The Brussels deal to save the Euro confounded its Anglo-Saxon doubters. The British press once again underestimated how integrated Europe really is.

Treaty change looms as the Eurozone edges closer towards greater fiscal union. **Roger Liddle** *looks at what this might mean for the future of the European Union and Britain's place within it.*

Last month's Brussels deal on the future of the Eurozone may yet prove to be technically flawed and insufficient. It may still be impossible, despite the measure of debt relief, for the Greeks to repay what they owe. The political gains from strong-arming private banks to accept some losses may be offset if the bond markets conclude that what happened in Greece might also happen in other sovereign debtors, as well as Italy and Spain. The risk is that the cost of borrowing might be forced up to unsustainable levels and that more rescues may need to be scrambled together at some future point.

Nevertheless, in the annals of this crisis, last week was of the highest political significance. Why? Because it demonstrated that with its back against the wall, Europe could muster the political will to save the Euro. I am confident Europe will now do whatever it takes.

Last autumn, Angela Merkel, the German Chancellor, declared that if the Euro fails, Europe fails − and for Germany that would be unthinkable. But the bond market and its Anglo-Saxon economic commentariat did not take her at her word, and at times she seemed unsure whether she even believed herself. Since the crisis first broke, German policy has looked behind the curve.

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At first Mrs Merkel was in denial about the very existence of the Greek crisis, hoping to put off the need for action until after the North Rhine Westphalia Land election in May 2010. Even then the problem was analysed as one of liquidity not solvency, with the pretence that fierce spending cuts and tax increases could produce a primary fiscal surplus that would make Greece's debt burden repayable, when in fact austerity simply strangled any prospect of growth.

The last eighteen months have not been a glorious episode in Germany's leadership of the European Union. The establishment of the new European bail out mechanism was marked by confusion and hesitation; the Irish rescue was managed, but only at such penal interest rates that critics compared it to the Allies' disastrous exaction of reparations from Germany after the First World War; and the protracted argument with the ECB about whether the burden and risk of future rescues on taxpayers could be shared by private bondholders was painstaking and destabilizing.

Yet, maybe German domestic politics allowed nothing different. It is not surprising that ordinary Germans baulked at the prospect of bailing out the Greeks whom they saw as a nation of improvident cheats, after Germany had been through more than a decade of company restructurings, job cuts, wage restraint and painful welfare reforms to restore its competitiveness. But Germany's political leadership seemed strangely reluctant to explain to their electorate the economic benefits that have flowed from a stable Euro. German exports, growth and employment would have been a lot weaker in an alternative world of a free floating, much stronger mark. And of course the foundation of Germany's post war prosperity, security and return to pride in its nationhood has been built on the wider stability brought about by post war European integration.

Indeed, last week showed that when it comes to the crunch, this remains the settled political consensus. Mrs Merkel went to Brussels with the strong backing of the big three politicians in the opposition SDP – Sigmar Gabriel, Peer Steinbrück and Frank-Walter Steinmeier – for decisive action to save the Euro. For the first time the Eurozone got ahead of the market.

The deal extended the loans to Greece to a future date at which they may never be repaid. It slashed the interest rates due on the loans, not just for Greece but for Ireland and Portugal as well. It recognised that the EU as a whole owed some obligation of solidarity as well as self interest to find ways of stimulating growth in the debtor nations to offset the unavoidable severity of domestic fiscal austerity. More significantly still, the deal laid the foundations of converting the ESM into a proper European Monetary Fund, which can purchase bonds in secondary markets, which has powers to intervene preventively before full scale rescues become inevitable and which can re-organise debt laden banks.

For the past year Europe, as so often, has infuriated its friends. Last week it set itself on a path that will in time confound its enemies.

If one simply reads the British press, one would be convinced that the Euro was on the point of collapse, that it was inevitable that Greece would be forced out and that a rising tide of Euroscepticism on the Continent would prevent Europe's politicians from acting to save the doomed Euro project. We have witnessed once again an absolutely classic British underestimation of the underlying dynamic of European integration. Ever since R A Butler, the then Chancellor, dismissed the Messina talks in 1956 that led to the Treaty of Rome as "archaeological excavations in an old Sicilian town", most of Britain has wilfully misread the Continent.

There is however one interesting and important exception in the present UK Government: George Osborne, the Chancellor of Exchequer. Whether or not he was motivated by the desire to divert attention from his embarrassing dinner dates with Rupert Murdoch, he gave a remarkable FT interview calling on the Eurozone to recognise the need for Fiscal Union. This of course is a dramatic flourish designed to send shivers down many British spines; fiscal Union is open to several different interpretations.

I for one do not believe it means that Brussels would decide on levels of tax and spend in each Member State, still less which particular taxes would be levied and what the composition of public spending would be. But Osborne is basically right. On the present trajectory that the Eurozone has now embarked upon, the end point will be some form of Eurobond with some element of joint liability of all Member States to fund public debt. This would stop the risk of contagion overnight and in my view result in a wall of Chinese money being invested in the Euro. However taxpayers in the creditor countries of the Eurozone cannot reasonably be expected to accept unlimited liabilities for other Member States' debts. So the inexorable logic is that each Member State would have to agree a binding debt limit with a new European Debt Management Agency every year.

This would be a major move in pooling sovereignty from which all participating Member States would benefit. Debt crises would be avoided and interest costs brought down, but fiscal prudence would be guaranteed. There is however one major snag. To come into existence these new arrangements almost certainly require Treaty change.

These are some of the many interesting questions which I intend to explore in the coming weeks and months. Would this be a Treaty for the Eurozone or the EU as a whole? I suspect the other Euro-outs like Poland, Denmark and Sweden would insist it is a Treaty for the EU 27. This would be a hugely significant development for the UK. Conservative Eurosceptics are already seizing on the possibility as an opportunity to re-shape the EU and repatriate powers to the UK. The Coalition will tremble to its very foundations as the Liberal Democrats fear Britain's membership of the European Union is being put in question. And Labour? This presents an opportunity to make a new positive case for a more social and democratic, as well as fiscally responsible Europe. Watch this space.

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