The Telegraph

Brussels prepares 'grand bargain' to save broken EU project

The new European Commission plans mark a major shift in policy

- Ambrose Evans-Pritchard, brussels

22 MAY 2017 • 7:36PM

The European Commission is to unveil radical plans for a eurozone fiscal union, pushing for an embryonic treasury with powers to fight economic recessions and to cope with shocks in hard-hit regions.

The EU budget authority will be backed by a joint eurozone unemployment fund, akin to social security in the US. The proposal entails an unprecedented level of shared risk among the EU eurozone states and marks a profound shift in thinking after years of rigid austerity and lack of investment.

Valdis Dombrovskis, the EU commissioner for the euro, said there would be a 'stabilisation fund' with resources to help blighted areas escape downturns. "We will give a bigger role to the aggregate fiscal stance of the whole eurozone in setting policy," he said at the European Business Summit in Brussels.

It is a belated admission that the narrow focus on debt-reduction during the eurozone debt crisis led to a contractionary bias, drawing the whole currency bloc into a deflationary vortex that ended in a 'Lost Decade' and proved counter-productive even in its stated goal of controlling the debt trajectory.

"This is something that will set alarm bells ringing in Northern Europe," said Guntram Wolff, director of the Bruegel think-tank in Brussels.

"However you design this, it will lead to fiscal transfers. All forms of insurance lead to moral hazard and then you have to deal with it," he said.

The Commission's long-awaited 'Reflection Paper' on how to relaunch monetary union on a better footing - due in early June - will call for a “fund for the protection of public investment during recessionary phases”, according to leaked papers obtained by the Frankfurter Allgemeine.

It would come under the "democratic oversight" of the European Parliament, giving it crucial legitimacy at federal level. This would rein in the over-mighty Eurogroup that effectively runs the eurozone today and acts as a law unto itself, operating in total secrecy and answering to no elected body.

While the new fund would not exactly be an EU treasury or finance ministry, it would be a major step in that direction if ever accepted by Germany and the northern creditor powers.

Mr Dombrovskis was careful to stress that the 'grand bargain' is not a fiscal give-away to improvident high-debt states. "Every member state is responsible for guaranteeing the stability of its public finances. Where there is risk sharing, there must also be risk reduction," he said.

Yet the plan is a major shift in policy. It is similar to proposals made by French president Emmanuel Macron during France's election campaign and suggests that the policy elites in Brussels are lining up behind him, as are the Italians and Spanish.

German Chancellor Angela Merkel must now move with care. She has refused to countenance 'eurobonds' or shared liability for legacy debt - and once said they would only happen over her dead body - but has now opened the door slightly to some sort of joint issuance for future debt.

Even this is a legal minefield. Germany's top court has already ruled that any formula involving budgetary liabilities cuts across the prerogatives of the German Bundestag, and would therefore violate the German constitution.

Hans-Werner Sinn, the former head of Germany's IFO Institute, says the eurozone is sliding headlong towards a 'transfer union', which is anathema to most German voters. "We're going to see regions that become dependent on transfers from other regions. Falling productivity is disguised," he said.

Guy Verhofstadt, leader of ultra-integrationist camp in the European Parliament and its chief Brexit negotiator, said the EU is a paralysed half-way house under the current structure. It cannot respond to crises and drifts from disaster to disaster. "Either we solve these problems or the EU will collapse," he said.

Mr Verhofstadt said the US had tackled the Lehman crisis very fast with a "three-stage rocket", mobilising vast sums to clean up the banking system (at a profit for taxpayers), to launch counter-cyclical fiscal stimulus, and to flood the credit system with quantitative easing.

"In Europe we just talked. We're always too little, too late. When we finally did do QE it was to avoid deflation. We have massive problems with our institutions," he said.

"There was no domino effect after Brexit, no 'Nexit' in the Netherlands, no 'Auxit', and no 'Frexit', but that doesn't mean the problem is solved."

"People are very critical of the EU and with good reason. It is not a union at all. It is a confederation of nation states based on the unanimity rule. The EU doesn't exist," he said.