



## Brexit Bombshell: EU Capitulates?

JOHN MAULDIN | June 28, 2016

This Is a **Special Brexit Edition** of *Outside the Box*.

As you may know, at Mauldin Economics we have a partnership with George Friedman of Geopolitical Futures. Today, I have two important Brexit stories George published over the weekend.

These two stories had an interesting origin. Last Saturday morning, I wrapped up *Thoughts from the Frontline* and then turned back to my packed e-mail inbox. There, I saw George's latest *Reality Check* analysis, "The Surprise at Brexit and the Social Crisis Behind It."

George makes an important connection between the Brexit vote and the developed world's growing class division and populist anger. He thinks it is a much bigger problem even than Brexit. Having written about the "Protected vs. Unprotected" problem several times, I immediately decided that I would send George's article to my entire *Outside the Box* list.

By pure coincidence, I left an hour or so later to drive to Austin for a preplanned afternoon and evening with George and Meredith. While we sat outside George's beautiful Hill Country home, marveling about the past week's events, my associate Patrick Watson sent me a just-released statement by the foreign ministers of the European Union's founding members: Belgium, France, Germany, Italy, Luxembourg, and the Netherlands.

Patrick knew I was on a much-needed break, but he thought it was important enough to interrupt me. I'm glad he did, too. I read it and immediately saw the significance. Then I showed George because, in poker terms, it looked to me like the EU leaders were throwing in their hand and wanted another deal.

George read it and had an even stronger reaction. I would tell you his exact words, but they are not suitable for publication.

Within 45 minutes, George had convened his analyst team (who evidently all work on Saturday afternoon) and put together another short note about this document's importance. You can read it below, too, right after the "Social Crisis" piece.

The mainstream press seems to either not have noticed this statement, or is missing its significance. I don't know why. Here we have six foreign ministers holding a photo opportunity, complete with a press release in multiple languages. They obviously wanted publicity.

What did they say? The key is they acknowledge "different ambitions" among EU member nations. That's diplomat-speak for "We all want different things."

Paraphrasing, the statement said, "*We recognize that our EU policies aren't working for everybody. That's okay. We just have to figure out how to make sure that everybody gets what they need, even if it means less control from Brussels.*"

I am reprinting George's two short notes below because I think the implications are important, even startling. The EU's armor is cracking.

And then I suggest that if you haven't already, consider [clicking on this link](#) and trying George's Geopolitical Futures service. Like it or not, we are now in a period where geopolitics is driving financial markets. This is not going to blow over next week. Brexit has kicked off what may be the most important international realignment since the Iron Curtain fell.

I know we all have full inboxes, but if you are relying on the mainstream media to tell you what's happening, you are way behind the news cycle—and probably missing the actual ramifications. Probably 90% of what we see is nonsense. Where do these people get their ideas? I feel much better having the George Friedman team's balanced, thoughtful approach.

I think we are just beginning to see a significant increase in the geopolitical news cycle, and you really do want to stay on top of it. Now, let's turn to George's wisdom.

Your thinking that now it gets fun analyst,



John Mauldin, Editor  
*Outside the Box*

## The Surprise at Brexit and the Social Crisis Behind It

By George Friedman

In looking at Friday's market decline, it is clear that the investment community was surprised at [the outcome of the referendum](#) in the U.K. What is most surprising is that they were surprised. There were two competing views of the EU. One view regarded the European Union as essential to British economic well-being. The other saw [the European Union as a failing institution](#), and saw Britain being pulled down if it remained.

The European Union has been caught in long-term stagnation. Eight years after the financial crisis it is still unable to break out of it. In addition, a large swath of Europe, especially in the south, is in depression with extremely high unemployment numbers. An argument could be made that these problems will be solved in the long run and that Britain should be part of the solution for its own sake. The counterargument is that if the problems had been soluble they would have been solved years ago.

For a financial community, there is a built-in desire for predictability. It can make money in good or bad markets and economies. It has trouble making money in uncertainty. Therefore, the financial community was inherently biased toward Britain remaining in the EU because it gave them predictability. There was a subconscious assumption that everyone had the same bias toward maintaining the status quo. This was not just the view of the global financial community. It was one shared with other elites – political, journalistic, academic and the rest.

Someone I know, who has many friends in Britain, told me that she didn't know anyone who favored a British exit. That was true. As the graduate of an elite college she is in touch with similar people around the world. This enclosure has profound social indications to consider, but in this case it created a psychological barrier to anticipating what was coming. When everyone you know thinks an idea is rubbish, it is hard to imagine that there is a majority out there that you haven't met that doesn't share your views.

There was also a sense of contempt for the opponents. The leaders, like UKIP leader Nigel Farage, were odd from the elite point of view. Their rhetoric was unseemly. And their followers by and large did not come from the places in London where the elite did. Their views were not the liberal, transnational views of the supporters of the EU. They led much narrower, harder lives and did not know the world as the pro-EU people did. So they were discounted. There was an expectation that the elite, who had governed Britain for so long, were dealing with an annoyance, rather than [a peaceful rising against them](#). Thus, in spite of the polls indicating the election would be extremely close, the "remain" supporters could not believe they would lose.

The reporters of leading British media were talking to their European and American counterparts. The politicians were doing the same. And the financial community is on the phone daily with colleagues around the world. The challenge that was posed in the U.K. referendum [is present in many countries around the world](#), albeit in different forms. What has become universal is the dismissive attitudes of the elite to their challengers. It is difficult for the elite to take seriously that the less educated, the less sophisticated and the less successful would take control of the situation. The French Bourbons and the Russian Romanovs had similar contempt for the crowds in the streets. They dismissed their lack of understanding and inability to act – right to the moment they burst into the palaces.

The analogy should not be overdone but also should not be dismissed. The distance between what I will call the technocratic elite and the increasingly displaced lower-middle and even middle class is becoming one of the major characteristics of our time. This elite did not expect "leave" to win because it was clear to them that the EU would work itself out. They didn't know anyone who disagreed with them – a measure of how far out of touch they had become with the real world. And above all, they were dismissive of the kind of people who led their opponents.

Not understanding their own isolation and insularity; not grasping the different world view of "leave" supporters or that they couldn't care less if the financial institutions of the City moved to Frankfurt; not grasping the contempt in which they were held by so many, the elite believed that "leave" could not win. Hence, they were surprised in spite of the fact that others, including myself in my book "Flashpoints: The Coming Crisis in Europe," had noted all of these trends.

In the end, the financial decline on Friday resulted from the lack of imagination of the elite. And it is that lack of imagination that led them to believe that the current situation could continue. That lack of imagination, the fact that the elite had no idea of what was happening beyond their circle of acquaintances, is a far greater crisis in the West than whether Britain is in the EU or even if the EU survives. We are living in a social divide so deep that serious people of good will and a certain class have never met anyone who wants to leave the EU or who supports blocking Muslim immigration or perhaps even who will vote for Donald Trump.

A democratic society cannot survive this divide. It occurred in the United States in the Great Depression, but was smashed by World War II when the young soldiers of all classes discovered that their lives depended on each other and social class meant nothing when the artillery opened up. The moderation of the post-war period had much to do with this experience.

Of course, World War II was unique and hardly the solution to a social problem. Nevertheless, something dramatic needs to happen. It will, as the situation becomes increasingly untenable. In the end, the palace doors may be kicked in. Hopefully, it will be done more politely and without the viciousness of the falls of the Bourbons and Romanovs.

No one had the right to believe that this couldn't happen. No one should believe that it will be confined to Britain. No one should believe that it won't happen again. The days when the elite could assert that the EU is going to be just fine in the face of evidence to the contrary are over.

## The EU Capitulates

By George Friedman

Today, foreign ministers from the European Union's six founding member states issued an extraordinary statement, declaring that they will "recognize different levels of ambition amongst Member States when it comes to the project of European integration." This was a landmark capitulation by the major European powers, accepting the idea that uniformity across the bloc is impossible and nations can choose the terms of membership.

The ministers – representing Belgium, France, Germany, Italy, Luxembourg and the Netherlands – publicly recognized that there is discontent across the bloc. The statement said that they will "focus our common efforts on those challenges which can only be addressed by common European answers, while leaving other tasks to national or regional levels."

This response [to the decision of British voters to leave the bloc](#) marks a profound change in the EU's formal goals and could signal a transformation in the EU's role. Until today, the EU — and many of its member states' governments — were formally committed to boosting integration. From banking regulations to refugee policies to everyday matters like cellphone fees, Brussels was moving toward greater interconnectivity and uniformity across the Continent.

On paper, the EU has sought to limit states' ability to bail out banks, cap fiscal deficits and set up a quota system for distributing newly arrived refugees, among other goals. And yet, the failure to respond effectively first to the financial crisis and then to the refugee crisis gave momentum to nationalist forces. The gap between the EU's formal aims and the preferences of some national-level governments has been widening as a result.

But successive crises and the diverging interests of member states led to fatigue with Brussels and, in some cases, active opposition to the bloc's policies. Some countries, like Hungary and Poland, began to ignore EU rules, with few consequences. The EU warned countries like Spain and Portugal time and again over their excessive budget deficits but failed to impose any meaningful repercussions. European officials, however, ignored growing signals that the bloc's formal aims and the realities in member states were growing further apart.

The decision of a major European economy to leave the bloc has led European leaders to recognize that [anti-establishment and anti-EU forces are gaining ground](#), and that as a result the bloc could be moving toward irrelevance.

The type of EU today's statement describes would ultimately reduce the bloc to a free trade zone. Given [Germany's hyper-dependence on exports](#), this was an urgent and desperate retreat to the one thing the Germans had to have: access to the European market. Germany, more than any other European country, is dependent on the EU, and its signature on this statement is an attempt to safeguard the country's economic interests in the wake of Britain's decision to leave. With anti-establishment parties gaining ground in Germany, France, Italy and beyond, incumbent governments are also seeking to appease their voters, who are becoming [more and more skeptical of Brussels](#).

Today's statement is thus a capitulation and a recognition that much of the European public does not share Brussels' enthusiasm for further integration. The EU has accepted that, if the bloc is to survive, each member will pursue its own policies and different levels of integration in the future.

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