"The Resentment Will Explode" - In Dramatic Twist, McKinsey Slams Globalization

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The IMF is getting nervous, and what it appears to be most concerned about, is a collapse of the status quo.

Moments ago, in a speech in Washington, IMF head Christine Lagarde said that "The greatest challenge we face today is the risk of the world turning its back on global cooperation—the cooperation which has served us all well. We know that globalization - and increased integration - over the past generation has yielded many economic benefits for many people."

The IMF is not alone: for years, consultancy giant McKinsey towed the party line as well saying in 2010 that "the core drivers of globalization are alive and well" and adding as recently as 2014 that "**to be unconnected is to fall behind.**"

That appears have changing, and cracks are starting to form behind the cohesive push for globalization, at least among those who benefit the most from globalization.

In a stunning study released today, one which effectively refutes all its prior conclusions on the matter, McKinsey slams the establishment's status quo thinking and admits that the economic gains of changes in the global economy have not been widely shared lately, **especially in the developed world**. In the report titled "Poorer Than Their Parents? Flat or Falling Incomes in Advanced Economies" it finds that prospects for income growth have deteriorated significantly since the financial crisis, and that the benefits from globalization are now over:

> *This overwhelmingly positive income trend has ended. A new McKinsey Global Institute report, Poorer than their parents? Flat or falling incomes in advanced economies, finds that between 2005 and 2014, real incomes in those same advanced economies were flat or fell for 65 to 70 percent of households, or more than 540 million people (exhibit). And while government transfers and lower tax rates mitigated some of the impact, up to a quarter of all households still saw disposable income stall or fall in that decade.*

As Bloomberg reports, Britain's vote to exit the European Union exemplifies what happens when people feel like the system is letting them down, Richard Dobbs, the co-leader of the research, said in an interview Wednesday, ahead of the report's release. **He likened the buildup of resentment over globalization to a dangerous natural gas leak in a row of houses.**

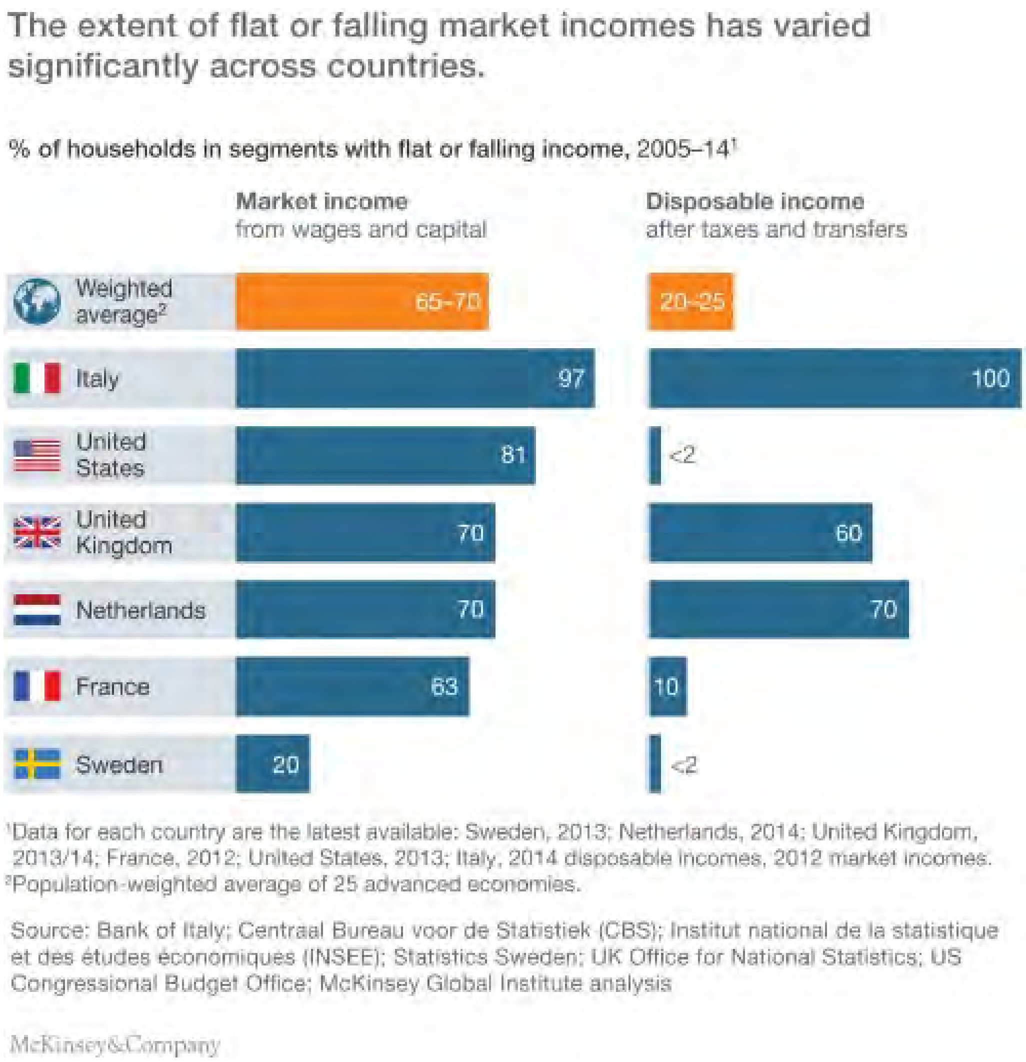
"One of them will explode. I did not think that it would be the U.K. first," said Dobbs, a senior partner of McKinsey and a member of the McKinsey Global Institute Council in London.

"When we launch a new policy, let’s think about the impact on those groups" who have been left behind, Dobbs said. Sometimes the goals of fairness and efficiency can conflict, he said. "Are we prepared to damage competitiveness a bit to reduce the risk of an explosion?"

To be sure, just like the IMF's U-turn on austerity after the failure of the second Greek bailout, McKinsey was unwilling to admit it has flop-flopped on such a critical position. Instead, Dobbs described the institute's stance on globalization as an "evolution," not a reversal. "**We’re not saying throw it all out. ... It’s about a**

sophistication in our thinking," he said. The McKinsey Global Institute still sees value in offshoring, immigration, trade, and so forth, Dobbs said: "Generally we're pro those, **but there's a however, and we need to be more aware of the however**."

In a startling finding, the report said that 65 to 70% of households in 25 advanced economies **were in income segments that had flat to falling incomes between 2005 and 2014, up from less than 2 percent between 1993 and 2005**. More troubling is that for some of the biggest supposed winners from globalization such as the US, this number is as high as 81%, while in Italy it soars to just shy of 100%!



A silver lining emerges when one takes into account "socialy equalizing" considerations such as transfers and taxes into account, aka government welafre. In that case, only 20 to 25% of households were in income segments that had flat to falling incomes between 2005 and 2014, the study said. Curiously, **the biggest winners from this reindexation were such socialist nations as Sweden, France and... the United States, which when accounting for government generosity would report less than 2% of household segments with falling income (**inexplicably, when applying government genersoity in Italy, the number of households who saw their income decline ***rose*** from 97% to 100%).

This is how McKinsey puts it:

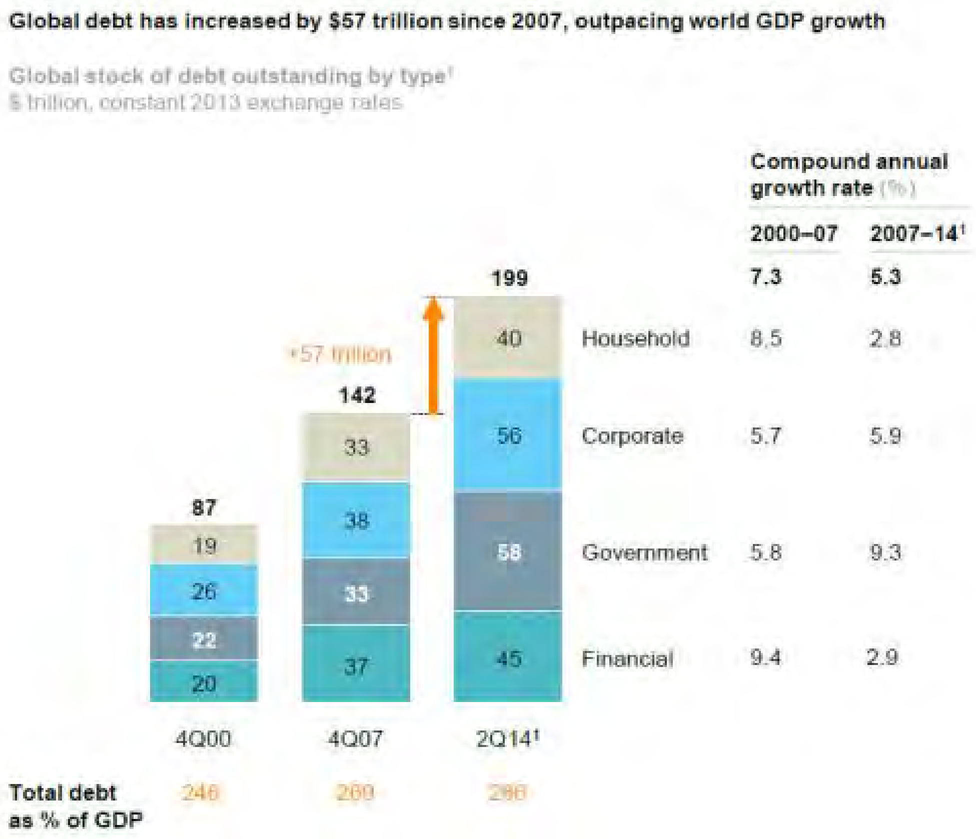
> *Labor-market practices can make a difference, as can government taxes and transfers —**although the latter may not be sustainable at a time when many governments have high debt levels**. For example, in Sweden, where the government intervened to preserve jobs during the global downturn, market incomes fell or were flat for only 20 percent of households, while disposable income advanced for almost everyone.*

> *In the United States, lower tax rates and higher transfers turned a decline in market incomes for four-fifths of income segments into an increase in disposable income for nearly all households. Efforts such as these—along with additional measures such as encouraging business leaders to adopt long-term thinking—can make a real difference.*

A less spun way of saying that is that the vast majority of social inequality in the US has been "smoothed over" courtesy of the government over the past decade, which of course, is another way of saying that the political class holds hundreds of millions of Americans hostage: "***if you want your welfare checks, EBTs, disability payments to continue, don't you dare force a political change or else...***"

One wonders just how sustainable this form of subsidized income truly is, especially if the mechanism that funds the US government apparatus, the dollar's reserve status which allows the US to issue trillions in debt with impunity, is somehow impaired. Not only that but as McKinsey also admits, government transfers "may not be sustainable at a time when many governments have high debt levels."

Why wasn't it just McKinsey which one year ago "discovered" just how massive the global debt load had risen to in the years since the financial crisis.



Perhaps the report's author could have synthesized McKinsey's previous findings to comment on the viability of such an artificial approach to keeping people happy.

Still, that does not change McKinsey's troubling conclusion that globalization is now hurting, not helping, the majority of people.

In fact, the summary adds, "If the low economic growth of the past decade continues, **the proportion of households in income segments with flat or falling incomes could rise as high as 70 to 80 percent over the next decade.** Even if economic growth accelerates, the issue will not go away: the proportion of households affected would decrease, to between about 10 and 20 percent—but that share could double if the growth is accompanied by a rapid uptake of workplace automation."

The conclusion, silver lining notwithstanding, is a troubling one for the IMF and for all those who defend globalization at any cost:

> *These findings provide a new perspective on the growing debate in advanced economies about income inequality, which until now has largely focused on income and wealth gains going disproportionately to top earners.* ***Our analysis details the sharp increase in the proportion of households in income groups that are simply not advancing—a phenomenon affecting people across the income distribution****. And the hardest hit are young, less-educated workers,* ***raising the spectre of a generation growing up poorer than their parents****.*
>
> ***The economic and social impact is potentially corrosive****. A survey we conducted as part of our research found that a significant number of those whose incomes have not been advancing are losing faith in aspects of the global economic system.* ***Nearly one-third of those who are not advancing said they think their children will also advance more slowly in the future, and they expressed negative opinions about free trade and immigration.***

They also tend to vote for things like Brexit and unsavory presidential candidates.

But our biggest concern is that just weeks after the BIS slammed central banks for merely boosting capital markets as a reaction to what is now clearly the failure of globalization to work ratably for all, and now McKinsey also splinter from the "all is well" camp, the response by policymakers has been one which not only does not address the underlying issue, but makes it even worse. Because if the world's elites are still deluded into believing that propping the world's stock markets to all time highs will somehow "trickle down" to the great unwashed masses, they will very soon get a very painful, and long overdue, reminder of just what happens in human history any time the vast majority is angry and feels betrayed by its "leaders."