

To have and have more: Wealth management and the growth of global inequality

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When it comes to global wealth inequality, we know how bad it's getting, but what do we know about who is responsible? When Oxfam reports that 1% of the world population owns more than the other 99% put together, the question arises: who or what is making the rich so much richer, and the poor so much poorer?

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It turns out we know surprisingly little about the key actors behind this momentous change. This creates a problem for policy makers who want to stop or reverse the growth of wealth inequality. The trend cannot be arrested without understanding its sources.

The research I've conducted over the past eight years suggests that some of the most important players have been overlooked: wealth managers. They are an elite group of lawyers, accountants, bankers and others who protect the fortunes of their high-net-worth clients from tax authorities and creditors, among others. To achieve these ends, wealth managers design complex, often multi-national structures composed of trusts, foundations and offshore corporations—the building blocks of tax avoidance, and law avoidance more generally. There are at least 20 000 wealth managers spread across 95 countries, and their control of billions in private capital flows plays a major role in the extreme concentration of wealth worldwide.

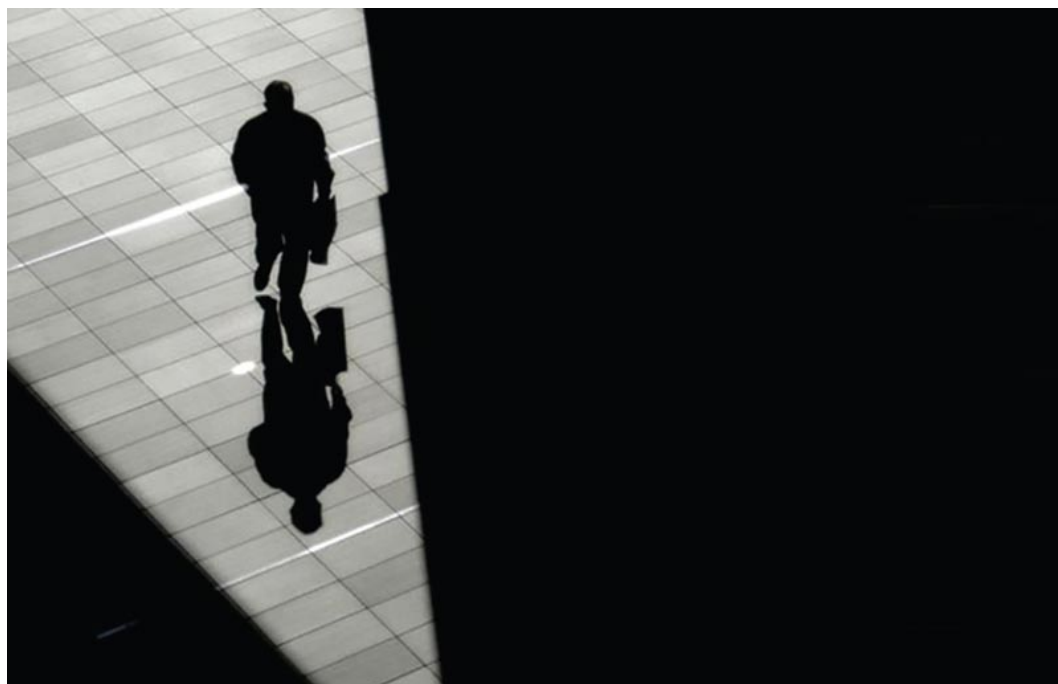
Making the rich richer

When economists such as Gabriel Zucman tell us that governments around the world lose \$190 billion annually in revenues due to tax avoidance by the ultra-rich, that points to the work of wealth managers. Such a feat is not accomplished by millionaires and billionaires themselves: they are otherwise occupied, often in accumulating more wealth or in spending it. Instead, the task of mastering the intricate and changing body of laws applying to tax, estates and multi-national

transactions falls to a highly specialised group of professionals. The skills they offer—which enable their clients to defeat the spirit of the laws without violating them formally—cost handsomely. That in itself is a major factor in the growth of inequality: the old saying “it takes money to make money” is true not because wealth accumulation is natural or inevitable, but because rich people can afford the best advisors.

This helps explain an unanticipated result of the 2008 financial crisis: while some expected it to be a great leveller in terms of inequality, the opposite occurred. Although the wealthy initially lost money in the crash, within a few years they had not only recouped it all, but had become wealthier than ever. According to Oxfam, the richest 62 people in the world increased their fortunes by a total of US \$500 billion between 2010 and 2015; meanwhile, the majority of the world’s population has yet to recover their losses. This can be attributed in part to the multi-pronged “wealth defence” strategy that professionals can provide to the world’s economic elites. This involves not only the avoidance of taxes and debts that could dissipate clients’ fortunes, but access to exclusive investment opportunities.


States and international organisations like the OECD are aware of the wealth management profession, which gets occasional mention in policy briefs and legislative hearings. But little effort has been made to address the professionals’ role in exacerbating inequality. Instead, the vast majority of political and institutional efforts to combat the problem have been directed at states (particularly offshore) and the wealthy themselves. These efforts have consistently proven to be disappointing. It seems that every time a loophole is closed or a sanction imposed, someone is there to get around it. That someone is often a wealth manager.



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Making the poor poorer

Wealth management techniques don't just make the rich richer: they also make the poor poorer . When professionals help high-net-worth individuals avoid paying their taxes or their private debts, the poor—and the middle class—bear the costs, both directly and indirectly. Indirectly, they pay through a reduction of public services, such as education, health care and transportation, which are critical for making a living and becoming upwardly mobile.

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The direct costs come from the surcharges on honest taxpayers and borrowers. Even with service cuts, the fiscal burden of the state must still be borne; tax avoidance by the rich shifts those costs downwards. In the US and Europe, estimates of this surcharge vary between 7% and 15% in additional taxes to cover the underpayment by the rich. At the same time, banks and other financing firms such as car dealerships raise the costs of borrowing to recoup their losses from high-net-worth individuals, who can default on their debts without penalty by using wealth management strategies. The resulting increase in borrowing costs has the largest impact on the poorest members of society, deepening their indebtedness and making upward mobility increasingly difficult to attain.

This has ominous long-term implications for human capital and national development. Drastic cuts in public services are occurring now in Greece, Spain and other EU countries where massive levels of tax avoidance by the wealthiest citizens depleted government coffers prior to the financial crisis. As underfunded states crumble, the most able and talented citizens often leave. Those left behind are ripe—in the words of economist Thomas Piketty—to be “tempted by

nationalist solutions, ethnic divisions, and the politics of hatred”. Thus, rising inequality creates a threat to democracy itself.

Perhaps the most significant political issue is how wealth managers’ work has enabled inequality to grow in obscurity for so long. Trusts, foundations and offshore finance work by concealing the true ownership of wealth. This not only makes it difficult to collect taxes and debts: it also cloaks economic privilege in a strategic veil of privacy.

Wealth managers have been very successful in keeping their clients off the radar, and limiting public awareness of the concentration of economic power. For example, a recent study by Michael Norton and Dan Ariely found that people in the US underestimate the extent of wealth inequality in their own country by 42%. Similarly, research conducted in Argentina suggests that the poor significantly underestimate how economically disadvantaged they are and have no idea how much better off the rich really are. This lack of awareness is partly due to the physical segregation of rich and poor in most parts of the world. But it is also linked to strategic obfuscation by wealth managers, who keep their clients’ affairs out of the newspapers and courtrooms that might otherwise expose the real extent of the economic divide.

A new approach to policy?

As the title of Tolstoy’s book about the wealth divide in his time put it, “What then must we do?” With 21st century inequality already so extreme, it may seem too late to reverse the trend. Since tightening tax laws, sanctioning offshore states, and pursuing tax avoiders in court has not stemmed the tide of wealth concentration, there would appear to be few options left.

My research points to a new policy direction: lawmakers must engage directly with the experts who control wealthy clients’ capital flows, and who devise the strategies that undo the intent of laws governing private taxation and debt. A recent study on Israel by Adam Hofri suggests some reason for optimism on this front. With a few targeted legal changes, the government there was able to co-opt wealth management professionals and enlist them on the front lines of combating tax avoidance by high-net-worth individuals. As a result, wealthy Israelis now have fewer incentives to take their money offshore, and Israeli wealth managers now profit from ensuring tax compliance as much as they once profited from facilitating avoidance.

Whether these innovations can be adapted to other national contexts remains to be seen. Some argue that Israel is a special case due to traditionally high levels of social solidarity. Others point out that recent opinion polling among Israelis reveals that social solidarity is now quite low, particularly when it comes to economic inequality and measures to combat it. This suggests that the case may offer a useful precedent, and even inspire a new approach at the OECD: focusing on wealth managers can help states address revenue losses from tax avoidance,

and enable governments, international organisations and others to combat the growth of economic inequality more effectively.

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