists call “jawboning,” or moving markets today with threats of action in the future. Presidents and Federal Reserve chairs have jawboned before, usually from behind a podium or in a carefully crafted statement. But when Trump wants to cut the cost of the next version of Air Force One or stop companies from sending jobs overseas, he bullies, intimidates and threatens via Twitter. His policies change by the week, but it’s clear they won’t fit any classic economic mold. What’s less certain is whether this ad-hoc approach will yield the results Trump advertises. Here are some basics of Trumponomics:**

## Employment

Like other Republicans, Trump sometimes talks about how economic growth creates jobs. More often, however, he talks as if there’s a fixed sum of jobs in the world. Jobs are “taken” by other countries, to be taken back through negotiation. When he cajoles companies to drop plans to invest in factories abroad, he uses a classic European approach known as dirigisme, which elevates the state’s interests over those of employers or free-market forces to influence corporate investment. Here, jawboning has created results, albeit minuscule in an economy that regularly creates more than 150,000 new jobs a month and in which 152 million people are already employed. Since the election, Fiat Chrysler, Wal-Mart, Lockheed Martin, Sprint and a half-dozen other large employers have pledged to hire more than 200,000 new workers. Critics say the numbers are inflated because companies are repackaging existing plans into something Trump can claim credit for as a way of currying favor.

## Trade

Trump is a protectionist on trade. In his first week in office, he withdrew the U.S. from the 12-nation Trans-Pacific Partnership that President Barack Obama had spent years negotiating. Free-trade talks with the European Union are likely to meet the same fate, yet Trump aides say he is open to a two-way trade deal with the U.K. Trump repeated his threat to impose a 35 percent tariff on goods sent from plants in Mexico to the U.S. He also reversed Obama administration decisions by agreeing to open negotiations over construction of the Keystone XL and Dakota Access pipelines – while insisting that developers use American-made materials. Having

called the North American Free Trade Agreement the “single worst trade deal ever approved in this country,” he invited the leaders of Mexico and Canada to talks on a new pact. He wants to confront China more forcefully through the World Trade Organization. Trump has also said he would instruct his Treasury secretary to declare that China manipulates its currency to sell products more cheaply to the U.S. China so far seems impervious to jawboning; it has yet to respond with any concessions.

## Fiscal Policy

The new president says he wants to preserve Social Security and Medicare, which aligns him more with Democrats than Republicans on entitlements. He is also wildly out of step with his party’s fiscal hawks in calling for investment of as much as \$1 trillion to revitalize public works, a classic liberal approach to governing and one way to reward the blue-collar workers who helped elect him. He sometimes says he will borrow money to do this while interest rates are low. His advisers say it could be done through tax credits. Trump hews to the Republican standard of lowering taxes to stimulate growth. He calls for individual and corporate tax cuts that analysts say would balloon the deficit by as much as \$6 trillion over 10 years. Trump has said that, like congressional Republicans, he prefers “dynamic scoring,” a wonky way of saying tax cuts will create growth, increase tax revenue and make spending cuts unnecessary. Trump says he would also assume increased tax revenue from fewer regulations – a move without precedent in government budgeting.

## Monetary Policy

Trump often singled out the Fed for scorn during the presidential campaign.

He accused Fed Chair Janet Yellen of keeping interest rates “artificially low” to improve Obama’s record on jobs. Trump’s views seem influenced by his personal experience as a real-estate developer. Under Yellen, the Fed has come around to the idea that the natural rate of interest – what the rate would be, without any policy intervention – is much lower than it has been historically, and perhaps even below zero. Trump is part of a generation accustomed to borrowing at much higher rates, as he did in the 1980s and 90s. At times, Trump shows libertarian instincts on monetary policy by supporting legislation to reduce the central bank’s independence with regular audits of policy deliberations.

## Regulation

True to his business roots, Trump says he believes regulation stifles economic growth. In his first 10 days in office, he signed orders requiring government agencies to revoke two existing regulations for each new one issued and to expedite environmental reviews on high-priority construction projects, such as bridges. He promised to roll back the Dodd-Frank Act on financial reform, the health-care plan known as Obamacare and Obama’s clean power plan. He has also said he would preserve rules that protect health and safety. He doesn’t seem to share others’ worries that deregulation could worsen climate change or invite another financial crisis. Deregulation fits his understanding of how economic growth is created: Businesses create jobs; by lowering taxes and cutting regulations, businesses will create more jobs. Since the election, some companies that have publicized new jobs have cited the promise of lower regulation under Trump – a classic jawboning result.

# The Strong Dollar

By Scott Lanman and Andrew Mayeda

**The almighty dollar is mightier than ever. As the U.S. economy chugs along and most others struggle, investors are flocking to it, enabling the U.S. to borrow lots of money at low interest rates. American consumers can feast on it, buying imported goodies for less. U.S. politicians tout it as evidence of the economy's eternal dynamism. Other countries are driving their currencies down, making their goods more competitive on the world market. Not the U.S. It stands out as the one nation that has traditionally preferred its money superpower-strong. That's a mixed blessing. The high dollar hurts some companies' earnings by reducing the value of sales abroad. It has held down U.S. inflation to levels considered too low. For the rest of the world, danger lurks in surging dollar-denominated debt sold in emerging markets like Brazil and India; the stronger dollar makes those bonds harder to repay. Now the policy may be ready for a re-think under President Donald Trump.**

## The Situation

In an interview with the Wall Street Journal days before he took office, Trump called the currency "too strong," signaling he may break with decades of allegiance to what's known as the strong dollar policy. During his confirmation hearing, Treasury Secretary nominee Steven Mnuchin told lawmakers that "an excessively strong dollar" could harm the U.S. economy in the short term while also noting a strong dollar is important over the long term. Trump's comments, he said, weren't meant as a longer-run policy, suggesting that the new president might take steps to weaken the dollar at times. The U.S. Dollar Index, which tracks the greenback against six major currencies, surged 28 percent from the start of 2014 to the end of 2016, including a 4 percent bump after Trump's victory. The move

toward higher interest rates in the U.S. – while they remain near zero or even negative in the rest of the world – has made the dollar more attractive, pushing its value up. Big-name American companies, including Apple, Mattel and Gap, blamed the dollar's strength for crimping profits in 2016.

A stronger dollar has meant a weaker yen, hurting U.S. automakers by helping Japanese competitors like Toyota, which make more money on each car sold in dollars. A slumping euro also means good things for companies in Europe that sell in the U.S. Yet for emerging-market economies, the strong dollar has lured capital away and limited domestic growth.

## The Background

The U.S. economy became the world's largest in the 1870s, yet the British pound remained the dominant currency. That changed starting with the creation of the Federal Reserve in 1913. World War I helped, too, by forcing other nations to suspend convertibility of their money to gold. The Bretton Woods agreement made the dollar's preeminence official in 1945 as it became the standard used to fix exchange rates. That system collapsed in 1971, but the dollar's ascendancy continued. In 1985, the Plaza Accord reached by the U.S. and the other four richest economies pushed down the dollar's value for awhile to slow Japanese exports. It didn't last. The dollar remains the dominant reserve currency, used by countries to pay international debts. In 1995, Treasury

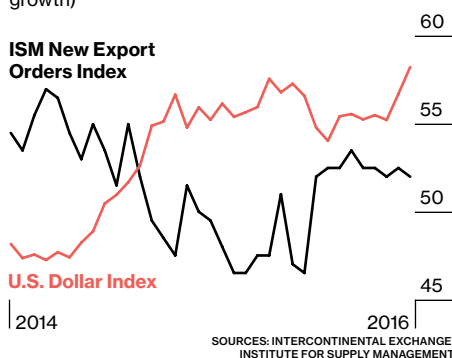
Secretary Robert Rubin asserted that a strong dollar is in the U.S. national interest, a mantra repeated by each of his successors (though not always with conviction). Even the global financial crisis of 2008 strengthened the dollar, as investors sought safety in U.S. debt.

## The Argument

The Treasury Department under President Barack Obama was unwavering in its allegiance to the strong dollar. Now the policy is looking more like a relic: The rising greenback has made it tougher for the Federal Reserve to raise interest rates, with Chair Janet Yellen saying in June that the surging dollar has harmed U.S. exports. Trump has said a strong dollar sounds better than it is in reality. Former Treasury Secretary and Obama adviser Lawrence Summers warned in early 2017 that a stronger dollar would hurt American workers competing with lower-paid Mexican workers, going against Trump's goal of ending offshore production of American goods and bringing manufacturing jobs back to the U.S. So Americans should hold off on the champagne, even if the strong dollar makes it a bargain.

## Stronger Dollar, Weaker Exports

Dollar index compares dollar with six major currencies (1973=100); ISM survey of company executives on month-to-month changes in manufacturing export orders (above 50 signifies growth)



# 28%

Amount the U.S. dollar surged against six major currencies, 2014-2016

# Mandatory Minimum Sentencing

By Andrew M. Harris

**The U.S. has more prisoners than any other country. With less than 5 percent of the world's population, the U.S. houses about a fifth of all convicts, at a cost of some \$80 billion a year. Mandatory minimum sentences for drug crimes, immigration violations and other offenses have left American prisons filled with low-level offenders serving long terms. The nation's federal inmate population more than doubled over the past two decades even as the number of violent crimes per capita declined by about 40 percent. Mandatory minimums came under pressure as the major U.S. political parties reached consensus that inflexible punishments take a toll on taxpayers, communities and families of the incarcerated. But the election of President Donald Trump, who cast himself as a law-and-order candidate, has set back expectations that the penalties would be further loosened.**

## The Situation

Trump's nominee for attorney general, Senator Jeff Sessions, has argued against further relaxing of sentencing rules. A Trump administration is unlikely to continue a policy put in place in 2013 by then Attorney General Eric Holder blunting the impact of mandatory minimums; Holder instructed federal prosecutors to charge minor criminals with lesser offenses so that the potential punishment matched the crime. President Barack Obama said in 2015 that long mandatory minimums should be shortened or eliminated. He stressed the disproportionate impact of the laws on racial minorities. Bills drawing bipartisan support were introduced in the U.S. Senate and House of Representatives to eliminate minimums for certain drug offenses, expand eligibility for exemptions and allow federal courts to disregard the mandatory minimums when they conflict with general sentencing standards. Those standards take into account such factors as the seriousness of the crime and the offender's specific role in it. Sessions opposed the proposals, dimming their prospects in a new Congress. A debate about mandatory minimums is also taking place in Australia.

## The Background

Mandatory minimum punishments for serious federal offenses are as old as the republic. Under the 1790 Crimes Act, the required sentence for treason, murder, piracy and forgery of government securities was death. Later, infractions with baseline punishments touched on slavery, the manufacture

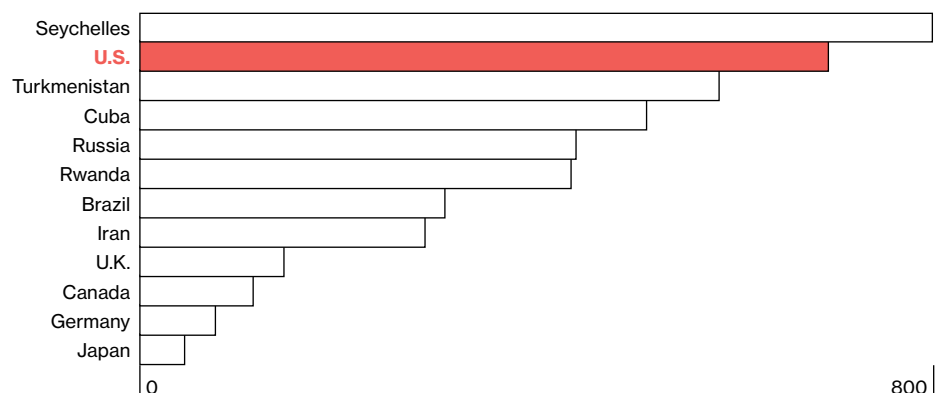
and sale of alcohol and, in the 1980s as crime rates rose, drugs. The discretion of judges was further limited in 1987 when a set of federal sentencing guidelines was put in place to curb the disparity in punishments for the same offenses in different regions of the U.S. These guidelines, in conjunction with mandatory minimums, were seen as leading to longer sentences. In 2005, the U.S. Supreme Court ruled that the sentencing guidelines could be no more than advisory, but mandatory minimums were unaffected by the decision. A 2014 decision by the U.S. Sentencing Commission to retroactively reduce most federal drug sentences brought the release of thousands of inmates, so that for the first time in three decades the federal prison population began to decline. It numbers about 190,000 inmates, 30,000 fewer than the peak.

## The Argument

The debate over punishments begins with a dispute over crime. In his campaign, Trump presented violent crime as a rising threat, a position mirrored by Sessions. National statistics show violent crime increased 3.9 percent in 2015, but that data point remains part of an overall, dramatic decline dating back to 1992, and the rate hasn't been this low since 1970. Defenders of mandatory minimums argue that a retreat from clearly defined sentencing will produce an increase in violent crime or a return to sentencing disparities. Advocates for change say fixed minimums are crude instruments of justice, one-way ratchets that create punishments too harsh for charged offenses. Racial minorities and the poor, they note, are incarcerated disproportionately.

## Incarceration Rates

Inmates per 100,000 population



NOTE: DATA IS FOR THE MOST RECENT PERIOD AVAILABLE, RANGING FROM 2012 TO 2016; SOURCE: INSTITUTE FOR CRIMINAL POLICY RESEARCH

# U.S.-Israel Relations

By Ethan Bronner

**A continent-sized superpower with hundreds of millions of citizens steeped in Christian tradition. A speck on a map half a world away with 8 million people, mostly Jews. They make for an unlikely friendship. Yet the U.S. and Israel are as close as any two countries. Advocates of the relationship see two societies built by immigrants immersed in democratic principles and refreshing informality. Skeptics see a lion held hostage by a mouse. U.S. patronage has clearly benefited Israel, where the relationship has long been viewed as sacrosanct. In the U.S., Israel is popular but there is disagreement over whether the closeness advances U.S. strategic goals.**

## The Situation

Israeli Prime Minister Benjamin Netanyahu hopes to establish a better connection with newly inaugurated President Donald Trump than he had with Barack Obama. Their strained relationship reached a low point in December, when the U.S. broke from its usual practice of blocking United Nations resolutions criticizing Israel. Under Obama, U.S. officials have been unusually harsh in their criticism of Israeli settlement of the West Bank, which the Palestinians hope to make the heart of an independent state. An earlier flashpoint came in 2015, when Netanyahu encouraged the U.S. Congress to kill a deal the U.S. and other world powers eventually signed with Iran over its nuclear program. Departing from decades-old U.S. policy, Trump has said he does not view Israeli settlements as an obstacle to peace. He also shares Netanyahu's criticism of the nuclear deal with Iran. Even under Obama, U.S. support for Israel grew steadily. In 2016, the U.S. agreed to provide a record \$38 billion in military aid over 10 years. The U.S. shares intelligence with Israel and conducts military exercises with its forces.

## The Background

For the first two decades after its birth in 1948, Israel wasn't an especially close ally of the U.S., which declined to sell it arms. U.S. Jews were a relatively timid minority, and American companies built relations with oil-producing Arab states. France, in conflict with its North African colony Algeria, was Israel's original patron, helping it develop nuclear weapons. The U.S. drew Israel close partly as a

U.S. Aid to Israel



result of Cold War calculations. The Soviet Union supported Israel's Arab enemies in the 1960s and 1970s. The U.S. airlifted supplies to Israel during the 1973 Arab-Israeli war, engaged in Mideast diplomacy and committed to maintaining Israel's military superiority over its foes. By the time the Soviet Union collapsed in 1991, the special U.S.-Israel relationship had developed vast new underpinnings. The two democracies see themselves as pioneering societies that are God-blessed and as refuges for the oppressed, so Israel has long had strong popular support in the U.S. American Jews, who became successful and outspoken as anti-Semitism declined, lobbied Congress and the White House to keep Israel close. So did evangelical Christians, who believe Israel's creation foretells the second coming of Christ. Their Republican leanings made support for Israel – originally a Democratic cause due to Jews' links to the party and Israel's early leftist orientation – bipartisan. The Iranian revolution and Arab terrorism, including the Sept. 11

attacks, tended to make Americans unsympathetic to Israel's enemies.

## The Argument

U.S. critics of the close relationship argue that the pro-Israel lobby skews U.S. foreign policy away from the national interest. By reducing Israel's need to make compromises with Palestinians and others in the region, they say, U.S. support breeds anti-Americanism and militancy in the Mideast. Israeli settlement building in the West Bank is a prime example. It deprives the Palestinians of land for a state and infuriates the Arab world. Fans of the relationship respond that it has achieved the U.S. goal of reducing the risk of major warfare between Israel and its neighbors in an oil-rich region. Israel's U.S.-aided strength persuaded Egypt and Jordan to make peace with it. The hostility of Israel's enemies, they say, is due more to their rejection of a Jewish state than it is to any Israeli or U.S. policy. The region is volatile and unpredictable, they say, whereas Israel is uniquely transparent, accountable and reliable.

# The Road to Brexit

By Simon Kennedy, Tim Ross and Ian Wishart

**U.K. Prime Minister Theresa May entered 2017 with just three months to meet her self-imposed deadline to trigger divorce talks with the European Union. In a much-anticipated speech on Jan. 17, she outlined her vision for what her Brexit secretary, David Davis, has called possibly “the most complicated negotiation of all time.” And that was before Parliament won the right to weigh in.**

## 1. What's taking so long?

Though Britain voted in June 2016 to leave the EU, May has stalled on starting two years of formal talks. She's wanted time to prepare a negotiating stance. The EU has stuck to its line that it won't hold even informal discussions until the U.K. triggers Article 50 of the Lisbon Treaty, which governs withdrawal from the bloc. And there was disagreement on who, exactly, has the power to invoke it.

## 2. So who has the power to invoke it?

May said she did, but the U.K.'s Supreme Court ruled that Parliament does. The government has introduced legislation – an act of Parliament – which is short and sweet, because May wants to stick to her timetable and limit the opportunity for lawmakers to add

amendments. Her critics in Parliament are nevertheless lining up to impose roadblocks, such as forcing May to give regular updates on negotiations or even to hold another referendum.

## 3. Could Parliament derail Brexit?

In theory, yes. In reality, no. While most members of Parliament were against Brexit, they're reluctant to act against the will of the voters. The opposition Liberal Democrats say they will oppose the triggering of Article 50 if May refuses to put the final deal to another referendum, but they only have nine seats. The Supreme Court also ruled unanimously that legislatures in Scotland and Northern Ireland don't get to vote on the Article 50 process. Scotland probably would have sought to block the exit.

## 4. What does May want?

In her Jan. 17 speech, May said she wants to pull the U.K. out of the single market. That's the only way the U.K. can control immigration from the EU, pay less into the bloc's budget and restore law-making powers to the U.K. Parliament and courts, she concluded. That's the formula for what's become known as a “hard” or “clean” Brexit.

## 5. What does Brexit mean for banks?

British bankers are voting with their feet. Executives from JPMorgan, HSBC and UBS all said in response to May's speech that they are likely to shift jobs and operations elsewhere to ensure continued access to the EU. After months of pushing to keep the current form of unrestricted access to the EU's single market after the U.K. leaves, bankers are lowering their sights. Having initially sought to maintain so-called passporting, which allows global banks with bases in London to provide services to the rest of Europe, lobby groups are increasingly focusing on securing a version of “equivalence,” which can give companies privileged, though targeted, market access.

## 6. What about trade?

May said she wanted to overhaul Britain's membership of the customs union, the tariff-free, low-bureaucracy club of mainly EU countries. She would still like easy trade with the bloc, but also wants the freedom to negotiate trade pacts with non-EU countries such as China and the U.S., which she can't do as part of the customs union. She also suggested any new relationship be phased in to give industries such as banking time to adjust. Her hand was strengthened when Donald Trump said in the days before becoming U.S. president that he would seek a speedy trade pact with the U.K., allowing May to show her EU counterparts that Britain can prosper outside of the bloc.

## Europe's Ties That Bind

○ **European Union** 28-nation single market of free trade and shared regulation; includes “free movement” of goods, services, capital and people

● **Euro Zone** 19 countries using the euro currency

● **European Economic Area** provides access to single market in exchange for payments; has “emergency brake” on free movement of people

⊗ **Customs Union** Circulates goods without duties, has uniform system for handling imports

○ **European Free Trade Association** Free-trade zone and network of agreements with other countries

Country	GDP*	Ties
Germany	\$3.36t	○ ● ● ⊗
<b>U.K.</b>	<b>\$2.86t</b>	○ ● ⊗
France	\$2.42t	○ ● ● ⊗
Italy	\$1.82t	○ ● ● ⊗
Spain	\$1.20t	○ ● ● ⊗
Netherlands	\$750b	○ ● ● ⊗
Turkey	\$720b	⊗
Switzerland	\$690b	⊙
Sweden	\$500b	○ ● ⊗
Poland	\$480b	○ ● ⊗
Belgium	\$460b	○ ● ● ⊗
Norway	\$390b	● ⊗
Austria	\$380b	○ ● ● ⊗
Denmark	\$300b	○ ● ⊗
Ireland	\$280b	○ ● ● ⊗
Finland	\$230b	○ ● ● ⊗
Portugal	\$200b	○ ● ● ⊗

Country	GDP*	Ties
Greece	\$190b	○ ● ● ⊗
Czech Republic	\$190b	○ ● ⊗
Romania	\$180b	○ ● ⊗
Hungary	\$120b	○ ● ⊗
Slovakia	\$90b	○ ● ● ⊗
Luxembourg	\$60b	○ ● ● ⊗
Bulgaria	\$50b	○ ● ⊗
Croatia	\$50b	○ ● ⊗
Slovenia	\$40b	○ ● ● ⊗
Lithuania	\$40b	○ ● ● ⊗
Latvia	\$30b	○ ● ● ⊗
Estonia	\$30b	○ ● ● ⊗
Cyprus	\$30b	○ ● ● ⊗
Iceland	\$20b	○ ● ● ⊗ ⊙
Malta	\$10b	○ ● ● ⊗
Liechtenstein	N/A	● ⊙

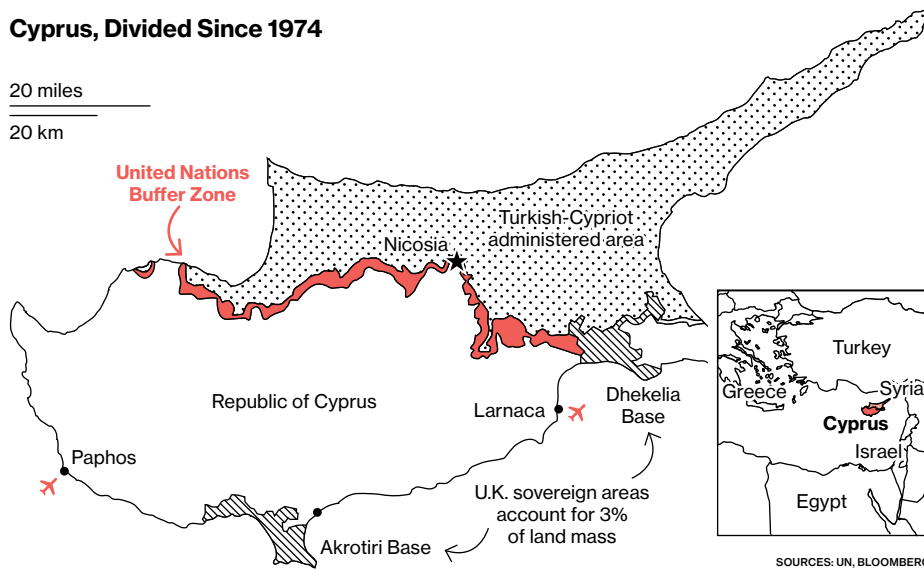
NOTE: CHANNEL ISLANDS, ISLE OF MAN, ANDORRA AND SAN MARINO ARE ALSO A PART OF THE CUSTOMS UNION; \*BASED ON 2015 DATA; SOURCES: WORLD BANK, EU, ETRA

# Reunifying Cyprus

By Paul Tugwell and Rodney Jefferson

One glance at the map shows you the importance of Cyprus. The eastern Mediterranean island is less than half the size of New Jersey, but its spot at the crossroads of Europe and the Middle East made it much fought-over for centuries. Since 1974, it's been split along ethnic lines between the self-declared Turkish Republic of Northern Cyprus and in the south, the Republic of Cyprus. Only the Greek-speaking south is internationally recognized. A militarized buffer zone runs across the island and through the capital of Nicosia. Now the lure of riches from selling natural gas — combined with high-stakes geopolitics — has eased ancient enmities and fueled optimism that the latest talks on reunification could end the long-frozen conflict. A deal would free up trade and investment and serve as a beacon of hope in a region roiled by violence and ethnic divisions.

## Cyprus, Divided Since 1974



Cyprus joining the European Union, but the United Nations-brokered blueprint was rejected in a vote by Greek-Cypriots. Since then, restrictions on crossing the buffer zone have eased, with some Turkish-Cypriots now working in the more prosperous south. Relations between the two sides warmed after the election of Mustafa Akinci as the Turkish-Cypriot leader in 2015. He supports reunification along with Cypriot President Nicos Anastasiades and they have pursued their own power-sharing arrangement — rather than one led by the UN.

## The Argument

Both sides want a deal that creates stability, unlocks investment and allows thousands of Cypriots displaced by the island's split to return home or be compensated for lost property. An agreement would end the legal limbo of the Turkish-Cypriots. It would also remove a barrier to Turkey joining the EU, since Turkey doesn't recognize the Republic of Cyprus and bars Cypriot-flagged planes and ships from entering its harbors and airports. While Turkish President Recep Tayyip Erdogan has supported the talks, he has long insisted that Turkish-Cypriots have equal rights and their safety be guaranteed by Turkey. It may be difficult for him to make concessions as he works to consolidate power at home in the wake of a failed coup attempt in July. Greek-Cypriots say a united Cyprus that's part of the EU doesn't need any foreign powers to guarantee security, arguing that Turkey should commit to the gradual withdrawal of its thousands of troops. Another failure to reach a deal could exhaust the reunification efforts of a generation that remembers the island before it was torn apart.

## The Situation

The two sides envision a federal state similar to Belgium, with a national government overseeing areas such as defense and foreign affairs. There are sticking points over land and property, but the biggest fight is over security. Cypriot leaders were joined at reunification talks in Geneva Jan. 12 by the foreign ministers of Greece, Turkey and Britain, which ruled Cyprus until its independence in 1960 and has military bases on the island. Under the agreement that ended colonial rule, all three countries were given the right to intervene if the island's territorial integrity or independence came under threat. Only Turkey is insisting on keeping that power. It says it's needed to safeguard Turkish-Cypriots, a minority of about one-fifth of the island's population of 1.1 million. There's a lot at stake: Energy companies including Exxon Mobil want to develop the surrounding area's oil and gas. Greece and Turkey, both members of NATO, have been at odds

over Cyprus. So reunification would also help strengthen the military alliance in the Mediterranean as Russia expands its influence in the region.

## The Background

Cyprus has been both a victim and beneficiary of its location. It changed hands between Assyrians, Egyptians, Greeks and Romans before coming under Byzantine rule. The Ottoman Turks seized it in the 16th century. The island was effectively partitioned in 1963 when fighting erupted between the two communities following a breakdown of the power-sharing arrangements put in place as part of independence from Britain. The island was fully divided in 1974 after Turkey invaded following a coup by supporters of union with Greece. As many as 150,000 Greek-Cypriots were forced south, and about 50,000 Turkish-Cypriots fled north, leaving behind land and property. A reunification settlement came close in 2004 prior to



# Challenging the Chaebol

By Peter Pae

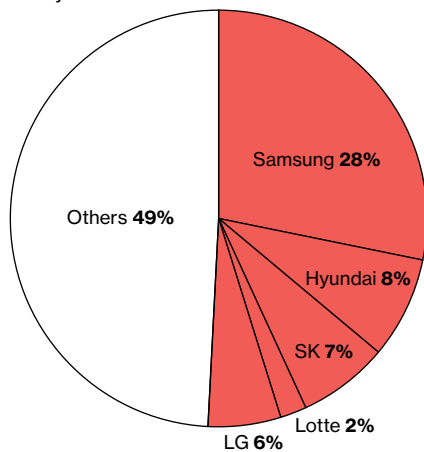
**The story of South Korea's transformation from economic minnow to the world's fifth-largest exporter owes much to its sprawling family-run conglomerates. Known as chaebol, these long-time pillars of the nation's "miracle economy" include the likes of LG, Hyundai, SK, Lotte and — largest of them all — Samsung. Yet the chaebol's oversized influence and cozy relationship with government, highlighted by a scandal that's engulfed the country's president, have put the conglomerates under an intense spotlight at the same time that many are navigating generational transitions. Is it time for change at the chaebol?**

## The Situation

South Korea's influence-peddling scandal took a dramatic turn in January as prosecutors sought permission to arrest Jay Y. Lee, the de facto head of Samsung Group, over allegations including bribery and embezzlement. A court later rejected the demand, though that decision doesn't halt the investigation and Lee could yet be indicted. Lee, also the vice chairman of Samsung Electronics, is accused of playing a role in payments of tens of millions of dollars that Samsung made to benefit a close friend of South Korean President Park Geun-hye. Investigators have focused on whether those payments were made in order to gain the backing of Korea's national pension fund for a controversial merger between Samsung affiliates in 2015 that helped smooth Lee's transition to power. President Park has since been impeached and her powers suspended.

## Five Biggest Chaebol = Half of Korean Stock Index

Weightings of companies in the Kospi Index as of January 2017



SOURCE: BLOOMBERG

At a parliamentary hearing in December, nine chaebol leaders seated together faced a barrage of questions from lawmakers, as hundreds of thousands of protesters calling for the president's ouster turned their anger to the country's conglomerates. After receiving the brunt of the verbal attacks, Lee ended nearly 13 hours of grilling with an apology and a promise: "If there is an alliance between companies and government, I will cut all ties. I think we've lost your trust." Samsung denies providing financial aid in return for favors. In 2016, the collapse of Hanjin Shipping and investigations into the conduct of the head of the Lotte retail group also served to erode confidence in the nation's industrial system.

## The Background

The term chaebol, which means "wealth clique" in Korean, is widely believed to have been influenced by Japan's zaibatsu – both share the same Chinese characters and meaning. Like the chaebol, zaibatsu were family-controlled conglomerates that dominated Japan's economy until they were disbanded by the U.S. government shortly after World War II. In Korea, establishing the chaebol was viewed as a key way to fast-track the country's economic development. Shortly after taking over the government in a military coup in 1963, Park Chung-hee, the father of the impeached president, launched a modernization effort driven by "guided capitalism" in which government-selected companies undertook major projects often financed with government-backed loans. There are now 45 conglomerates that fit the traditional definition of a chaebol, according to Korea's Fair Trade Commission. The top 10 chaebol own

# 45

Number of chaebol in South Korea

more than 27 percent of all business assets in South Korea.

## The Argument

While the chaebol helped make South Korea an economic success story, many politicians and investors argue that the system is a cultural relic poorly suited to the 21st-century economy. The shares of chaebol-linked companies trade at lower multiples of earnings than their peers in the U.S., Europe or Japan (a phenomenon called the Korea discount) because of concern over cronyism and cross-ownership. Ordinary South Koreans are also increasingly questioning the consolidation of wealth among a handful of families and the stifling effect chaebol have had on small businesses and startups. People are no longer prepared to turn a blind eye to illegal and improper relationships between government and business as they were in the past when the chaebol were seen driving growth and creating jobs, according to Professor Kim Sang-jo of Hansung University. Amid the public criticism, regulators and investors have been pushing to unravel cross-shareholdings and revamp the governance structure of the chaebol. The merger of the two Samsung affiliates in 2015 – the subject of the current investigation – was opposed by activist investor Paul Elliott Singer and only succeeded by a narrow margin, thanks to the support of the state pension fund.

# Automakers Under Scrutiny

By Kartikay Mehrotra and David Welch

Sometimes it can seem like the entire automotive industry is under investigation. Volkswagen is racking up fines and has had seven executives indicted for the tricks it played to enable its diesel-powered vehicles to pass emissions tests. Audi — a VW unit — also is accused of similarly rigging gasoline-fueled cars. Fiat Chrysler is being investigated by the U.S. Environmental Protection Agency, and Germany's Daimler AG has also been sued over diesel emissions. Mitsubishi Motors admitted to doctoring fuel-economy claims. Air-bag maker Takata has recalled more than 100 million faulty airbags linked to 17 deaths worldwide. The General Motors ignition-switch debacle is blamed for the loss of at least 120 lives and led to \$2.1 billion in fines and legal settlements with more potentially coming.

## 1. Why are so many companies in trouble?

Most of the environmental cases deal with stringent emissions standards put in place by the Environmental Protection Agency in 2001. Carmakers were given until 2010 to comply. Chrysler and the maker of its engines bet they could beat the competition to market. They did so, in 2007, but with a truck allegedly incapable of meeting those standards over its lifetime, according to a consumer lawsuit, which says Chrysler's diesel Dodge Ram trucks from 2007 to 2012 were rigged to cheat smog tests.

## 2. Then why is VW the poster child for emissions cheating?

Chrysler is accused of having done it first, but VW has already admitted fault and agreed in January 2017 to pay \$4.3 billion in penalties to the U.S. That sum is in addition to the \$19.1 billion that VW must set aside to pay fines and compensate affected customers and dealerships. The German automaker will have to buy back cars and also fund pollution-reduction projects. VW still faces additional claims as well as criminal probes in Germany. Chrysler could soon help VW shoulder the reputational burden that comes with diesel cheating. Along with facing suit for allegedly building a standards-violating truck, Chrysler's been issued a notice of violation by the EPA for breaching the Clean Air Act. If it's found it cheated emissions tests, Chrysler could be liable for civil penalties.

## 3. Is this the first time carmakers have been caught cheating?

Emissions cheating dates back to at least the 1970s, when carmakers were rolling out automobiles that turned

off anti-pollution systems when the air conditioning was on. Others had sensors to activate pollution controls only at testing temperatures. In 1973, U.S. regulators accused VW of cheating. It settled with a \$120,000 fine. GM paid \$45 million in 1995 after being accused of circumventing pollution controls.

## 4. Is emissions the only issue?

Not by a long shot. In addition to Takata's exploding air bags and GM's faulty ignition switches, lawyers and government investigators in recent years have delved into Toyota accelerator pedals, Honda's underreporting of fatal accidents and injuries, incomplete safety recalls by Fiat Chrysler and overstated fuel economy by Ford, Hyundai Motor and Kia Motors. GM hid changes the company made to its faulty ignition system only to have the undisclosed fix revealed in a deposition by a trial lawyer. Federal safety regulators discovered it later. Similarly, Takata and Honda had settled lawsuits before issuing widespread recalls of the air-bag inflators.

## 5. What do the different scandals have in common?

Lawyers. Though researchers first uncovered VW's cheating in September 2015, lawyers followed up with their own investigations of carmakers — first VW, then its Audi and Porsche units, then Mercedes and Fiat Chrysler. Some of the same lawyers behind the VW diesel case also filed the Audi gasoline-engine lawsuit and the Chrysler case and continue to investigate additional potential violators of the U.S. Clean Air Act. Meanwhile, the researchers at West Virginia University who first detected VW's excess

# \$23b

Amount VW must pay in the U.S. to settle diesel cheating scandal

emissions continue to search for pollutant-spewing automobiles.

## 6. What's this doing to the auto industry?

With diesel's credibility now in question, carmakers are putting more resources into electric vehicles. That kind of innovation is expensive, and the fines companies are facing are potentially huge. VW recently agreed to a deal with employees that will slash as many as 30,000 jobs worldwide to save 3.7 billion euros (\$3.9 billion) and aid its recovery efforts. With consumer confidence in its brands shaken and profits waning, VW's ability to make new models that will win back customers is going to be hampered by scandal costs exceeding \$23 billion.

## 7. How do consumers know whom to trust?

Carmakers have won back customers after previous cheating scandals, just not right away. VW, which had thrived on a global reputation as automotive royalty, has been tarnished by its self-professed deception. The question for consumers will not only be if or when to trust these automotive brands, but whether to trust new technologies. That's exactly why it's so important for VW and other carmakers to figure out their path forward in a future of lower emissions and higher scrutiny.

# Art World in the Courts

By Katya Kazakina and Hugo Miller

**What do a Russian billionaire, Donald Trump-impersonator and Malaysian bon vivant have in common? They've all found themselves under scrutiny within the past year thanks to the art they bought or sold. Authorities and collectors from Singapore to New York have made claims of money laundering, hidden markups and flat-out scams running amok in the opaque art trade.**

## **Wildenstein tax fraud trial**

**Who** French tax authorities versus art dealer Guy Wildenstein

**What** Wildenstein, 71, a fourth-generation scion of the wealthy art-dealing dynasty, faced charges by a French court of attempting to avoid taxes by concealing paintings and other assets. The trial lifted the veil on the family's business secrets, including the existence of an offshore trust for 2,500 paintings valued at \$1.1 billion. Guy said he didn't learn of many of the financial machinations until his father, Daniel, died in 2001.

**Status** French judges cleared Wildenstein on Jan. 12.

## **Billionaire vs. the Free Port King**

**Who** Dmitry Rybolovlev vs. Yves Bouvier

**What** The dispute between Russian fertilizer billionaire turned art collector Rybolovlev and Bouvier, an art dealer with an empire of high-end storage facilities in free ports around the world, rumbles on two years after Bouvier's arrest in Monaco. In a complaint filed in the Mediterranean principality, Rybolovlev alleged that Bouvier, acting as his agent, overcharged him as much as \$1 billion in putting together a \$2 billion collection of works by Leonardo da Vinci, Pablo Picasso and Amedeo Modigliani. Bouvier says he was a seller, not an agent. The case, even if it never goes to trial, has shone a spotlight on the Geneva Free Ports and the art traded within its underground bunkers. Bouvier's art-storage company Natural Le Coultre is the largest tenant there. Rybolovlev also filed a case in Singapore, where Bouvier is a resident.

**Status** A Singapore court is expected to rule in early 2017 on whether it's the appropriate jurisdiction for the case.

## **Alec Baldwin's Wrong Painting**

**Who** Alec Baldwin vs. art dealer Mary Boone

**What** Baldwin, an actor and acclaimed Donald Trump-impersonator on NBC's Saturday Night Live, sued New York art dealer Boone for selling him the wrong Ross Bleckner painting for \$190,000. Baldwin long admired Bleckner's "Sea and Mirror" painting and asked Boone, who represents the artist, to find it. Baldwin got a Bleckner painting, but it turned out to be a version different from the one he wanted. Boone hit back with allegations that Baldwin avoided New York City sales tax by shipping the painting to California and then bringing it back to Brooklyn.

**Status** The case is pending.

## **Shvo's Alleged Dodge**

**Who** Manhattan District Attorney Cyrus Vance vs. real-estate developer Michael Shvo

**What** Shvo, who once turned an old New York City gas station into a pop-up art installation, dodged more than \$1 million in state and local taxes over six years while buying paintings, jewelry, furniture and a Ferrari, Vance alleged. In addition, Shvo Art Ltd. avoided at least \$275,000 in taxes on profits from the sale of fine art and furniture, according to Vance. Shvo claimed the company and its assets were located offshore, the complaint says, but the business was really at his offices and homes in New York City and the nearby Hamptons seaside resort.

**Status** Shvo pleaded not guilty in September and was released on \$500,000 bail while awaiting trial.

## **Justice and the Malaysian Playboy**

**Who** U.S. Justice Department vs. financier Jho Low

**What** 1MDB, the investment and development fund owned by the Malaysian state, is in the crosshairs of U.S. prosecutors who say money was siphoned off into real estate, artworks and other investments. Low, known for partying with U.S. celebrities Lindsay Lohan and Paris Hilton, allegedly laundered more than \$400 million in funds misappropriated from 1MDB, according to the Justice Department. Low bought paintings by Jean-Michel Basquiat, Claude Monet and Vincent van Gogh, and pledged some of the art to secure a \$107 million loan from Sotheby's, prosecutors say. Sotheby's wasn't accused of wrongdoing, but the case highlights how auction houses are turning into shadow banks, lending outside the regulated financial system.

**Status** Low has previously described his role with 1MDB as informal consulting that didn't break any laws. His relatives are fighting to keep the family's possessions from being seized by the U.S.

## **Going After Gagosian**

**Who** New York Attorney General Eric Schneiderman vs. art dealer Larry Gagosian

**What** Schneiderman went after mega-dealer Gagosian for not paying taxes, claiming Gagosian Gallery's California affiliate, Pre-War Art Inc., sold and shipped almost \$40 million of art to customers in New York without collecting or remitting state and local sales taxes. In addition, Schneiderman claims the gallery sold a significant volume of art in New York that was shipped out of state without paying the required taxes.

**Status** In July 2016, the gallery agreed to pay \$4.28 million while denying any wrongdoing.

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