The full realization of the European banking union is faltering. Without solidarity, it will remain a halfway system unable to achieve its objectives.

Solidarity is a founding value of European integration. In the words of Robert Schuman "L'Europe ne se fera pas d'un coup ni dans une construction d'ensemble: elle se fera pour des réalisations concrètes, créant d'abord une solidarité de fait". The principle acquired even more prominence with the Lisbon Treaty, which formally extended the meaning of the term to include solidarity among generations.

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In the aftermath of the financial crisis, recourse to solidarity avoided the worst, helping to build the new European economic governance—but not without tensions. Some member states and political parties feared that the creation of a banking union would ultimately lead to a transfer union, in which wealthier countries like France or Germany would be forced to provide financial support to economically weaker ones, like Greece.

Tensions were partially caused by the different definition of the concept of solidarity across Europe. In southern countries solidarity entails helping people in need regardless of the circumstances, while for northern ones help should only be provided under strict conditions to prevent moral hazard. Germany in particular continues to condition financial burden-sharing to structural reforms and measures. Last December, Angela Merkel, commending Schaeuble for his role during the Greek negotiations, reminded that her government's principles were and still are: "No aid without conditionality. Responsibility and solidarity go together and it must remain this way".

George Soros has predicted that Germany's fear of becoming the deep pocket of Europe would be fatal for the EU: "Germany is afraid of becoming the deep pocket of Europe in a transfer union … If you think about normal nation-states, every country is in some sense a 'transfer union'. It is always the more-productive, more-successful parts of a country that have to support the less-developed regions".

In the particular case of the EU's banking union, the areas in which solidarity so far has proved particularly difficult to be achieved are: first, the functioning of the Single Resolution Mechanism (SRM); second, the Direct Recapitalization Instrument of the European Stability Mechanism (DRI); third, the set-up of a pan-European Deposit Insurance Scheme (EDIS).

Solidarity within the Single Resolution Mechanism

The Single Resolution Mechanism (SRM) establishes uniform rules and procedures for the resolution of failing credit institutions, which apply to banks covered by the Single Supervisory Mechanism. It has been fully operational since 1 January 2016. Its purpose is to ensure a timely and orderly resolution of failing banks, limiting the costs supported by taxpayers. When, in spite of stronger EU supervision, a bank is likely to fail, the Single Resolution Board (SRB) decides whether and when to start the procedure. Resolution is financed by the Single Resolution Fund (SRF) after bail-in and all other options have been exhausted. In these cases, the SRF's backing is essential since it enables a bank (either in its original form, by means of a bridge bank or through a bad bank) to continue operating while it is being restructured.

To avoid using taxpayers' money, the SRF is directly financed by contributions from the banking sector: all credit institutions within the scope of the mechanism contribute to the Fund in accordance to their size and risk profile. Bank contributions are collected by national resolution authorities and pooled at the Union level.

A key issue during negotiations concerned ways to achieve a smooth transition from existing national resolution funds to the SRF while ensuring its adequate financing. Recourse had to be made to an intergovernmental agreement (ratified by January 2016 by all euro area member states), which details how national contributions will be gradually pooled during an eight-year transition period.

In fact, pursuant to the agreement, in its first phase contributions levied on banks at domestic level will be kept by the Fund in separate "national compartments". These compartments will only be used for the resolution of institutions established or authorized in the contributing state. National compartments will be gradually abandoned in favour of a system in which contributions from all compartments may be used, irrespective of the country where the banks in distress is registered.

When the funds of a compartment are insufficient to finance a particular resolution, the agreement envisions the possibility of temporary transfers among national compartments. In spite of the above, full mutualisation is proving difficult to be achieved.

The agreement contains a number of safeguards. For instance, a state may reject lending requests on different grounds: if the transfer exceeds a given amount, if the state is going to face other resolutions in the near future, or if the requesting state cannot provide sufficient repayment guarantees.

Even recent developments show lack of political will. In December 2015, to avoid loans among national compartments as well as funding shortfalls, a system of public bridge financing arrangements was put in place. Each participating member state committed to back its national compartment through a loan to the SRB, with national credit lines to be drawn only as a last resort and to be repaid by banks operating in the requesting state. As a result, full and effective solidarity within the SRM/SRF will take more than the eight years initially planned.

The ESM’s Direct Recapitalization Instrument

Another tool to implement solidarity in the euro area is the Direct Recapitalization Instrument of the European Stability Mechanism (DRI). Introduced in December 2014, it was conceived to sever the link between banks and sovereigns. The new instrument allows the ESM to provide financial assistance to directly recapitalize systemically important banks operating under the ECB’s supervision.

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However, especially for its restrictive eligibility criteria, the DRI was received with criticism and even the Five presidents' report requested a review. First, ESM member states agreed on a €60 billion self-imposed ceiling, which the IMF considered too low. Second, as mentioned, the DRI is available only for systemically relevant credit institutions. Third, it may be requested only by an ESM member unable to provide full financial assistance to a bank without greatly affecting its fiscal sustainability. Fourth, preconditions for the activation of the DRI include: the bail-in by private investors, a contribution by the relevant national resolution fund or by the SRF, as well as by the requesting country (which can be waived only under exceptional circumstances).

In other words, even a state in distress has to contribute to the recapitalization of its banks, thus increasing public debt, impairing market access and reinforcing the vicious circle between sovereigns and banks, rather than severing it.

The European Deposit Insurance Scheme

In 2010, the European Commission put forward a proposal to amend the existing Directive on Deposit Guarantee Schemes (DGSs) to increase depositors' confidence and further harmonize existing national schemes. In its impact assessment, the Commission highlighted the disproportion between the financing level of national DGSs and the worth of covered deposits in the EU, with some DGS not even able to withstand a medium-size bank failure. The situation was aggravated by the lack of solidarity among schemes.

As the establishment of a single European DGS is still unfeasible, the Commission proposed the introduction of a "mutual borrowing facility", granting a national scheme the right to borrow from other schemes, should its resources be insufficient. The text adopted in December 2013 was watered down compared to the Commission's proposal and read as follows "Members States may allow DGSs to lend to other DGSs within the Union on a voluntary basis" (emphasis added), provided that a set of conditions was met.

In the current situation, borrowings among DGSs are unlikely. However, as pointed out in the Five Presidents' Report, and also by the IMF, the current national set-up remains vulnerable to sizeable local shocks, in particular when both the sovereign and its national banking sector are perceived as frail. To reassure citizens that the safety of their savings does not depend on geographical location, the European Commission has recently put forward a proposal for a European Deposit Insurance Scheme (EDIS).

The EDIS will be implemented in three phases: first, an initial re-insurance phase, in which access to EDIS funds will be granted only once a DGS has depleted its own resources, with a cap on EDIS contributions; second, an intermediate phase of co-insurance, in which EDIS will complement national schemes from the moment in which depositors have to be reimbursed, with EDIS' share gradually increasing over the years; finally, from 2024, EDIS will fully insure national DGSs without substituting them. To reduce moral hazard, EDIS will only be available to countries in which the DGS complies with EU rules.

The major obstacle in building a true banking union is the scarcity of inter-state solidarity in the EU.

As in the case of the SRF, EDIS will be privately funded through ex ante fees paid by the banks of participating Member States. To reduce moral hazard, riskier banks will be demanded higher contributions.

As advocated by Andrew Duff in his Protocol of Frankfurt: "The banking union will remain inherently unstable in the absence of a federal European deposit insurance scheme, enjoying the joint and several guarantee of the Eurozone members […]." The foregoing shows that the major obstacle in building a true banking union is the scarcity of inter-state solidarity in the EU. To put it like Lorenzo Bini-Smaghi, "The search for the correct balance between providing adequate support to those in need and avoiding moral hazard represents today the most complex point of the European political debate".

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