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**BRITAIN'S WEALTH EXPLOSION**

**by**

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## BRITAIN'S WEALTH EXPLOSION

*'Britain's super-rich have seen their wealth soar into the stratosphere.'*<sup>1</sup>

Twenty years ago, Britain was one of the most *equal* countries in the developed world. Today it is one of the most *unequal*.<sup>2</sup> Having first fallen and then levelled off in the post-war era, the wealth gap between the rich and the poor began to rise again in the late 1980s and is now at levels not seen for over a generation.

It is a trend that has been driven by a remarkable revolution - a great surge in both the numbers of the mega-rich and in the level of their wealth. Whether we take the company boardroom, the deal-making entrepreneur or the investment banker, the story is the same - the super-rich have been getting richer at a much faster pace than the rest of the population. The number of billionaires in Britain – a mix of entrepreneurs, aristocrats, deal-makers and tax exiles – has more than tripled since 1990 while the number of people worth over £100 million has risen more than fivefold. Since 1997, the number with 'liquid assets' of more than £5 million has more than doubled to 9,000, despite the carnage of the 2000 stock market crash.<sup>3</sup>

This is tearaway growth by historical standards and is leading to a greatly increased concentration of wealth at the very top. The *Sunday Times* – in its annual charting of the nation's richest 1000 – called the 2004 personal wealth increase at the very top 'an explosion'. A year later, in 2005, as the assets of the top 1000 had soared yet again, they called it 'stratospheric'. The scale of the wealth boom has not been seen in Britain in recent memory, certainly not for nearly a century.

Britain is now back to levels of pre-tax income inequality last seen at the end of the 1940s. Official figures for the share of wealth enjoyed by the top one per cent shows inequality back to levels of more than a generation ago.<sup>4</sup> The very wealthiest within the top one per cent are almost certainly enjoying wealth shares that take them back even earlier. Britain may not be back to the extreme levels of inequality that prevailed

up to the 1920s when a tiny proportion of the population, a mix of the landed aristocracy and the new industrial and commercial barons, held an even greater share of the nation's wealth and income. But in those times, the constraints on wealth-making were much weaker, monopolies could operate largely unchecked, the Inland Revenue was in its infancy, unions were few and regulations minimal. It was a society in the process of transition and that degree of inequality was eventually to prove unsustainable.

What is surprising is how in today's much more mature democracy and complex and regulated economy, the top few thousand individuals are able to win such large shares of the economic wealth of the country.

Increasingly the limits of what the rich can achieve are being raised. Richard Branson and the Barclay brothers both own their own island. Indeed, privately owned islands have become sufficiently big business a company has been formed - Vladi Private Islands – specialising in selling them to the super-rich. Recent islands on their books have included Therese Island in the Seychelles for £3 million or Musha Cay in the Bahamas for £31 million. Premiership football clubs are being used, in effect, as toys of the global super-rich. For a swimsuit for a special occasion and location, you'd need £15 million in spare cash to buy one 'dripping in diamonds' designed by Gideon Oberson. And if you're after an exclusive 'Ghengis Khan' Westminster watch, designed by Swiss craftsmen which comes with tiny, moveable hand-carved figures on a black onyx dial and chimes the melody of Big Ben on the hour and half hour, it will set you back £320,000. A modern tycoon lifestyle certainly doesn't come cheap.

The emergence of the centi-millionaire class has spawned new industries including a rapidly expanding professional and very well paid servant class that looks after the mega rich. They research and provide expensive and exclusive holidays, they buy, deliver and construct the personal cellars to store the world's finest wines. They conduct the bidding to acquire the world's most expensive impressionists, post-impressionists, Picassos and Modiglianis. They organise the purchase of the yacht, the

mansion and the private jet. For those who can't yet afford one of their own, you can always hire one for up to £400,000 a day from firms such as NetJets and Bookajet.

Britain has never been short of the very rich and the trappings that go along with them. But what has been witnessed in the last decade and a half is altogether of a different order. Today's mega-rich may not compare in power and fortune with the Victorian aristocracy and the Edwardian industrialists and financiers, but they greatly outclass their predecessors in the post-war era. Today's rich are wealthier, less embarrassed by their wealth and much happier to flaunt and trumpet it. The 'stealth wealth' culture and 'conspicuous abstention' that characterised the post-war decades has been replaced by a voracious consumerism, especially by the younger breed of the enriched. Although the wealthiest classes have long indulged in some slight-of-hand in their dealings with the revenue, today's super-rich are even more adept at hiding it away from the taxman through what one critic has dubbed 'the seedy backstreets of global finance'.

The last two decades have not just seen a remarkable swelling of the ranks and a sharp rise in the value of the wealth of those at the top. Top fortunes that would once have taken a lifetime to accumulate can now be built, and sometimes lost, in just a few years. James Dyson, the inventor of the bagless vacuum cleaner has built a business empire worth a billion pound in twelve years. John Caudwell's £1.28 billion mobile phone business has been built in 16 years. Joanne Rowling, the author of the Harry Potter novels, has become a half-billionaire in just eight years, and moved in the process from downtown Edinburgh to millionaire's row in Totteridge, north London, one of the most expensive streets in Britain. Philip Green, the high street retailer has gone from nowhere to over £4 billion in little more than a decade. This is breakneck speed, bringing him billionaire status faster than anyone else in British history.

Britain's wealth explosion has strong roots in the parallel rush that has been occurring in the United States. There, the remarkable growth in wealth at the top over the last

fifteen years has been likened by one expert to an 'economic megashift'.<sup>5</sup> Between 1982 and 2004, the number of billionaires in the US soared from 12 to 313, a 25-fold jump.<sup>6</sup> Where America led, Britain has followed. The former ideological and cultural divide that used to distinguish attitudes towards personal enrichment and acceptable levels of inequality between the two nations has been closing sharply. Indeed, what has been occurring is an almost uniquely Anglo-Saxon phenomenon. There are no real cultural or economic parallels in continental Europe.

Not so long ago, a soaring wealth gap would have proved politically unacceptable. But the climate has changed. For the most part, the remarkable wealth explosion of recent times has been broadly welcomed across the political spectrum. Tony Blair has gone out of his way to defend the super-rich. As Peter Mandelson once told the CBI, New Labour is relaxed about people getting 'filthy rich'.

And that is what increasing numbers have become. Britain's richest residents – from deal-making entrepreneurs like Philip Green to City financiers like Michael Spencer – are sitting on fortunes that are much greater than their predecessors of a generation and more ago. Not so long ago Britain's land-owning aristocracy was seen as a spent force. Yet they have seen their wealth soar, the product of rising land and property values. As a result, they made up 13 per cent of the Sunday Time's list of Britain's top 1000 in 2005. Others in the list include descendants of the commercial and industrial barons of the nineteenth century, names like Sainsbury, Vestey, Guinness, Rothermere, Rothschild, some of whom are richer than their forbears. They have been joined by groups of the new rich. They include hedge fund operators and financial speculators. Amongst the most prominent are those who have pioneered the private equity revolution. In retail alone, stores as diverse as Harvey Nichols, Heal's, Hamley's, Homebase and Halfords have been taken private in the last five years. Philip Green owes his remarkable fortune to, first the way he built his capital base by asset-stripping companies like Sears as a springboard to taking Bhs and then Arcadia private and turning them around.<sup>7</sup> Others who have been enriched by the private equity revolution include Damon Buffini of Permira, Mike Smith of CVC and Martin

Halusa of Apax. The *Economist* has dubbed their pay 'gravity-defying'.<sup>8</sup>

There are of course a variety of explanations – economic, technological, social and political - for the sharply rising shares of income and wealth enjoyed by the richest. These differing explanations are all important, but there is one overarching change that lies behind it – a fundamental shift in our cultural and political attitudes towards the very rich. Without this change, inequality would not have risen at the rate that it has. It is certainly the case that the rewards that are increasingly commonplace today would not have been acceptable in the immediate post-war decades.

The fluctuating fortunes of the rich, and the poor, and the gap between them can be traced to the way in which the political and public climate and wider economic conditions interact. Governments can leave the issue of distribution alone or intervene to raise the floor or cap the ceiling. In the nineteenth century, the state largely left things alone. Spurred on by the opportunities created by the industrial revolution, the last decades of the century brought the first great wealth explosion in Britain, and along with it, an increase in the number of those with exceptionally large fortunes. In the opening years of the new century, the first breaks were applied. This brought some protection for the poorest, but did little to thwart the progress of the very rich. The spendthrift extravagance of the 'roaring twenties' contributed to the 1929 crash. This led to the first great reckoning for the rich with repercussions that lasted for more than a generation. The levels of inequality prevailing up to that time had, eventually, proved unsustainable. In the two or three decades after the crash, personal fortunes shrank, the breaks were applied much more firmly and the wealth gap narrowed.

The 1970s brought another turning point. Political and public support for welfarism had cooled as economic difficulties mounted and under Mrs Thatcher, the breaks on wealth creation and inequality were loosened. She believed above all that what Britain needed for economic revival was a more entrepreneurial spirit. During the 1980s, in the name of promoting wealth creation, controls on banks and their lending

and investment practices were lifted, most state-owned monopolies were privatised and corporate and top income tax rates were cut. Following the 'big-bang', British investment banks slowly lost their hold on the City and within a decade had been displaced by giant American banks and their more cutthroat values and methods. The result – a huge bonanza for those working in the City, investment bankers, corporate lawyers and executives alike.

Under Tony Blair's premiership, attitudes towards the rich have barely changed. For the last twenty years, economic, political and cultural conditions have been back in harmony for the rich. The stock market boom may have turned to bust in March 2000, just as it had in 1929, but this time with much less severe consequences for the wealthiest. Some lost all their money, but most of those at the top of the income and wealth leagues continued to flourish. Unlike the aftermath of 1929, the rich bounced firmly back and the breaks have stayed off.

So does the rising gap between the rich and the poor no longer matter? The broad consensus of political opinion is that as long as we raise the floor and improve the lot of the poorest, the gap is no longer something to worry about. This is perhaps one of the defining characteristics of the shift away from the social-democratic values that used to dominate post-war politics and opinion. Three principal arguments are used to defend the growing wealth gap: first, that it reflects an increasingly meritocratic Britain; second, that wealth creation driven by higher rewards is much more important than wealth distribution; third, that wealth at the top harms nobody else. These are all arguments made by Tony Blair and New Labour insiders.

So do these arguments stand up? Well, there is nothing especially meritocratic about today's super-rich elite. As we have seen, a significant, if slightly declining, proportion of those at the top are those who have inherited wealth – landowners and the descendants of the commercial and industrial barons of the nineteenth century together with the offspring of more recent business giants such as Lucas White and Robert Hanson – sons of James Hanson and Gordon White, members of the 'Mayfair

Set ` who made big money out of controversial takeover and asset-stripping activity from the 1960s. While there has been an increase in the number of today's business elite who are 'self-made' - who have not inherited a business or a fortune - most of today's super-rich in fact come from a relatively privileged background. 'New money' is not, in general, a sign of a more opportunistic culture. According to one detailed study by historian Tom Nicholas, 'Becoming a business leader in Britain is still largely determined by the interconnected characteristics of a wealthy family and a prestige education... there has been no democratisation of British business over the last century and a half.' <sup>9</sup> In his book, *The Death of Gentlemanly Capitalism*, Philip Augar claims that in 2000, a third of senior investment bankers and brokers had been to an English public school. <sup>10</sup>

Secondly, are the soaring fortunes at the top the product of exceptional levels of new wealth creation? If that is what has happened we could, at least in some ways, be relaxed about the soaring gap. Few could quibble with contemporary levels of personal enrichment if they reflected successful business creation and added value at historic levels in a way which benefited society as a whole. But is this really what has been driving runaway executive pay, soaring City fees and record bonuses?

Regrettably for us and our political leaders, the answer appears to be largely no. Of course, there are many examples of successful entrepreneurs from James Dyson and Anita Roddick to Stelios Haji-Ioannou who have created wealth, jobs and opportunities and who are widely seen as worth their place at the top. The internet pioneers deserve to be seen as business giants who have presided over a profound business and social revolution. But founding entrepreneurs hardly dominate the rich lists. Those that are there are not conspicuously more successful than earlier path-breaking business leaders and entrepreneurs from William Lever to Simon Marks. We are not living through a new entrepreneurial and economic renaissance in which the new rich are making society generally wealthier, dragging up the rest of us along with them. There is no evidence that today's escalating rewards are linked to historically high and internationally exceptional levels of skill, risk-taking and effort. In

fact, Britain has internationally low innovation and productivity rates.

The hard truth is that today's escalating personal fortunes are not closely linked to record levels of wealth creation. Rather, the ranks of the rich contain many tycoons, investment bankers and business executives who, far from creating wealth, have taken advantage of today's much more pro-rich culture to grab a larger slice of the cake for themselves, swelling their own bank accounts at the expense of others.

It cannot therefore be claimed that today's rich are never or even rarely hurting nobody else. Far from being what some pro-wealth supporters claim is a 'positive sum-game' with no losers, what is happening is a complex transfer from ordinary taxpayers, shareholders and customers. Sometimes, of course, such transfers are the legitimate reward for successfully outstripping the opposition. By outmanoeuvring Sainsbury's with superior business methods, Tesco's has shifted income from one group of shareholders, and directors, to another. Often, however, such transfers are far from defensible.

The rich of course do not look at it like this. They typically see themselves as more deserving and more meritocratic than the moguls of the past. For over a century, those framing anti-poverty policies have distinguished between the deserving and the undeserving poor. There is no reason in principle why such a distinction should not be applied to the rich. We might then define the 'deserving rich' as those who create wealth from scratch or add value to existing firms and give something back. Those who simply rig the system unfairly for their own benefit and at the expense of others – could be seen as 'undeserving'.

The idea of separating the rich into two such camps is not entirely new. When, to the outcry of the landed aristocracy, David Lloyd George doubled death duties on inherited wealth in 'the people's budget' of 1909 to help pay for the old age pension, he was redistributing income from the 'undeserving rich' – those who were wealthy by virtue of their father's or grandfather's graft – to the 'deserving poor'. When President

Franklin D Roosevelt rounded on the super-rich in the 1930s – ‘ the unscrupulous money-changers` - he was blaming them, with some justification, for the Great Crash which ushered in the world depression of the 1930s. When Geoffrey Howe imposed a windfall tax on bank profits in his famous budget of 1981, the justification was that they had received an unearned windfall gain as a result of the government’s anti-inflation high interest-rate policy. Attempts – mostly unsuccessful – by successive British governments to tax unearned increases in land values has always been inspired by a view that too much of the gain from planning decisions unjustly accrues to rich landowners and property speculators.

Today’s business elite would contain some who would certainly end up firmly in most people’s list of the deserving. But far from all. The modern entrepreneur tends to play a very different role from the moguls of the past. Today they are more likely to have made their money not from building firms and products from scratch or adding value by introducing new processes but through financial raiding, deal-making and speculative share and property dealing that involve less risk and arguably create less if any wealth.

The wealthy Russian oligarchs like Roman Abramovich, who have chosen to relocate to Britain, are rich because of the way they took advantage of the privatisation rush initiated by Boris Yeltsin. Some see them as the modern-day equivalent of the ‘robber barons` of the nineteenth century. Far from being the men who discovered the oil, laid the pipelines, built the refineries, took the risks, they have simply inherited the wealth created by earlier generations mainly by being a small favoured and influential group of insiders who successfully subverted plans for the wealth to be shared.

Since the 1980s, successive directors of insurance companies and banks - and their shareholders - have become rich through the promotion of financial products from personal pension schemes and endowment mortgages to protection insurance and by charging excessive fees on credit cards at the expense of customers. No new wealth has been created in the process. Money has simply been redistributed in often

highly unscrupulous ways from unwitting and gullible customers in their scores of thousands.

Redistribution can also take place through the tax system. Some of the huge wealth gains of recent times have come, in effect, from the broad body of taxpayers. Modern entrepreneurship and tax avoidance, legal as it is, largely go hand-in-hand. There are few top tycoons who have not exploited tax loopholes to boost their personal fortunes. Philip Green has saved close to £500 million in tax in the last three years by vesting ownership of his companies – Bhs and Arcadia – in the hands of his wife Tina who is a resident of Monaco. With 5000 Britons, mostly businessmen, living in Monaco, the tax-haven has become known as *le rocher anglais*. Sir Richard Branson is just one of many top entrepreneurs who register their companies offshore. Lakshmi Mittal, Hans Rausing and Rupert Murdoch are also all large-scale tax avoiders. It is other taxpayers who are the losers.

Twenty years ago, the typical chief executive of a FTSE 100 company earned some 25 times the pay of the average worker. Today it is close to 120 times.<sup>11</sup> This surge in the pay gap might be justified if it had been driven by a transformation in Britain's business performance. But this is decidedly not the case. One recent study from Manchester University shows that top company heads have enjoyed pay increases that have greatly outstripped a range of measures of business performance. 'Value-skimming' is how the authors defined it. Their conclusion, that 'top managers in giant firms appear to be an averagely ineffectual officer class who do, however, know how to look after themselves'.<sup>12</sup> The business magazine, *Management Today*, has condemned the growing gulf in pay as defying 'any sense of fairness'.<sup>13</sup>

'Rewards for failure' have become the norm. Most chief executives have negotiated contracts that, even when pushed, guarantees them generous pay-offs known as 'golden parachutes'. Sir Peter Davies presided over a falling share price and plunging profits before he picked up up £2.4 million on being ousted by Sainsbury's. A few months later, bonuses of £807,000 were paid to the executives of the Jarvis

Group despite the company's share price crashing from 566p to 9.5p. The management expert Charles Handy has noted that such payouts have made ineptitude by senior executives the shortest route to millionaire status. In America they are known as 'golden condoms' because they 'protect the executive and screw the shareholder'.<sup>14</sup>

Most City lawyers, accountants and investment bankers are also engaged in a form of 'value-skimming'. The City in effect operates as a giant, informal cartel charging excessive fees ( known as 'the croupier's take' ) for activity that, for the most part, involves the transfer ( or sometimes the destruction ) of wealth rather than its creation. Increasingly, the emphasis is on short-term, 'fast-buck' making deals which are mostly at odds with the patient organisation- building on which enduring companies and long-term wealth creation are founded and which was the way in which many large and successful companies were originally built. Mergers and acquisitions are often driven by the prospect of fat bonuses and fees for directors and their City advisers rather than the long-term interest of the company. Marconi is one of the best known examples, one of Britain's most successful companies effectively sunk by a City-led acquisition-led strategy which brought colossal fees for the investment bank advising the company, but which ultimately brought the company down, though not before its top directors walked away with generous pay-offs.

Economists differ about the wider economic benefits of the merger boom of recent times, one fed and watered by the investment banks in search of ever-rising profits. 'Merge or die' was often the rallying cry to company executives. The evidence is strong, however, that the main effect of mergers has been to achieve wealth redistribution from the buying firm to the selling firm and are as likely to destroy as create value. The merger of AOL and Time Warner in 2000, designed to create a world-class modern media company rather led to some of the largest losses in corporate history. One study of the impact of recent mergers in the UK, US and continental Europe concluded that ' shareholders of acquirers experience wealth losses on average or at best break even... The odds of positive and significant value

creation for acquirer shareholders may even be less than 50%, which is what would get with the toss of a fair coin.<sup>15</sup> What all merger and acquisition activity has in common, of course, are the massive fees and bonuses generated for the investment banks and directors involved. Those who clinch the deals nearly always walk away enriched and unharmed, whatever the outcome.

One former banker has described the finance industry as 'bloated and parasitic'.<sup>16</sup> Philip Augar, a former top executive at Schroders has described the money paid to brokers 'a social and moral disgrace'.<sup>17</sup> Financial speculation, the source of many modern fortunes, is rarely associated with creating value. As one leading figure in the hedge fund industry has admitted, 'when I first went into the City, I could not believe that anyone would want to pay me so much for creating nothing'. In 1998, the chief executive of the giant investment bank Credit Suisse First Boston admitted, 'OK. If I am being honest with you then yes, let's whisper it, but the truth of the matter is that all of us are overpaid. There is nothing magical about what we do. Anybody can do it'.<sup>18</sup> Following his inquiry into the Great Crash of 1929, Judge Ferdinand Pecora described the investment bankers of the time as having 'heads I win, tails you lose ethics'.<sup>19</sup> Seventy-five years on, not that much has changed.

A vibrant entrepreneurial and innovate culture is vital to economic progress. Exceptional merit and dynamism deserve generous reward. Hierarchies are necessary and desirable. Some degree of inequality is necessary to maintain incentives and to allow a properly opportunistic culture. All societies ultimately only function effectively if the distribution of rewards are seen to be fair, in line with individual contributions to society. But in the last decade and a half, however, rewards and merit seem to have become increasingly decoupled at the very top.

More than 100 years ago, the business financier and guru, JP Morgan – then one of the most powerful men in America – argued that executives should earn no more than twenty times the pay of the lowest paid company employee. In his 1943 essay, 'The Lion and the Unicorn', George Orwell recommended a maximum differential of

15:1. Franklin D Roosevelt and JK Galbraith have also argued for limits between the top and the bottom. In the post-war decades differentials between the broad mass of workers and their bosses were much closer to these levels than they are today, where in some companies they stand at several hundred to one or even more.

There is, of course, nothing new about the issue of the role and merits of the rich. The wealthiest have inspired and annoyed in equal measure throughout history. What is new is the tearing up of the post-war contract, a kind of deal that led to what some have called 'the great levelling'. The age of egalitarianism now seems to have been somewhat short-lived. We now appear to be in a new and wholly different era, one in which we are returning to much higher levels of wealth concentration, one much more accepting of growing inequality, one much closer to American than European social norms.

Successive and welcome attempts to encourage a new enterprise culture would, we were promised, lead to a process of 'trickle down' that would, ultimately, benefit us all. In fact, what has happened is that the rich and the super-rich have taken an increasingly disproportionate share of the nation's wealth. The bottom half of the population, meanwhile has experienced a fall in the share of its wealth from ten per cent in 1986 to six per cent in 2002. We in an age of 'trickle up' rather than 'trickle down.'

## NOTES

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<sup>1</sup> *Sunday Times*, April 3, 2005

<sup>2</sup> M Brewer, A Goodman, J Shaw, A Shephard, *Living Standards, Inequality and Poverty*, IFS, 2005; C Jencks and Gary Burtless, 'American Inequality and its Consequences' in HJ Aaron, JM Lindsey and P Nivola, (Eds), *Agenda for the Nation*, The Brookings Institution, Washington, 2003; AB Atkinson, 'Distribution of Income and Wealth', in AH Halsey and J Webb, *Twentieth Century Social Trends*, Macmillan, 2000, fig 10.9 p 367.

<sup>3</sup> Successive annual Rich Lists published by the *Sunday Times* since 1989; specialist wealth consultants Datamonitor

<sup>4</sup> See S. Lansley, *Rich Britain*, Politico's, 2006, chapter 2

<sup>5</sup> K Philips, *Wealth and Democracy*, Broadway Books, 2002, p 109

<sup>6</sup> *Forbes*, 22 September, 2004

<sup>7</sup> S Lansley and A Forrester, *Top Man: How Philip Green Built His High Street Empire*, Aurum, 2005.

<sup>8</sup> *Economist*, 27 November, 2004

<sup>9</sup> T Nicholas, 'The Myth of Meritocracy: An Inquiry into the social origins of Britain's business leaders since 1850', mimeo, London School of Economics, 1999, p 26.

<sup>10</sup> Philip Augar, *Death of Gentlemanly Capitalism*, Penquin, 2000, p 308

<sup>11</sup> Lansley op cit, p 76

<sup>12</sup> I Ertuk et al., 'Pay for Corporate Performance or Pay as Social Division? Rethinking the Problem of Top Management Pay in Giant Corporations', *Competition & Change*, Vol. 9, No. 1, March 2005.

<sup>13</sup> *Management Today*, 13 January, 2003.

<sup>14</sup> G. Haigh, *Bad Company*, Aurum, 2004, p.86

<sup>15</sup> S Sudarsanam, *Creating Value from Mergers and Acquisitions*, Prentice Hall, 2003, p 1-2.

<sup>16</sup> E Chancellor, 'The croupier takes too much', *Prospect*, February 2003

<sup>17</sup> Augar op cit, p 331

<sup>18</sup> Quoted in P Augar, *The Greed Merchants*, Allen Lane 2005, p59

<sup>19</sup> Augar op cit, p 85