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The Pandora Papers and the threat to democracy

Property laws have long been written by and for the wealthy. But the more they insist that their actions are legal, the less the public trusts the law

The 'Pandora Papers,' a new investigation led by the International Consortium of Investigative Journalists, has fuelled outrage around the world. Politicians, businesspeople, sports stars, and cultural icons have been caught in the act of hiding their wealth and lying about it. But how likely is a reckoning for the lawyers and accountants who helped them?

There is nothing new about the practices the ICIJ's investigation uncovered. True, the sheer scale, sophistication, and legal fire power deployed to allow today's ultra-rich and powerful to game the law may be newsworthy. But the only truly shocking revelation is that it took more than 600 journalists from around the world to expose these practices, often risking their own safety and professional futures. The difficulty of that task attests to how well lawyers, legislatures, and courts have tilted the law in favour of elites.

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To hide their wealth, today's rich and powerful have availed themselves of centuries-old legal coding strategies. In 1535, King Henry VIII of England cracked down on a legal device known as 'the use,' because it threatened to undermine existing (feudal) property relations and served as a tax-avoidance vehicle. But thanks to clever legal arbitrage, it was soon replaced by an even more powerful device: 'the trust.'

Legally encoded by solicitors and recognised by courts of equity, the trust remains one of the most ingenious legal tools ever invented for the creation and preservation of private wealth. In the old days, it allowed the wealthy to circumvent inheritance rules. Today, it is the go-to vehicle for tax avoidance and for structuring financial assets, including asset-backed securities and their derivatives.

The trust

Functionally, a trust alters the rights and obligations to an asset without observing the formal rules of property law; it thus creates a *shadow* property right. Establishing a trust requires an asset – such as land, shares, or bonds – and three personas: an owner (settlor), a manager (trustee), and a beneficiary. The owner transfers legal title (though not necessarily actual possession) over the asset to the trustee, who promises to manage it on behalf of the beneficiary in accordance with the owner's instructions.

Nobody else needs to know about this arrangement, because there is no requirement to register the title or disclose the identities of the parties. This lack of transparency makes the trust the perfect vehicle for playing hide and seek with creditors and tax authorities. And because legal title and economic benefits are split among the three personas, nobody willingly assumes the obligations that come with ownership.

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The trust became a favoured legal device for global elites not through some invisible hand of the market, but rather by purposeful legal design. Attorneys pushed existing legal boundaries, courts recognised and enforced their innovations, and then lawmakers (many of them presumably beholden to wealthy donors) codified those practices into statutory legislation. As previous restrictions were stripped away, trust law expanded its remit.

These legal changes ensured that an ever-greater array of assets could be held in trust, and that the role of the trustee could be delegated to legal persons rather than honourable individuals like judges. Moreover, fiduciary duties were curtailed, the trustees' liability was limited, and the lifespan of the trust became increasingly elastic. Together, these legal adaptations made the trust fit for global finance.

The distrust

Countries that lacked this device were encouraged to emulate it. An international treaty, the 1985 Hague Convention on Trusts, was adopted with this goal in mind. In countries where lawmakers have resisted the pressure to sanction trusts, attorneys have fashioned equivalent devices from the laws governing foundations, associations, or corporations – betting (often correctly) that courts would vindicate their innovations.

While some jurisdictions have gone out of their way to be legally

hospitable to private wealth creation, others have tried to crack down on tax and legal arbitrage. But legal restrictions work only if the legislature controls which law is practiced within its jurisdiction. In the age of globalisation, most legislatures have been effectively stripped of such control, because law has become portable. If one country does not have the 'right' law, another one might. As long as the place of business recognises and enforces foreign law, the legal and accounting paperwork can be channelled to the friendliest foreign jurisdiction, and the deed is done.

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National legal systems thus have become items on an international menu of options from which asset holders choose the laws by which they wish to be governed. They don't need a passport or a visa; all they need is a legal shell. Assuming a new legal identity in this way, the privileged few can decide how much to pay in taxes, and which regulations to endure. And if legal obstacles cannot be overcome quite that easily, lawyers from leading global law firms will draft legislation to make a country compliant with the 'best practices' of global finance. Here, tax and trust havens such as South Dakota and the British Virgin Islands offer the gold standard.

The costs of these practices are borne by the least mobile and the insufficiently wealthy. But turning law into a gold mine for the rich and powerful causes harm well beyond the immediate inequities it generates. By potentially undermining the legitimacy of the law, it threatens the very foundation of democratic governance.

The more that wealthy elites and their lawyers insist that everything they do is legal, the less the public will trust the law. Today's global elites might be able to continue to conjure private wealth from law. But no resource can be mined forever. Once lost, trust in the law will be difficult to regain. The wealthy will have lost their most valuable asset of all.

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