Restrictions on Foreign Ownership: European Community and International Framework

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Abstract: Capital movements were fully liberalised in 1990 within the European Community. In 1994, through the entry into force of the Maastricht Treaty, this fundamental freedom gained the same status as the other single market freedoms, and its governing principles were inserted in the EC Treaty. On this occasion, the prohibition of restrictions within the Community was extended unconditionally to capital movements to and from third countries. However, while full freedom was established as a rule, the new regime provided also for specific exceptions which give the right for the Community or its Member States to maintain or introduce restrictive measures, in particular with respect to foreign ownership of EU assets.

The purpose of this paper is twofold. Firstly, it describes thoroughly the possibilities offered by the EC regime on capital movements for adopting such restrictive measures vis-à-vis foreign operators, and reviews the practical use of exceptions by the Community or its Member States (at least when these are identified in the latter case). Then, it illustrates how existing restrictions at Community or Member States level are reflected in the international commitments made by both categories of entities under specific agreements, such as the OECD, the GATS, or Bilateral Agreements concluded by the Community or its Member States. Implicitly, it highlights methodological issues which may harm the consistency between the different reference frameworks, and the resulting difficulty in identifying all restrictions to foreign ownership of EU assets.

Keywords: foreign ownership, capital movements, restrictions, international agreements

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* Views expressed in this paper are exclusively those of the author. They should not be attributed to the European Commission

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1. THE EUROPEAN COMMUNITY REGIME ON CAPITAL MOVEMENTS

1.1. The definition of concepts

The present regime on the freedom of capital movements and payments in the European Union is governed essentially by a small number of articles in the Treaty establishing the European Community ('the Treaty'). Logically, the particular meaning of *'capital movements'* and *'payments'* should also be found within the same legal framework. Nonetheless, a rapid glance at these articles will reveal the absence of any definition as such. In such circumstances, recalling briefly the history of these transactions in the post-World War II European integration process is necessary to have a good grasp of the concepts of 'capital movements' and 'payments' under the Community regime.

1.1.1. The foundations of the Community

Following the establishment of the European Coal and Steel Community in 1952, the six founding members expressed the wish to expand rapidly the existing co-operation to a common market and a customs union. In the Spaak report which served as a basis for the negotiations on the Treaty of Rome ('the EEC Treaty'), the free movement of the main *'production factors'* (capital and labour) was considered to be essential for the proper functioning of a *'common market'*. But, taking into account the reluctance of Member States to liberalise capital movements (justified notably by the fear of speculative flows triggered by divergent monetary policies), the report selected certain types of capital transactions that should be given priority (in particular direct investment and transactions in securities).

The Treaty of Rome, which came into effect on 1 January 1958, was based on the principle of the four freedoms: the free movement of goods, of persons, of services and of capital. Besides the principles, the Treaty presented the foundations of the Community in four separate chapters in the following order: (1) free movement of goods, (2) agriculture, (3) free movement of persons, services and capital and (4) transport. Although the Treaty did not express any priority order in the accomplishment of the above freedoms and objectives, the Community had been characterised for a long time by the first two foundations (the free trade of goods and the common agricultural policy), while the accomplishment of the other freedoms – in particular the free movement of capital – materialised much later.

The fundamental Treaty provisions concerning *capital* were included in Article 67(1), which established the obligation for Member States to lift restrictions on the free flow of capital, but only *'to the extent necessary to ensure the proper functioning of the Common Market'*. This provision implied that the liberalisation of capital movements was conditional upon progress in the freeing of trade, which appeared to be a more immediate objective of the Common Market. In addition, the vague character of the derogation clause allowed some Member States to claim that the basic intention was to liberalise investment flows in the real economic sphere and not short-term flows of a financial nature. Moreover, the Treaty established also a link between the freedoms of capital movements and financial services in Article 61(2), where it was specified that the liberalisation of bank and insurance services should progress concurrently with the progressive liberalisation of capital movements. These provisions indicate that capital was basically assuming a dual function under the EEC Treaty, i.e. a factor of production necessary for the Common Market and an enabler of other basic freedoms defined in the

Treaty. Besides these capital-related provisions, Article 67(2) provided for the free settlement of cross-border current payments by the end of a four-year transitional period.

Finally, procedures for secondary legislation which would implement the above Treaty obligations were provided for by Articles 69 and 70. This led to the successive adoption of a series of directives that implemented Article 67(1). They listed categories of capital movements that benefited from varying degrees of liberalisation, and the process of capital movements liberalisation was finally accomplished with the entry into force – on 1 July 1990 – of Directive 88/361/EEC of 24 June 1988, which provided for the full freedom of capital movements and payments.

1.1.2. An implicit methodology

In order to define the degree of liberalisation to be reached, the directives implementing Article 67(1) of the Treaty had to specify the types of capital movements that had to be freed. By doing so, these directives referred implicitly to the classification of transactions that was already applied in the internationally standardised balance-of-payments methodology and definitions. According to these rules, there is a traditional distinction between *'current account'* and *'capital account'* transactions. The *'current account'* includes exports and imports of goods and services as well as unilateral transfers (including current returns linked to an asset, e.g. the dividends paid by a foreign company on its shares), which give rise to, or are a use of, current national income. Transactions affecting the international investment position of the country (e.g. investment, purchase of securities, central bank operations, etc.) rather than its current income form the *'capital account'* of the balance-of-payments. This enabled a view to be taken on the country's position with regard to the rest of the world.

However, balance-of-payments statistics do not distinguish between the *real transaction* involved and the related *financial flows.* Therefore, the measurement of a country's external position is usually carried out in terms of the financial flows, although both types of transactions should not be confused. In the same way, administrative controls on capital movements may be based on the nature of the *underlying transaction*, but were generally enforced by commercial banks on the related *financial flows* through foreign exchange legislation. Such a distinction may seem fairly academic with respect to the imposition of restrictions; since these are effective if they apply *either* to the transaction *or* to the flows. In contrast, the distinction is essential in a process aiming at liberalising capital movements, insofar as the underlying transaction *and* its related flows have to be free. While the Treaty lacked a fundamental definition of capital movements, two important European Court of Justice judgements clarified the above uncertainties. In 1984, the Court ruled[1] that capital movements were not just the settlement of an underlying real transaction, but had to be defined as financial operations directed towards depositing or investing means of payment. And in 1986, it ruled[2] that discriminatory national regulations concerning liberalised capital transactions should be eliminated as well.

On the basis of what precedes, and without entering into unnecessary details, we can now attempt to define summarily what is covered by the present Community regime on capital

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[1] Luisi & Carbone (Joined cases C-296/82 and C-26/83)

[2] Brugnoni & Ruffinengo (Case 157/85)

movements and payments. In simple terms, *'capital movements'* can be defined as *transactions achieving the transfer of ownership on assets (financial settlement and underlying transaction), carried out by any natural or legal persons on a cross-border basis.* As to *'payments'*, these cover *any current transfers of money connected with the movement of goods, services or capital.*

1.2. The nomenclature of capital movements

Although the above explanations should offer the necessary tools to identify what 'capital movements' are, it would of course be useful to have at our disposal a more comprehensive listing of such transactions, so as to deepen the interpretation of this concept. In the Community context, the most useful document in this respect is probably Annex I to Directive 88/361/EEC of 24 June 1988[3] (O.J. N° L 178/5-18), which presents a classification of capital movements according to the economic nature of the assets and liabilities they concern, denominated either in national currency or in foreign exchange. All capital movements[4] listed in this nomenclature are taken to cover, in particular, all the operations necessary for the conclusion and performance of the transaction and related transfers as well as the access to all financial techniques allowing to carry out the operations in question. However, the same annex makes clear that this nomenclature does not constitute an exhaustive list, and should therefore not be interpreted as restricting the scope of the full liberalisation of capital movements.

While Directive 88/361/EEC was rendered obsolete by the entry into force of the present regime on capital movements on 1 January 1994, the European Court of Justice has ruled[5]that its Annex I maintains its indicative value for interpretation purposes.

1.3. The present Community regime on capital movements and payments

Through the entry into force of the above directive, capital movements achieved finally the same level of liberalisation as the other fundamental freedoms that form the basis of the internal market. Unlike the other freedoms, full capital movements liberalisation had not been provided for by directly effective Treaty provisions, but by secondary legislation that still needed transposition into the legal order of Member States. However, the provisions governing capital movements became also primary law when the Maastricht Treaty on European Union entered into force on 1 January 1994.

1.3.1. The legal framework[6]

Since the entry into force of the Maastricht Treaty on 1 January 1994, Article 67(1) of the EEC Treaty and Directive 88/361/EEC implementing that article and governing capital movements and payments for the European Community have been replaced by a series of

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[3] See Annex 1

[4] Some current operations in the field of insurance also appear in the nomenclature for particular reasons not treated here.

[5] Case C-222/97

[6] Relevant Treaty provisions, legislation and Court of Justice rulings are available for consultation on Directorate-General for Economic and Financial Affairs' following webpage: http://europa.eu.int/comm/economy_finance/about/activities/activities_freecapitalmovement_en.htm

new articles that were inserted in the EC Treaty, in a specific chapter[7] devoted to 'capital and payments'. Although these articles form at present the fundamental legal basis of the capital movements and payments regulation for the European Community, they have to be interpreted in the light of some other legal sources to constitute the comprehensive set of rules that govern this freedom. One can distinguish four categories of legal sources that will be briefly presented below.

1.3.1.1. The EC Treaty articles

On 1 January 1994, the new Articles 73(b) to 73(h) of the EC Treaty governing capital movements and payments came into effect. Since the ratification of the Amsterdam Treaty, the numbering of these articles has been changed to Articles 56 to 60[8].

In contrast to what was provided by the previous Article 67(1) EEC, the present chapter on 'capital and payments' does not contain any provisions to enable the implementation of the internal freedom through secondary legislation. The provisions of Articles 56 to 60 EC are declared 'directly applicable'.

The notion of 'direct applicability' expresses the capacity of Treaty provisions to penetrate directly into the legal order of Member States, without the need for secondary legislation (e.g. regulation, directive, etc.) and national transposition measures. This can be explained by the presumption that the obligation imposed through Article 56 EC to prohibit all restrictions on capital movements is so clear that no secondary legislation is needed for its implementation and that national courts can apply its provisions.

Besides the specific Treaty provisions governing 'capital and payments', other Treaty articles that have a broader scope of application also play a role in the definition of the capital movements regime. In particular, this is the case for the 'general exceptions' provisions included in the EC Treaty that can justify exceptions to the freedom over and above those specifically introduced in the chapter on capital and payments. These 'general exceptions' will be described eventually under the discussions on third country restrictions applicable by EU Member States.

1.3.1.2. Regulation (EC) N° 332/2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments

This piece of secondary legislation does not belong, strictly speaking, to the provisions defining the Community regime on capital movements. Nonetheless, it establishes a financial instrument that aims at granting financial support to Member States experiencing balance-of-payments problems. Although such problems originate from macro-economic imbalances, they can be emphasised by a significant liberalisation of capital movements. Furthermore, any loan granted by the Community in pursuance of this Regulation may be accompanied during the period of the financial assistance by, in particular, the reintroduction of restrictions on specific capital movements according to Article 120 EC. The Regulation is therefore considered to complement in a natural way the basic capital movements provisions.

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[7] Title III – Free movement of persons, services and capital, Chapter 4 – Capital and payments.

[8] See Annex 2 – "Capital and Payments Articles of the Treaty Establishing the European Community".

Originally, the balance-of-payments' financial assistance had been established by Regulation (EEC) N° 1969/88 which was adopted on 24 June 1988, that is to say on the same day as Directive (EEC) N° 88/361 for the implementation of Article 67(1) of the Treaty. Such a simultaneous adoption did not occur by chance, but denoted the will to establish an updated balance-of-payments financial mechanism precisely at the time that capital movements were to be fully liberalised within the Community. This Regulation merged two previous Community financial mechanisms, namely the instrument for medium-term financial assistance[9]and the Community loan mechanism designed to support the balance-of-payments of Member States[10] (the so-called 'oil facility'), into a single facility providing medium-term financial assistance.

Since the start of the third stage of economic and monetary union, the Member States participating in the single currency no longer qualify for medium-term financial assistance. However, the Council considered that the financial assistance facility should be retained in order to meet not only the potential needs of the present Member States which have not adopted the euro but also the needs of new Member States until such time as they adopt the euro. Therefore, Council Regulation (EC) N° 332/2002 was adopted on 18 February 2002 with a view to repeal the previous legislation and provide for an amended mechanism which takes into consideration the changes brought by the introduction of the single currency. Broadly, most of its original features remain unchanged, including the possibility to reintroduce capital movements restrictions once it is activated and subject to Council approval.

1.3.1.3. The Communication of the Commission on certain legal aspects concerning intra-EU investment[11]

This Communication has no binding character as such and is therefore different in its nature from the classical secondary legislation (i.e. regulation, directive, decision) that cab be adopted in pursuance of Treaty provisions. It is an interpretative text that has been adopted by the Commission on the basis of Court of Justice jurisprudence. Indeed, it must be recalled that the basic Treaty articles governing the freedom are directly applicable and do not allow for any secondary legislation.

The creation of the Single Market gave rise during the nineties to a large increase in intra-EU investments that extended to many sectors of the economy. This evolution took place partly in a context of liberalisation of economic sectors that were traditionally organised as public monopolies. Confronted with this situation, some Member States felt the need to monitor and, in some cases, to control this important development through the imposition of 'special control rights' on privatised activities in specific economic sectors or undertakings. Since such measures could generate restrictions on cross-border flows of capital, they can be incompatible with the freedom of capital movements (Article 56 EC) and the right of establishment (Article 43 EC) and can hinder the functioning of the Single Market.

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[9] Council Decision 71/143/EEC (O.J. L 73, 27.3.1971), as last amended by Decision 86/656/EEC (O.J. L 382, 31.12.1986).

[10] Council Regulation (EEC) N° 682/81 (O.J. L 73, 19.3.1981), as amended by Regulation (EEC) N° 1131/85 (O.J. L 118, 1.5.1985).

[11] O.J. C 220/06, 19.7.1997

Considering the difficulties in assessing the compatibility of such measures, the Commission decided to adopt this Communication. Its objectives were to indicate to national authorities and economic operators how the Commission interprets the Treaty in this respect, notably on the basis of the well-established case law of the European Court of Justice. This should help on the one hand Member States to design policies that do not breach Community law and on the other hand to allow private economic operators to be aware of their rights stemming from the Treaty insofar as intra-EU investment was concerned. However, since the Commission has no institutional power to interpret the Treaty, this Communication did not prejudge the interpretation that could ultimately be given in this field by the European Court of Justice.

1.3.1.4. The European Court of Justice case law

Due to its fully liberalised nature, as well as the direct applicability of its essential provisions, the freedom of capital movements is governed by an extremely limited set of rules with direct applicability. The abstract character of these basic rules as well as the specific and general exceptions to these rules offered by the Treaty leads sometimes to misinterpretation by legislators, and subsequently to breaches of Community legislation and the opening of infringement procedures by the Commission.

In this context, the role of the jurisprudence of the European Court of Justice as an additional legal source is of significant importance. Court rulings play an essential role in the detailed interpretation of capital movements rules and exceptions, as well as in the development of general principles applicable to capital movements. Although the number of ECJ judgements with direct relevance to capital movements rules is somewhat limited, they constitute essential references for any assessment of the compatibility of existing restrictions with Community law.

1.3.2. The basic principle of freedom

Capital movements and payments are free under the Community regime governing this pillar of the Single Market. This fundamental principle is enshrined in Article 56 of the EC Treaty, which reads as follows:

"1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.

2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited."

According to Article 56 EC, all restrictions on capital movements and payments are prohibited. However, the Treaty is silent as to the nature or the scope of restrictions that have to be abolished. Originally, the first Directive implementing a partial liberalisation of capital movements dealt specifically with the abolition of foreign exchange controls, undoubtedly because exchange controls on capital transfers were then the main instrument to prevent both capital flows and the specific transactions.

Later, in the context of other economic freedoms, the ECJ ruled that the term 'restriction' should be interpreted in a broader sense so as to cover all forms of 'obstacles' to the free exercise of such freedoms, and this principle applies mutatis mutandis to the freedom of

capital movements. This means that the suppression of foreign exchange controls is not sufficient. The freedom applies as well to the underlying transaction. For instance, not only should cross-border investments be free in foreign exchange legislation, but also in economic sector-related legislation.

This general notion of ‘obstacle’ encompass, in particular, the specific case of ‘administrative obstacles’, which implies that all forms of abusive administrative practices should also be abolished. Moreover, the ECJ confirmed that not only ‘direct obstacles’ were incompatible with the freedom, but also ‘indirect obstacles’. Good examples of indirect obstacles that frequently collide with the freedom of capital movements are discriminatory fiscal regimes which strongly discourage economic operators to carry out specific transactions abroad. For instance, tax breaks offered to fiscal residents if they invest exclusively in specific categories of domestic securities, at the expense of foreign ones, can prove incompatible with the freedom.

Moreover, according to one of the general principles enshrined in the Treaty, any discrimination on grounds of nationality shall be prohibited (Article 12 EC). Furthermore, any discrimination based on residence of the parties and location of investment have to be abolished in accordance with the regime governing capital movements.

Finally, while Article 56 EC fully liberalises capital movements and payments between Member States, it also provides for the same liberalisation between Member States and third countries. This liberalisation vis-à-vis third countries was inserted in the Treaty when the present regime entered into force on 1 January 1994. Its unconditional character means that capital movements involving third countries are free as far as the European Community is concerned, independently of the level of liberalisation reached by such third countries. The absence of any reciprocity condition results from the fact that the Treaty is made up of a set of unconditional rights and obligations. As concerns payments, this implied only a codification of liberalisation that had already been achieved by all Member States in accordance with their commitments under the Articles of Agreement of the International Monetary Fund.

1.3.3. The Treaty exceptions to the freedom

The opening part of both paragraphs forming Article 56 EC, “Within the framework of the provisions set out in this Chapter”, specifies that any interpretation of these provisions must take into consideration the complementary provisions laid down in the succeeding Articles 57 to 60 EC, which offer several possibilities either to limit this principle of absolute freedom of capital movements or to be exempted from it in specific cases. Such a clarification was also necessary from an institutional point of view insofar as any reference to other chapters’ provisions for the application of the freedom would have endangered its applicability.

Besides this set of exceptions relating specifically to the provisions of Article 56 EC, other Treaty exceptions of a more general nature can also apply on the freedom of capital movements. This combination of specific and general exceptions delimit the scope of the derogatory regime to the freedom.

Broadly, admissible exceptions can be distinguished according to their eligible user. On the one hand, Member States have the right to refer unilaterally to these exceptions with a view to maintain or introduce restrictions either in national legislation or international

commitments. According to the provisions referred to, restrictions may be imposed either vis-à-vis third countries exclusively, or vis-à-vis third countries and other EU Member States. In this context of subsidiarity, compatibility with Treaty rules depends primarily on each Member State's correct interpretation of such exceptions in the light of the ECJ jurisprudence. On the other hand, the Community has the right to amend the existing capital movements regime between third countries and itself, but only with respect to specific categories of capital movements transactions. Logically, both types of restrictions have to be consistent with each other, as well as with the Treaty.

2. THIRD COUNTRY RESTRICTIONS APPLICABLE BY EU MEMBER STATES

2.1. Specific restrictions on capital movements

2.1.1. Third country restrictions in national legislation

According to Article 56 EC, all restrictions to capital movements between Member States and between Member States and third countries shall be prohibited. Therefore, internal and external capital movements of the Community appears to be, at first sight, on an equal footing with regard to their level of liberalisation.

While an institutional guarantee for the free movement of capital within the Community is logical insofar as this freedom is a pre-condition for the completion of the Single Market as well as for the economic and monetary union, the decision to liberalise unilaterally vis-à-vis third countries does not appear necessary. This radical change in comparison with the original Treaty provisions was probably motivated by the Community's wish to facilitate its international trade and financial transactions, as well as an awareness that it would be unmanageable to have a differentiated regime for most types of capital movements. Furthermore, some Member States desired at the time to ensure that the single currency was not undermined by distortions with respect to operations with third countries.

Article 57(1) EC reads as follows:

"1. The provisions of Article 56 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment – including real estate – establishment, the provision of financial services or the admission of securities to capital markets."

While Article 56 EC fully liberalises capital movements by default, Article 57(1) clearly indicates that the extension of this freedom to third countries is not unlimited. *Member States* and the *Community* have the right to maintain restrictions on capital movements that existed as at 31 December 1993 under, respectively, national and Community law, in relation to the specific transactions that are mentioned in Article 57(1) EC.

Since Article 57(1) does not set any time-limit for such restrictions, Member States and the Community may enforce them as long as they are considered appropriate. In the same way, this article does not specify how such restrictions may be liberalised by either Member States or the Community. In case of amendment, are they supposed to be completely abolished or is it authorised to relax them progressively without achieving an immediate removal? Although the jurisprudence does not provide a clear answer to this

question, the latter option is generally considered to be covered by the provisions of Article 57(1), provided such relaxation of restrictions is not followed by a strengthening at a later stage (i.e. a 'ratchet' mechanism or standstill and rollback). Moreover, one should note that Article 57(1) EC does not require any specific notification that would allow a reliable identification of third country regimes applicable at national level.

With regard to the scope of application of these provisions, it should be noted that restrictions applying to 'provision of financial services' are covered by Article 57(1). Since most capital movements are carried out by recourse to financial services provided by financial institutions (e.g. acquisition of securities, conclusion of a bank loan, etc.), the possibility to restrict capital movements vis-à-vis third countries might be broader than those formally mentioned in Article 57(1).

Nonetheless, it should be noted that the efficiency of restrictions, compatible with Article 57(1), enforced by a Member State vis-à-vis one specific third country is actually conditional upon the absence of a more liberal regime between that same third country and another Member State. For instance, should the establishment of economic operators from a specific country be prohibited by a Member State, this restriction could easily be circumvented if such an establishment was authorised in another Member State, allowing thereby further establishments in the whole Community.

2.1.2. Tax differentiation

The complete liberalisation of capital movements can have repercussions on the taxation of capital income. The free allocation of capital within the Community and beyond its external borders limits severely Member States' ability to protect the integrity of their national tax system. Such negative consequences are particularly felt in the field of direct taxation, in particular personal and corporate income tax as well as taxation of interest and dividends.

Considering the relative lack of harmonisation in the fiscal area at Community level, as well as the prospects of a further integration of the Single Market in the framework of the economic and monetary union, Member States felt it necessary to introduce in the Maastricht Treaty the provisions of Article 58(1)(a) EC, which allow for a certain degree of fiscal differentiation of taxpayers according to the place of residence or the place where their capital is invested. Since no such fiscal carve-out existed in the pre-1994 capital movements regime, Article 58(1)(a) EC could be considered to represent a step backwards with respect to the liberalisation process of capital movements.

Article 58(1)(a) reads as follows:

"1. The provisions of Article 56 shall be without prejudice to the right of Member States:

(a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;"

A superficial reading of Article 58(1)(a) might give the impression that Member States have a wide margin of manoeuvre to invoke this fiscal exception. However, all

exceptions stipulated in Article 58(1) and (2) have to be interpreted by Member States in the light of the provisions of paragraph (3) of the same Article[12], which provide that adopted restrictions may not constitute an arbitrary discrimination or a disguised restriction, as well as in accordance with the ECJ jurisprudence in this area.

Considering the potential impact of this exception, the formulation of Article 58(1)(a) can be considered as somewhat vague, in particular with regard to its precise meaning and scope of application. In order to clarify some of these uncertainties, an explanatory Declaration[13] was included in the Maastricht Treaty, which introduced the notion of standstill on intra-EU differentiation existing by 31 December 1993 at the latest (in accordance with the general objective of completion of the Single Market). Implicitly, this confirms that fiscal discriminations imposed against third countries after the end of 1993 are still compatible with the Community regime. The latter principle is an illustration of the fact that, despite the liberalisation with non-EU countries imposed by Article 56 EC, there are some more exceptions to the strict free movement of capital towards third countries than within the Community.

On the basis of both sources, it appears that Member States are authorised to treat differently on the one hand 'domestic investments' and 'foreign investments' (usually, 'foreign investments' will be discriminated against through a less favourable tax treatment) and on the other hand taxpayers according to their place of residence (usually, fiscal residents will be treated less favourably than foreign residents, which frequently benefit from tax exemption in most Member States). The definition of the concept of 'place of residence' remaining Member States' competence so far, the latter option leads sometimes to contradictions between incompatible national regimes (the same person may be resident in two countries at the same time).

In this context of loose terminology and vaguely defined scope of application, one might think that the European Court of Justice case law was destined to provide for a significant contribution to the interpretation of Article 58(1)(a) and, thereby, to a certain level of tax harmonisation at Community level. In fact, most ECJ tax cases are grounded on non-discriminatory principles ensuing from the free movement of persons or services, or the right of establishment, rather than from the free movement of capital. The reason for this can be precisely attributed to the fiscal carve-out that was inserted in the present Community regime since 1 January 1994. It may have incited the ECJ, whenever possible, to base its judgements on any other related Community freedoms which do not suffer from such imprecision as to the scope of an important exception. One might also suggest that this strategy allows the Court to escape the huge responsibility of setting up 'definitive' guidelines for the interpretation of the provisions of Article 58(1)(a) and effectively harmonising EU taxation on the income from capital.

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[12] Article 58(3): *"The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56."*

[13] Declaration: *"The Conference affirms that the right of Member States to apply the relevant provisions of their tax law as referred to in Article 58(1)(a) of this Treaty will apply only to the relevant provisions which exist at the end of 1993. However, this Declaration shall apply only to capital movements between Member States and to payments effected between Member States."*

2.1.3. Prudential measures

The establishment of a regime of freedom of capital movements in the EC Treaty was a pre-requisite for the progressive integration of financial markets within the European Community. The sustained adoption of secondary legislation led to the appearance of a Community legal framework governing financial services, institutions and markets which played an essential role in this integration process.

Almost all segments of the Community financial system are now covered by an appropriate legislation, though to varying degrees, which deals in particular with the regulation and supervision of market risks in general. Depending on the legislation involved, the responsibility for the prudential supervision of financial institutions is generally assumed by the competent authorities of the home country.

Prudential rules, being essentially restrictions to the freedom of capital movements, can be considered as compatible with Article 56 EC only insofar as they are covered by a specific exception enshrined in the Treaty for that purpose, such as in Article 58(1)(b) EC. Moreover, prudential supervision and rules being primarily Member States' responsibility, the possibility to derogate from Treaty obligations has to be defined at national level.

Article 58(1)(b) reads as follows:

"1. The provisions of Article 56 shall be without prejudice to the right of Member States:

(a) (…)

(b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security."

To try to establish a comprehensive list of admissible prudential rules is not only impossible (the evolution of markets, products and practices could lead to the imposition of new rules in the future), but also ultimately reserved for ECJ interpretation. As already explained, prudential rules are exceptions to the provisions of Article 56 EC, and the European Court of Justice is the sole institution responsible for Treaty interpretation.

However, in consideration of the uncertainty affecting this matter, the existing financial legislation at Community level is the most relevant source of information with respect to national prudential rules that could be considered as compatible (although EU secondary legislation could be judged by the ECJ to be contrary to Treaty provisions, including those on prudential measures). Furthermore, it should be noted that, in the absence of EU secondary legislation, unregulated financial services have also to abide by fundamental Treaty rules (including the provisions of Article 56 EC), as soon as these are involved.

Under these circumstances, the issue of restrictions ensuing from prudential considerations will be dealt with in Chapter 3 devoted to measures adopted by the European Community, since these form the essential guidelines for the application of corresponding measures by EU Member States. The compatibility of prudential measures

applied to unregulated financial sectors with Article 56 EC will be discussed at the same time.

2.1.4. Public policy and public security restrictions

Since 'public policy' and 'public security' considerations were already mentioned as acceptable exceptions in the other economic freedoms, the incorporation of these exceptions in the capital movements area by the entry into force of the present regime was justified.

Unfortunately, the EC Treaty does not define the concepts of 'public policy' and 'public security' (like many other concepts). This leaves quite a margin of discretion available to Member States to invoke these exceptions to forbid, or at least control, specific capital movements. A situation whereby cross-border capital movements are liberalised by Community legislation while the determination of restrictions based on public policy and public security considerations is left to Member States gives rise to legal uncertainties, leaving it to national courts and ultimately the European Court of Justice to determine the nature and scope of application of such measures.

While the concept of 'public policy' was not a permissible exception to capital movements in the previous regimes adopted in accordance with the EEC Treaty, the ECJ recognised already its compatible character in 1981[14]in declaring that capital movement freedom may undermine the economic policy of one of the Member States or create an imbalance in its balance of payments. Furthermore, while it might be assumed that the existence of specific provisions allowing a certain degree of fiscal differentiation imply that tax consideration do not fall under the concept of 'public policy', the ECJ once ruled the opposite arguing that maintaining the coherence of the fiscal system of a member State was a matter of 'public policy'. More recently, the ECJ ruled[15] that Article 58(1)(b) precludes a system of prior authorisation for foreign direct investment which confines itself to defining in general terms the affected investments as representing a threat to 'public policy' and 'public security', with the results that the persons concerned are unable to ascertain the specific circumstances in which such authorisation is required.

The above examples illustrate the evolutionary character of the concepts of 'public policy' (mainly) and 'public security' in the context of capital movements. The number of specific national concerns that could fall within the meaning of such concepts will possibly expand with the development of ECJ jurisprudence. In any case, the present case law devoted to these Treaty exceptions has already demonstrated that they may not be considered as discretionary tools at the disposal of Member States to derogate from their Treaty obligations. In fact, they are increasingly becoming very tightly defined and specific.

2.2. Specific restrictions to the right of establishment

Articles 56 EC and following only govern 'capital movements' and 'payments'. This explains why this article is preceded by the sentence *"Within the scope of the provisions set out in this Chapter"*, which seems to delimit the scope of its coverage. Moreover, the right of establishment is governed notably by Articles 43 to 48 EC. However,

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[14] In 'Casati' (Case C-203/80, Judgement of 11 November 1981)

[15] In 'Paris Church of Scientology v Prime Minister' (Case C-54/99, Judgement of 14 March 2000)

‘establishment’ is also a subset of ‘direct investment’ under the Community legislation. According to the EU definition[16], ‘direct investment’ includes in particular *“establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings.”*

Therefore, Article 58(2) EC establishes a link between both chapters of the Treaty by stating that *“The provisions of this Chapter shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with this Treaty.”*, while Article 43 EC introduces a similar reference by providing that the right of establishment is *“subject to the provisions of the Chapter relating to capital”*. In conclusion, the field of application of the two chapters on establishment, on the one hand, and on capital movements, on the other hand, are distinct even if they overlap.

Such cross-references between distinct chapters can also be explained by the adoption scheme of the provisions involved. The liberalisation of capital movements and payments was only completed in 1994 with the introduction of Article 56 and following as a free-standing chapter in the Maastricht Treaty. In contrast, the chapter relating to the right of establishment was already included in the 1957 Treaty.

2.3. General exceptions of the Treaty

Besides the above specific categories of restrictions, which belong to the provisions governing respectively the freedom of capital movements and the right of establishment, the Treaty provides also for more general exceptions in its final provisions.

2.3.1. Restrictions on property ownership

Article 295 EC reads as follows:

“This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership.”

This article states that the Treaty is neutral vis-à-vis the system of property ownership existing in Member States, which means that public and private ownership may coexist in the legal order of member States. This allows Member States to maintain public ownership in any case (e.g. public utilities companies), if they consider it more appropriate. Historically speaking, it might be useful to note that, at the time of adoption of the Treaty, a number of Member States had extensive interests in what would now normally be regarded as market sectors.

While the purpose of this article is well defined, its abstract character has sometimes led to some misunderstandings. In particular, it is generally considered that Article 295 EC does not allow Member States to dismember the right of ownership in a way that national authorities would retain special control rights after privatisation of State companies. National laws that define all types of public and private ownership in Member States have to be compatible with basic Treaty provisions, and in particular those which govern capital movements and, as explained earlier, such special rights are generally incompatible with Treaty rules.

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[16] See Annex I to Directive 88/361/EEC of 24 June 1988.

This interpretation of the provisions of Article 295 EC was recently confirmed by the ECJ in three recent rulings on special control rights of Member States[17]. These rulings rejected the extensive arguments of Advocate General Ruiz-Jarabo Colomer on the primacy of Article 295 EC in his opinion of 3 July 2001[18].

2.3.2. Restrictions for 'national security' and 'defence' considerations

Article 296 EC reads as follows:

"1. The provisions of this Treaty shall not preclude the application of the following rules:

(a) no Member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of its security;

(b) any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes.

2. The Council may, acting unanimously on a proposal from the Commission, make changes to the list, which it drew up on 15 April 1958, of the products to which the provisions of paragraph 1(b) apply."

On the basis of this article, Member States may derogate from their capital movements obligations when national security is threatened either in general or in connection with the production of or trade in defence material. Typical measures that could serve that purpose are restrictions to investments in defence material manufacturers. Although the list referred to in Article 296(2) EC should help defining the scope of application of this exception, it appears to be somewhat old-fashioned insofar as the original version adopted in 1958 was never updated afterwards. It is also somewhat at odds with the progressive identity of interest in this area of Member States, insofar as there is no distinction between intra- and extra-EU security considerations. Anyhow, compatibility of restrictions with Treaty rules must be assessed on a case-by-case basis.

2.3.3. General interest considerations

Although 'general interest' is not formally mentioned in the exceptions of the Treaty, the ECJ developed this notion (also known as 'general good' or 'mandatory requirements') in various judgements. By nature, it appears to be close to the concept of 'public policy' and 'public security', but with a potentially broader scope of application. In these judgements,

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[17] 'Commission v Portuguese Republic' (Case C-367/98): "48. However, those concerns cannot entitle Member States to plead their own system of property ownership, referred to in Article 222 [295] of the Treaty, by way of justification for obstacles, resulting from privileges attaching to their position as shareholder in a privatised undertaking, to the exercise of the freedoms provided for by the Treaty. As is apparent from the Court's case law (*Konle*, cited above, paragraph 38), that article does not have the effect of exempting the Member States' system of property ownership from the fundamental rules of the Treaty."

[18] 'Commission v Portuguese Republic, French Republic and Kingdom of Belgium' (Cases C-367/98, C-483/99, C-503/99).

the Court considered that the need to protect the 'general interest' authorises Member States to derogate from Treaty obligations, including those governing capital movements.

While the ECJ jurisprudence devoted to capital movements exceptions justified by 'general interest' considerations is fairly limited, it should be pointed out that the use of such exceptions by national authorities of certain Member States has become more frequent in the past ten years. During this period, the Community adopted a set of directives aiming at gradually liberalising various public utilities sectors (energy, post, telecommunications, airports, etc.) generally managed by State monopolies. This incited most Member States to embark on a privatisation process of such sectors so as to enhance their efficiency in a context of growing economic integration. The consequence of such an economic reform was a huge increase of investment flows to and within the Community. Confronted with this situation, some Member States felt it necessary to introduce specific measures in order to monitor, and in some cases control, this important development.

Such measures generally imposed direct and indirect restrictions to cross-border investments in the above-mentioned sectors or companies. The long list of national restrictions includes in particular: authorisation procedures for investments in the company (beyond certain thresholds), veto rights on important decisions of management bodies (mergers, acquisitions, disposal of assets, etc.), limitation of voting rights, privilege to appoint management, etc. Usually, such restrictions are termed 'golden shares', although the term 'special rights' is probably more appropriate insofar as the previous term refers only to a specific legal means to enforce such rights.

In most cases, Member States justified such restrictions by the need to protect the 'general interest' in the sectors involved, arguing that the protective provisions of Community directives were insufficient to actually guarantee the quality and the continuity of service in crisis situations. In spite of the reference to Treaty exceptions, the Commission considered that these restrictions could prove to be incompatible with the freedom of capital movements (Article 56 EC) and the right of establishment (Article 43 EC). Therefore, it published in 1997 a Communication[19] the aim of which was to indicate how it interpreted the Treaty provisions relating to these basic Single Market freedoms, on the basis of the ECJ jurisprudence in this matter.

In the first place, the Communication discusses the various exceptions that could justify discriminatory restrictions against investors (including 'public policy' and 'public security'). Then, it goes thoroughly into the analysis of the conditions under which non-discriminatory restrictions, based on 'general interest' requirements, could be considered as compatible with the Treaty.

These conditions may be summarised as follows:

- *"National measures liable to hinder or make less attractive the exercise of the fundamental freedoms guaranteed by the Treaty must fulfil <u>four conditions</u>: <u>they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing</u>*

[19] Communication of the Commission on certain legal aspects concerning intra-EU investments – 19.7.1997 – O.J. 97/C 220/06

the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it."[20]

- Furthermore, when such national measures are enforced through *'general authorisation procedures'* these can only be considered as compatible with Articles 56 and 43 EC if they satisfy three additional conditions: they must be based on a set of objective criteria, stable over time, and made public.

  These conditions are justified by the need to reduce the discretionary powers of national authorities to a minimum and offer legal certainty to the investor. Otherwise, each non-discriminatory 'authorisation procedure' could be implemented in such a way that its outcome would inevitably be discriminatory, while the ECJ indicated on several occasions that fundamental freedoms of the Treaty cannot be rendered illusory and exercising these rights cannot be submitted to the discretion of the administrative authorities[21]. These requirements imply that 'national interest' considerations are not recognised as an acceptable criterion in such 'authorisation procedures'.

- Finally, the Communication recalls that the ECJ declared that exceptions to Treaty rules exclude any interpretation based on economic considerations[22].

Although the Communication's goal was to avoid any misinterpretation by Member States of Treaty exceptions allowing restrictions to investment – with an emphasis on 'general interest' justifications – one has to deplore a significant use of such measures in the past years, in a way that has been frequently considered by the Commission as contrary to Community law. This has led the Commission to open a number of infringement cases involving various Member States and economic sectors. Several of these have already been referred to the ECJ, others are at different stages of the infringement procedure, and some 'special rights' have been abolished.

The first judgement dealing with such type of restrictions is *Commission v Republic of Italy*[23], where the ECJ found that, by adopting the 1994 Law on Privatisation and Decree Laws on ENI and Telecom Italia, the Republic of Italy had failed to fulfil its Treaty obligations under Articles 43, 49 and 56 EC. However, one should underline that Italy acknowledged during the procedure its breach of Community legislation, which deprives us of a more detailed opinion of the Court on the justifications that could have been produced in this case.

On 4 June 2002, the ECJ came with a second wave of judgements[24] relating to three cases involving the same type of restrictions. Portugal was condemned for its framework law on privatisation which established the possibility of restricting foreign participation (beyond certain thresholds) in individual laws privatising Portuguese companies. France

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[20] 'Reinhard Gebhard' – Case C-55/94 – Judgement of 30 November 1995

[21] See in particular 'Luisi & Carbone' (Joined Cases C-296/82 and C-26/83), 'Bordessa' (Joined Cases C-358/93 and C-416/93), and 'Sanz de Lera' (Joined Cases C-163/94, C-165/94, and C-250/94)

[22] 'Federación de distribuidores cinematográficos' (Case C-17/92, Judgement of 14 May 1993)

[23] Case C-58/99, Judgement of 23 May 2000

[24] 'Commission v Portugal' (Case C-367/98), 'Commission v France' (Case C-483/99), 'Commission v Belgium' (Case C-503/99)

was also condemned for holding a *'golden share'* in the company *'Elf-Aquitaine'*, which established a system of prior authorisation for all shareholdings exceeding certain voting rights ceilings as well as a veto right to oppose any decision to transfer or use as security the assets of four subsidiaries of the company. In contrast, the ECJ authorised Belgium to maintain the decree defining the special rights attached to the *'golden share'* held in *'Distrigaz'* and *'Société Nationale de Transport par Canalisations'*, which provides for the possibility to oppose (and eventually annul) any major strategic company's decision which could adversely affect the country's interest in the energy sector. The economic sectors covered by the French and Belgium cases are respectively petroleum products and gas distribution and transport, while the Portuguese measures potentially cover many sectors.

In the Belgian ruling, the Court considered that the special powers attached to the 'golden share' were justified, in particular, by the following reasons: the regime is one of opposition within strict time-limits (no prior authorisation is required), the regime is limited to certain decisions concerning the strategic assets of the companies in question (the veto right does not cover the ownership of the capital of these companies), the regime directly relates to the public service obligations incumbent on both companies.

At first sight, the way Belgium has conceived its special powers of intervention in strategic decisions of *'Distrigaz'* and *'SNTC'* which directly impact on the safeguarding of supplies and transport of gas products might become a reference for other Member States willing to equip public utilities undertakings with similar tools. However, a careful reading of this ruling reveals that the ECJ chose not to take into consideration[25] the general interest requirements stipulated in the Community directive liberalising the gas sector[26], simply because the Commission's application was lodged before the transposition deadline of this directive expired. Precisely, these general interest requirements are intended to safeguard the supply and transport of gas, which might lead implicitly to the conclusion that any national measures mirroring these Community provisions might be considered as redundant, and fail therefore to meet the usual proportionality requirement imposed by the jurisprudence in the future.

Under these circumstances, it seems advisable to consider that the Belgian case, although it established in combination with the two other cases a useful dividing line between compatible and incompatible measures in the area of general interest protection, should exclusively be seen in the light of the above procedural reservation. In other words, under the assumption that the deadline for the transposition of the gas directive would have expire, it might be argued that the ECJ could have ruled differently, and possibly condemned Belgium for its 'golden shares' in both companies.

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[25] '*Commission v Kingdom of Belgium*' (Case C-503/99, Judgement of 4 June 2002, par. 54)

[26] Directive 98/30/EC of 22 June 1998 concerning common rules for the internal market in natural gas

Box 1. Main Findings of 4 June 2002 ECJ rulings

These Court rulings are extremely important since they clarified significantly how restrictions to capital movements[27] offered by the Treaty could be implemented in national measures accompanying the privatisation of public undertakings. In practice, they established several fundamental principles which should govern the characteristics of such type of measures in similar circumstances, and confirmed implicitly most of the principles set out in the 1997 Communication of the Commission. Summarily, these rulings established the following principles:

- The rules at issue are a restriction to the free movement of capital within the meaning of Article 56 of the Treaty, since they dissuade investors in other Member States from investing in the capital of those undertakings.
- Article 295 EC ('property ownership') does not have the effect of exempting the Member States' systems of property ownership from the fundamental rules of the Treaty, even when privatisation is accompanied by the issue of special shares in favour of the State.
- In case of overriding requirements of the general interest, non-discriminatory restrictions to the free movement of capital, in order to be justified, must be suitable for securing the objective pursued, must not go beyond what is necessary in order to attain it, so as to accord with the principle of proportionality.
- As regards a prior administrative authorisation scheme, it must be based on objective, non-discriminatory criteria which are known in advance to all concerned, and all persons affected by a restrictive measure of that type must have a legal remedy available to them (a scheme failing to meet these conditions has a discretionary nature and cannot therefore be compatible with Community rules).
- The safeguarding of supplies of petroleum and gas products in the event of a crisis falls within the ambit of a legitimate public interest.
- 'Economic policy objectives' cannot justify restrictions to capital movements. Objectives considered as such are, in particular, *"choosing a strategic partner, strengthening the competitive structure of the market concerned or modernising and increasing the efficiency of means of production"*.

[27] The ECJ did not assess existing restrictions from the 'right of establishment' angle. For instance, see Case C-367/98: *"56. To the extent that the legislation in issue involves restrictions on freedom of establishment, such restrictions are a direct consequence of the obstacles to the free movement of capital considered above, to which they are inextricably linked. Consequently, since an infringement of Article 73b [56] of the Treaty has been established, there is no need for a separate examination of the measures at issue in the light of the Treaty rules concerning freedom of establishment."*

3. THIRD COUNTRY RESTRICTIONS APPLIED BY THE EUROPEAN COMMUNITY

3.1. The legal grounds

3.1.1. Third country restrictions in Community legislation

As discussed earlier[28], the provisions of Article 57(1) EC provides for the possibility for *Member States* and the *Community* to maintain restrictions on capital movements that existed as at 31 December 1993 under, respectively, national and Community law, in relation to the specific transactions that are mentioned in this article (i.e. direct investment – including real estate – establishment, the provision of financial services or the admission of securities to capital markets).

This provision allowed the Community to give access to its markets to third countries, but in certain areas only to the extent that it could obtain comparable advantages for its own economic operators from third countries.

3.1.2. Amendment to third country restrictions

While paragraph 1 of Article 57 EC provides for the right to *maintain* restrictions on specific capital movements transactions existing before the entry into force of the present regime on 1 January 1994, paragraph 2 of the same article provides for the possibility to either *further liberalise* or *restrict* these transactions.

Article 57(2) EC reads as follows:

"2. Whilst endeavouring to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible and without prejudice to the other Chapters of this Treaty, the Council may, acting by a qualified majority on a proposal from the Commission, adopt measures on the movement of capital to or from third countries involving direct investment – including investment in real estate – establishment, the provision of financial services or the admission of securities to capital markets. Unanimity shall be required for measures under this paragraph which constitute a step back in Community law as regards the liberalisation of the movement of capital to or from third countries."

In practice, this article provides for a differentiated decision-making process according to the purpose of the planned amendments to the capital movements regime between the Community and third countries. If the Community wishes to further liberalise capital freedom with third countries – with respect to the four categories of transactions mentioned in Article 57 – it should adopt the necessary measures proposed by the Commission by a qualified majority. In actual fact, such measures would impact on the 'right of establishment' and the 'freedom to provide services', which are currently regulated through Community legislation. In contrast, any measures which would constitute a step backwards in Community law (whatever the impact on individual national law might be in our interpretation) with regard to the level of liberalisation applicable to the transactions covered by Article 57(2), requires unanimity.

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[28] See "2.1.1. Specific third country restrictions", page 9.

3.1.3. The EMU safeguard clause

The legal basis governing the economic and monetary union has been inserted in the EC Treaty. While most provisions describe the preparatory steps that lead to this objective, Article 59 aims at ensuring its continuity by providing for a safeguard clause:

"Where, in exceptional circumstances, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of economic and monetary union, the Council, acting by a qualified majority on a proposal from the Commission and after consulting the ECB, may take safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary."

The protective measures foreseen in this article could exclusively be invoked if EMU were endangered by extremely disturbing capital movements with third countries. Considering the number of Member States that have already entered the third stage of the economic and monetary union and the aggregated economic weight of the euro-zone, it may be argued that the probability of such "serious difficulties" happening is quite small. It should also be emphasised that any measures would have to be taken for the EU area as a whole rather than the euro area. Given also the six month period permitted, it could be suggested that any measures taken would be more likely to be technical rather than involving comprehensive exchange controls.

3.1.4. Financial sanctions on third countries

Article 60 forms the legal basis for imposing financial sanctions on third countries. It reads as follows:

"1. If, in the cases envisaged in Article 301[29], action by the Community is deemed necessary, the Council may, in accordance with the procedure provided for in Article 301, take the necessary urgent measures on the movement of capital and on payments as regards the third countries concerned.

2. Without prejudice to Article 297[30] and as long as the Council has not taken measures pursuant to paragraph 1, a Member State may, for serious political reasons and on grounds of urgency, take unilateral measures against a third country with regard to capital movements and payments. The Commission and the other Member States shall be informed of such measures by the date of their entry into force at the latest.

The Council may, acting by a qualified majority on a proposal from the Commission, decide that the Member State concerned shall amend or abolish such measures. The

[29] Article 301 : "Where it is provided, in a common position or in a joint action adopted according to the provisions of the Treaty on European Union relating to the common foreign and security policy, for an action by the Community to interrupt or to reduce, in part or completely, economic relations with one or more third countries, the Council shall take the necessary urgent measures. The Council shall act by a qualified majority on a proposal from the Commission."

[30] Article 297 : "Member States shall consult each other with a view to taking together the steps needed to prevent the functioning of the common market being affected by measures which a Member State may be called upon to take in the event of serious internal disturbances affecting the maintenance of law and order, in the event of war, serious international tension constituting a threat of war, or in order to carry out obligations it has accepted for the purpose of maintaining peace and international security."

President of the Council shall inform the European Parliament of any such decision taken by the Council."

Article 60(1) EC provides for *Community* sanctions against third countries, in the context of the Common Foreign and Security Policy of the European Union mentioned in Article 301. The European Union lacking legal personality, the establishment of a link between both articles was necessary so as to allow the European Community to adopt such restrictions and for these to be compatible with the freedom.

These restrictions may cover by definition all types of capital movements and payments. In practice, they usually materialise in the shape of freezing of bank accounts and other financial assets of specific natural and legal persons or a ban on foreign direct investments in the country involved. Such restrictions are sometimes adopted in response to United Nations sanctions (Security Council Resolutions), although this does not form a necessary condition. Financial sanctions are defined and implemented through the adoption by the Council of regulations that benefit from direct applicability in the legal order of Member States. Recent examples of financial sanctions adopted by the Community are the freeze of funds and the ban on investments in relation to the Federal Republic of Yugoslavia[31] and the flight ban and the freeze of funds and other financial resources in respect of the Taliban in Afghanistan[32].

Article 60(2) EC provides for *national* sanctions against third countries for "serious political reasons and on grounds of urgency". Considering the right of the Council to amend or abolish such measures afterwards, such sanctions should be seen as transitional measures awaiting the adoption of similar sanctions by the Community. Moreover, the ECJ declared in *Commission v Greece*[33], which dealt with the imposition of an economic embargo on Macedonia in pursuance of Article 297 EC, that such sanctions should be designed in consideration of the Community's interest instead of the national interest. Therefore, recourse to the provisions of paragraph 1 could be seen progressively as the rule in a context of a growing political union.

3.1.5. Balance of payments safeguard clauses

Articles 119 and 120 EC provide for the actions that can be undertaken by the Commission and the "mutual assistance" that can be granted by the Council to help a Member State in serious balance of payments difficulties to overcome the crisis. Within the "mutual assistance", the granting of a medium-term financial assistance by the European Community plays an important role. Regulation 1969/88/EEC establishing a single facility for granting such loans gives effect to the principle enshrined in Articles 119 and 120 EC.

The Commission may recommend the granting of a medium-term financial assistance to the Member State in difficulties in accordance with the provisions of Article 119(2), which reads as follows:

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[31] Council Regulation (EC) N° 1294/1999 of 15 June 1999

[32] Council Regulation (EC) N° 337/2000 of 14 February 2000

[33] Case C-120/94 – Order of the Court of 29 June 1994

"2. The Council, acting by a qualified majority, shall grant such mutual assistance; it shall adopt directives or decisions laying down the conditions and details of such assistance, which may take such forms as:

(a) a concerted approach to or within any other international organisations to which Member States may have recourse;

(b) measures needed to avoid deflection of trade where the State which is in difficulties maintains or reintroduces quantitative restrictions against third countries;

(c) the granting of limited credits by other Member States, subject to their agreement."

Article 119(2)(b) provides in particular for the possibility to "reintroduce quantitative restrictions against third countries". These quantitative restrictions include restrictions to capital movements that would be considered necessary to avoid a further deterioration of balance of payments accounts. It should be noted that such restrictions would exclusively apply vis-à-vis *third countries*.

Should the above measures prove insufficient, complementary measures could be adopted in accordance with the provisions of Article 119(3) EC, which reads as follows:

"3. If the mutual assistance recommended by the Commission is not granted by the Council or if the mutual assistance granted and the measures taken are insufficient, the Commission shall authorise the State which is in difficulties to take protective measures, the conditions and details of which the Commission shall determine.

Such authorisation may be revoked and such conditions and details may be changed by the Council acting by a qualified majority."

In contrast to the "quantitative restrictions" of Article 119(2) EC, such "protective measures" (including restrictions on capital movements) have a broader scope of application insofar as they can be imposed against third countries and other Member States. Similar measures can also be temporarily adopted on initiative from the Member State in difficulties in accordance with the provisions of Article 120 EC, subject to further confirmation by the Council under the procedure foreseen by Article 119 EC.

Legally speaking, the list of restrictions to capital movements that the Member State concerned may introduce is included in the Decision adopted by the Council to grant medium-term financial assistance. The most recent example is the Decision to grant a €8 billion loan to the Republic of Italy during its 1993 balance of payments crisis.

3.1.6. Other Community restrictions

According to the provisions of Articles 56 to 60 EC, the above categories of restrictions form the exhaustive list of restrictions which may be adopted (or approved) by the Community in the field of capital movements. However, it should be noted that some other categories of restrictions, which are formally reserved for Member States, are sometimes initially implemented through Community legislation and eventually transposed in national laws.

Although it is, by definition, difficult to list all these particular circumstances, they mostly relate to the provisions of Article 58(1)(b) EC, and in particular the measures for the '*prudential supervision of financial institutions*'. While these are supposed to be

conceived, adopted and implemented at Member States' level, they have generally been inserted in Community directives governing the activities of financial institutions. Implicitly, the right of Member States to take such requisite measures is limited to the area of financial institutions which are unregulated at EU level so far (provided these measures shall not constitute means of arbitrary discrimination or a disguised restriction on the free movement of capital, as provided for by Article 58(3) EC).

3.2. Horizontal Community regimes

3.2.1. *Competition policy*

The EC Treaty provides for a comprehensive set of provisions on competition policy which establishes competition rules and merger control on a Community wide basis. The basic principles of this competition regime are found in Articles 85 to 90 EC. There are no different rules applying to investors from third countries as compared to investors from the European Community.

3.2.2. *Taxation policy*

Although there are numerous provisions in national tax laws which affect investment in and from third countries, there are hardly any rules in the few EC provisions on direct taxation.

As far as the primary EC law is concerned, it must be reminded that Article 58(1)(a) of the Treaty, which is part of the capital movements regime, allows a distinction to be made in tax laws with regard to the place of residence of investors or the place where the capital is invested.

For the rest, many measures adopted at EC level in the field of direct taxation and capital duty are of a fairly low binding character, such as Council Resolutions, Protocols and Commission Recommendations. The range of the binding EC framework is limited and consists mainly in the following measures:

- Under Directive 85/303/EEC[34], capital duty may not exceed a 1% rate. This provision is indistinguishably applicable to domestic and foreign investment.
- Directives 90/434/EEC[35] and 90/435/EEC[36] provide for the application by Member States of similar tax rules in case of mergers, divisions, transfers of assets and exchanges of shares in the former, and the grouping of parent companies and subsidiaries in the latter. The removal of discriminatory national tax rules on such transactions was considered to be necessary for the

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[34] Council Directive 85/303/EEC of 10 June 1985 amending Directive 69/335/EEC of 17 July 1969 concerning indirect taxes on the raising of capital.

[35] Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States.

[36] Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

establishment of an effective functioning single market. These two directives give rights to EU companies from which companies not established do not benefit.

3.3. Sector-related Community regimes

3.3.1. Air transport

For a long time, air transport was largely regulated independently by Member States within the Community and based on the Chicago Convention. National markets were generally characterised by restrictions that limited access for other Community operators, and prevented therefore cross-border investments by European airlines. When the European Single Market was created in 1992, the Commission considered that a similar approach should be applied to the air transport industry with a view to get rid of existing restrictions within the Community. This led to the adoption of the "Third Package", which consisted of a set of regulations which established the concept of "Community air carriers", i.e. Community-owned airlines with equal rights of access to the internal market and with equal responsibilities under the law.

As the single air transport market took shape with the third package, legitimate concerns about the treatment of Community carriers in foreign markets and the defence of Community interests as a whole led to the insertion in these regulations (as well as in subsequent EU legislation) of restrictive provisions vis-à-vis third countries. These may be summarised as follows:

- Free market access is reserved for air carriers entitled to obtain an *operating licence* from EU Member States. According to Article 4 of Regulation N° 2407/92[37], such air carriers ('Community air carriers') must have their principal place of business and, if any, their registered office located in a Member State. Furthermore, they shall at all times be effectively controlled by Member States and/or nationals of Member States, either directly or through majority ownership.

- According to Regulation N° 2408/92[38], exclusively Community air carriers are permitted by Member States to exercise *traffic rights* (i.e. the right to carry passengers, cargo, mail) between two Community airports. Nonetheless, according to Regulation N° 2343/90[39], a tiny number of other air carriers - which used to exercise intra-Community traffic rights prior adoption of the above regulation – may keep these rights.

- With respect to the *allocation of slots* at Community airports, Regulation N° 95/93[40] stipulates that Member States may reserve certain slots at Community airports for domestic scheduled services (Article 9). Moreover, if a third country (a) does not grant Community air carriers treatment comparable to that granted by

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[37] Council Regulation (EEC) N° 2407/92 of 23 July 1992 on licensing of air carriers.

[38] Council Regulation (EEC) N° 2408/92 of 23 July 1992 on access for Community air carriers to intra-Community air routes.

[39] Council Regulation (EEC) N° 2343/90 of 24 July 1990 on access for air carriers to scheduled intra-Community air service routes and on the sharing of passenger capacity between air carriers on scheduled air services between Member States.

[40] Council Regulation (EEC) N° 95/93 of 18 January 1993 on common rules for the allocation of slots at Community airports.

Member States to air carriers from that country, or (b) does not grant Community air carriers de facto national treatment, or (c) grants air carriers from other third countries more favourable treatment than Community air carriers, appropriate action may be taken to remedy the situation in respect of the airport(s) concerned (Article 12).

- Access to the market for the provision of *groundhandling services* to third parties has been liberalised by Directive 96/67/EC[41]. However, Member States still have the right to require that such suppliers be established within the Community (Article 6). Furthermore, Community suppliers of groundhandling services and self-handling airports users benefit from a safeguard clause similar to the one existing in Regulation N° 95/93 above, which allows Member State to redress any unequal treatment by third countries.

In economic terms, the key third country restriction of the above package is the requirement for Community air carriers to be majority-owned and effectively controlled by Member States and/or their nationals. While the majority ownership of the capital means that third country investment in such carriers must not exceed 49.9%, the complementary *'effective control'*[42] condition may further limit such investment possibilities. Depending on the circumstances of an individual case, a single third country stake of almost 50% may well prevent Community shareholders from actually controlling the carrier within the meaning of the Regulation.

Community establishment requirements for air carriers and groundhandling services providers form *direct restrictions* on establishment and direct investment by third country operators in the air transport industry. Community rules governing the exercise of traffic rights can also be considered as a direct restriction insofar as they exclusively apply to a Community air carrier. In contrast, reciprocity requirements in the field of allocation, of slots and groundhandling services constitute only *indirect*, albeit powerful, *restrictions* vis-à-vis third country operators.

3.3.2. Maritime transport

In view of the establishment of the Single Market, the Community decided to apply the freedom to provide services to maritime transport within Member States and therefore to do away with the long-standing tradition of national measures previously limiting access to this market. This intra-EU liberalisation took shape thanks to the adoption of the necessary Community legislation in 1992. With respect to its relations with third countries, the Community had already adopted in 1986 several regulations which aimed at safeguarding the continuing application of commercial principles in shipping activities. Since Community shipowners were increasingly faced with new restrictions imposed by third countries on the freedom to provide maritime transport services, the Community considered that this discriminatory treatment might have harmful effects on its trade

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41 Council Directive 96/67/EC of 15 October 1996 on access to the groundhandling market at Community airports.

42 Regulation N° 2407/92, Article 2(g): "effective control means a relationship constituted by rights, contracts or any other means which, either separately or jointly and having regard to the considerations of fact or law involved, confer the possibility of directly or indirectly exercising a decisive influence on an undertaking, in particular by: (a) the right to use all or part of the assets of an undertaking; (b) rights or contracts which confer a decisive influence on the running of the business of the undertaking."

policy as a whole. Therefore, it was decided to endow the Community framework with the tools that would enable it to force third countries to progressively abolish existing restrictions and prevent the introduction of new ones. The most relevant capital movements provisions in the maritime transport framework are the following:

- Regulation N° 3577/92[43] applying the principle of freedom to provide services to maritime transport within Member States, reserves the benefit of its application to 'Community shipowners'. According to Article 2(2) of the regulation, a 'Community shipowner' shall mean, in particular, *"shipping companies established in accordance with the legislation of a Member State and whose principal place of business is situated, and effective control exercised, in a Member State"*. In contrast to air transport legislation, this regulation does not define the notion of 'effective control' in this context. At least, it is understood to mean either capital majority or board majority by Community nationals of undertakings. This requirement may influence investment decision by third country nationals and undertakings.

- Regulation N° 4055/86[44] applying the principle of freedom to provide services to maritime transport between Member States and between Member States and third countries reserves its application for (a) nationals of a Member State established in another Member State than the service beneficiary, and (b) national of Member States established outside the Community and to shipping companies established outside the Community and controlled by national of Member State. According to Article 7, the Council *"may extend the provisions of this regulation to nationals of a third country who provide maritime transport and are established in the Community"*.

3.3.3. Inland waterways transport

Existing restrictions on investment in this sector are as follows:

- Some very specific restrictions are laid down in Regulation N° 2919/85[45], which implements some provisions of the Revised Convention for the navigation of the Rhine of 17 October 1979. The six contracting states to this Convention are five EU Member States (Belgium, Germany, France, the Netherlands and the United Kingdom) and Switzerland. The Regulation stipulates that vessels may have access to the Rhine Navigation provided their owner is, inter alia, (a) a national of one of the contracting states, or (b) a legal person established in one of the contracting states, managed and directed by persons the majority of whom are nationals of contracting states residing or established in one of these states. Strangely, this Community regulation endorses a discriminatory treatment of

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[43] Council Regulation (EEC) N° 3577/92 of 7 December 1992 applying the principle of freedom to provide services to maritime transport within Member States (maritime cabotage).

[44] Council Regulation (EEC) N° 4055/86 of 22 December 1986 applying the principle of freedom to provide services to maritime transport between Member States and between Member States and third countries.

[45] Council Regulation (EEC) N° 2919/85 of 17 October 1985 laying down the conditions for access to the arrangements under the Revised Convention for the navigation of the Rhine relating to vessels belonging to the Rhine Navigation.

certain Member States with respect to direct investment and establishment in this specific area.

- Regulation N° 3921/91[46] entitles carriers to carry out transport of goods or persons within a Member State in which he is not established provided, inter alia, (a) he is established under the laws of a Member State and (b) the vessels used for this purpose are owned either by natural persons who are national of a Member State or by legal persons which are majority-owned by Member States nationals.

- Regulation N° 1356/96[47] implements the freedom to provide transport services of goods and passengers between Member States. In essence, the conditions under which carriers may supply such transport services are similar to these imposed under Regulation N° 3921/91.

3.3.4. Fisheries

- Regulation N° 2792/1999[48]provides for, in particular, a management of Community fleet in such a way that its capacity does not exceed the annual fishing objectives fixed in the 'Multiannual Guidance Programme' (annual limits for the exploitation of the main species and sharing of quota between Member States) adopted for individual Member States. To achieve this, one of the appropriate measures at the disposal of Member States is the cessation of fishing activities through the permanent transfer of the vessel to a third country, which implies a permanent exclusion of fishing in Community waters. For this purpose, Member States may take measures to promote the creation of 'joint enterprises' with one or more partners who are nationals of the third country in which the vessel is registered.

- According to Regulation N° 104/2000[49], all fishing vessels flying the flag of one of the Member States will enjoy equal access to ports and first-stage marketing installations throughout the Community.

3.3.5. Energy

- The Community is contracting party to the Energy Charter Treaty. According to this Treaty, the Community will endeavour to accord to investors from other contracting parties as regards investment in the Community (the "Making of Investments") 'most favoured nation' treatment. A supplementary treaty is supposed to establish binding rules as regards the freedom of energy related capital movements between contracting parties.

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[46] Council Regulation (EEC) N° 3921/91 of 16 December 1991 laying down the conditions under which non-resident carriers may transport goods or passengers by inland waterway within a Member State.

[47] Council Regulation (EEC) N° 1356/96 of 8 July 1996 on common rules applicable to the transport of goods or passengers by inland waterway between Member States with a view to establishing freedom to provide such transport services.

[48] Council Regulation N° 2792/1999 of 17 December 1999 laying down the detailed rules and arrangements regarding Community structural assistance in the fisheries sector.

[49] Council Regulation N° 104/2000 of 17 December 1999 on the common organisation of the markets in fishery and aquaculture products.

- Under Directive 94/22/EC[50], the Commission may, according to Article 8, propose that the Council allows one or more Member States to refuse authorisation to an entity of a third country, if that third country does not grant Community entities a treatment comparable to that granted by the Community to third country residents.

3.3.6. Audiovisual

At present, there are no Community rules which would prevent or restrict an investor from abroad, be it from another Member State or a third country, investing in the Community audio-visual sector (freedom of investment), or prevent or restrict a foreign branch or subsidiary from operating in the Community audio-visual sector on equal terms with Community controlled companies (national treatment). This does not exclude that such restrictions exist on the level of individual Member States.

However, the existing Community framework covering this sector contains various *'performance requirements'* and *'Community incentives'* which impact indirectly on freedom of investment and establishment:

- Directive 89/552/EEC[51] implements certain provisions laid down in the *European Convention on Transfrontier Television* adopted by the Council of Europe, which aims at promoting European audio-visual markets by privileging works of such origin in television broadcasting. According to Article 4 of the Directive, broadcasters must reserve a majority of their transmission time for European works (i.e. originating from Member States, European third countries party to the Convention, or other European third countries with which the Community has concluded agreements relating to the audio-visual sector).

- Council Decision 2000/821/EC[52] provides for Community financial support with a view to encourage the development of European audiovisual works. Undertakings benefiting from Community funding must be owned, whether directly or by majority participation, by Member States and/or by nationals of Member States, although this programme may also be opened to some European third countries.

- Decision N° 163/2001/EC[53] implements a training programme focussing on new digital technologies, the cost of which is substantially funded by the Community. The beneficiaries of this programme have to be nationals of either Member States or European third countries listed in the Decision.

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[50] Directive 94/22/EC of the European Parliament and of the Council of 30 May 1994 on the conditions for granting and using authorisations for the prospection, exploration and production of hydrocarbons.

[51] Council Directive of 3 October 1989 on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities.

[52] Council Decision 2000/821/EC of 20 December 2000 on the implementation of a programme to encourage the development, distribution and promotion of European audiovisual works (MEDIA Plus, 2001-2005).

[53] Decision N° 163/2001/EC of the European Parliament and of the Council of 19 January 2001 on the implementation of a training programme for professionals in the European audiovisual programme industry (MEDIA Training, 2001-2005).

3.3.7. Financial services

3.3.7.1. Direct investment and establishment

Besides the achievement of the internal market, the Community framework on financial institutions and their activities established fundamental rules governing the economic relations between the Community and third countries in these areas. Some restrictions apply on direct investments in and establishment of such financial institutions, either vis-à-vis other Member States or third countries.

As far as third countries are concerned, the framework was characterised by the imposition of reciprocity requirements in the field of market access (i.e. first entry, or pre-establishment) and the provision of financial services (post-establishment). While the Directives involved are still in force, most third country restrictions have been waived by the Community under the GATS. Implicitly, this means that third country restrictions remain exclusively binding for non-WTO members.

Existing restrictions in the various segments of the financial sector are as follows:

- Credit institutions are subject to specific restrictions laid down in Directive 89/646/EEC[54] and Directive 2000/12/EC[55]. When Community credit institutions are not granted by a third country (a) *'effective market access'* comparable to that granted by the Community to credit institutions from that third country and (b) *'national treatment'* in the carrying-on of banking activities, Member States must limit or suspend their decisions regarding pending requests for authorisations and acquisitions of holdings by direct or indirect parent undertakings governed by the laws of the third country in question.

- Restrictions affecting non-life and life insurance companies, which are laid down respectively in Directive 90/618/EEC[56] and Directive 90/619/EEC[57], are similar to these provided for in the above directives governing credit institutions.

- In the field of securities, Community investment firms benefit also from similar reciprocity requirements and redress facility, in accordance with the provisions of Directive 93/22/EEC[58]. Furthermore, Directive 89/298/EEC[59] provides also for a reciprocity requirement vis-à-vis third countries with respect to the recognition of

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[54] Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC.

[55] Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions.

[56] Council Directive 90/618/EEC of 8 November 1990 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance.

[57] Council Directive 90/619/EEC of 8 November 1990 on the coordination of laws, regulations and administrative provisions relating to direct life assurance.

[58] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.

[59] Council Directive 89/298/EEC of 17 April 1989 coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public.

public offer prospectuses drawn up and scrutinised in accordance with the laws of the non-member.

- According to Directive 85/611/EEC[60], undertakings for collective investment in transferable securities (UCITS) must be located in the Member State where the investment company or the management company of the unit trust has its registered office. Furthermore, the head office must also be located in the same Member State.

Following striking failures in the field of supervision of Community financial institutions in the beginning of the past decade, the above directives were amended by Directive 95/26/EC[61] with a view to reinforcing prudential supervision across the whole financial services sector. One of the objectives pursued was that the competent authorities of Member States should not authorise a financial undertaking to carry on its business if close links[62] between that undertaking and other natural or legal persons might prevent an effective exercise of supervisory functions. This measure is equally applicable on Member States and third countries.

Moreover, this Directive introduced for insurance undertakings and credit institutions the general requirement that head offices be situated in the same Member State as their registered office (as already provided for by the UCITS Directive).

4. INTERNATIONAL MEMBER STATES AND EU COMMITMENTS

As described above, the Community regime on capital movements not only establishes the fundamental principle of freedom of transactions and related payments, but also provides for the introduction or maintenance of restrictions by Member States and the European Community. While restrictions at the disposal of EU Member States impact on capital movements to or from either other EU Member States or third countries, restrictions adopted by the Community under Article 57(1) and (2) EC affect capital movements between all EU Member States and third countries.

Among the four fundamental freedoms provided for by the Treaty of Rome in 1958, the freedom of capital movements was the last to be achieved (in 1990). It meant also an advanced stage of economic and financial development and integration for the Community, which materialised in the creation of a single market nearing completion. However, this European integration took shape during a more general process of international economic policy co-operation which impacted, in particular, on the treatment of capital movements and payments.

Shortly after World War II, the Articles of Agreement of the International Monetary Fund provided for the liberalisation of payments and current transfers. In 1961, the members of

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[60] Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

[61] European Parliament and Council Directive 95/26/EC of 29 June 1995 amending (various Directives) with a view to reinforcing prudential supervision.

[62] 'Close links' means a situation in which two or more natural or legal persons are linked by participation or control.

the new Organisation for Economic Co-operation and Development adopted a Code of Liberalisation of Capital Movements with a view to remove restrictions "to the extent necessary for effective economic co-operation". Furthermore, the General Agreement on Trade in Services provided also for commitments in the field of establishment of third country service providers.

Depending on the forum involved, either EU Member States took part individually in the liberalisation process as sovereign countries, or the Community and its Member States were the relevant parties. By definition, commitments entered into by an EU Member States as a member of an international organisation have to be consistent with the EU framework on capital movements. However, these commitments generally represent a combination of EU adopted texts dealing in particular with capital movements (see above regulations and directives) and self-decided implementations of EU Treaty restrictions (according to Articles 57 to 60 EC).

Because international forums diverge in geographical scope and methodology, the aggregation of both types of commitments by all EU Member States cannot give a comprehensive view on the external part of the EU regime on capital movements, but a reliable estimation instead. Moreover, it gives information on restrictions adopted independently by EU Member States according to Treaty exceptions (which are not subject to notification under Treaty rules). Finally, it indicates the respective nature and intensity of restrictions maintained by EU Member States, and allows us therefore to derive some general conclusions on the potential internationalisation of ownership of assets within the European Community.

4.1. The OECD Code of Liberalisation of Capital Movements

4.1.1. Structure and principles

Besides the reduction or abolition of obstacles to the exchange of goods and services and current payments, one of the essential objectives of the OECD is "to maintain and extend the liberalisation of capital movements"[63]. This founding principle materialised in the two OECD Codes of Liberalisation on, respectively, "Capital Movements" and "Invisible Operations" (dealing with cross-border services). Both codes are flexible frameworks allowing OECD members to define freely their own pace of liberalisation of capital movements and services, and to consolidate the opening process by making their commitments largely irreversible. Although the codes are legally binding instruments, commitments cannot be enforced insofar as no jurisdictional body was foreseen[64]. Therefore, the correct implementation of commitments essentially relies on a compliance review process and peer pressure.

The *Code of Liberalisation of Capital Movements* comprises two separate lists of transactions. The original List A covers medium- and long-term transactions. List B, which was added to the Code's obligations in 1989, covers short-term capital flows and real estate acquisitions. Although the content of these two lists of capital movements is very close to the EU nomenclature of capital movements, the principles governing both liberalisation instruments perceptibly differ.

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[63] Article 2(d) of OECD Convention of December 1960

[64] The only ultimate sanction would be the exclusion from the organisation.

Box 2. Main provisions of the OECD Code

General undertaking: Members subscribe to a general undertaking to fully liberalise capital movements (and invisible operations) on a cross-border basis.

Lodging of reservations: With a view to cover remaining restrictions, members may lodge and maintain reservations for specific transactions (a) exclusively by the time they subscribe to the general undertaking for items of List A (standstill obligation), and (b) at any time for items of List B. *Under the EU regime, Member States either have to enforce the mandatory restrictions provided for by Community regimes or may have recourse to the limited exceptions provided for by the Treaty.*

Non-discrimination: By default, other OECD members may not be discriminated under the Code. However,

(a) the *first exception* concerns provisions to ensure compatibility with "special customs or monetary systems" (to date only the European Community and the Belgium Luxembourg Economic Union have been officially recognised as such)) where broader internal liberalisation does not have to be extended to all OECD members automatically.

(b) the *second exception* consists in either imposing reciprocity requirements in specific areas or applying a discrimination among investors originating in various OECD members (other than the discrimination resulting from "special customs or monetary systems"). However, the OECD has never officially determined whether the Annex E which governs reciprocity is 'open' (i.e. allows new reciprocity requirements) or 'closed' (i.e. does not). *Discriminatory practices vis-à-vis other EU members are prohibited under the EU regime, with the exception of limited Treaty exceptions. As far as third countries are concerned, discriminatory treatment may be imposed by Community regimes or applied by Member States for specific transactions. Formally, the regime does not allow for discriminatory treatment between several third countries.*

Public order and security: OECD Codes provides for the right of members to refer to "public order and security" considerations in order to reintroduce restrictions. Such restrictions may be used by members when circumstances require their application, without any need to lodge a reservation for specific transactions (which implies a relative lack of transparency for this type of restrictions, at least in comparison with classical reservations). *Under the EU regime, members have also the right to freely decide to recourse to these Treaty exceptions, although their implementation has to comply with the principles established by the Court of Justice.*

National interest measures: Direct investment is free in principle, unless (a) it has a purely financial character, or (b) "a specific transaction or transfer would have an exceptionally detrimental effect on the interests of the Member concerned". *In practice, these measures allow the protection of national interests of economic nature, while these are not acknowledged as admissible exceptions under the Treaty.*

Derogation clause: When liberalisation measures result either in serious economic and financial disturbances or deterioration of the balance of payments, members may benefit from derogation clauses which allow them to reintroduce controls on a temporary basis. *EU Member States which have not adopted the euro and experience a serious deterioration of their balance of payments may reintroduce restrictions on specific capital movements, provided these are approved by the Community. In contrast, "economic and financial disturbances" are not recognised by the Treaty as a justification for temporary controls on capital movements.*

Prudential measures: Although OECD Codes recognise the risks possibly encountered by financial sectors in economies characterised by liberalised capital accounts and the corresponding need to reintroduce restrictions or controls on a temporary basis, permanent prudential measures laid down in financial sector regulations are not covered by a specific prudential carve-out. Actually, prudential measures are not viewed as restrictions and, therefore, no reservation under the Codes' obligations needs to be lodged. Implicitly, OECD members remain free to impose the measures that they consider to be appropriate, which may possibly lead to excessive restrictions and/or discrimination of other OECD members. *Under the Treaty, prudential measures are considered as restrictions, but may be justified by a general prudential carve-out provision. Depending on the financial activities involved, these prudential measures may be defined by directives, and therefore benefit from a minimum harmonisation.*

The general provisions of the *Code of Liberalisation of Current Invisible Operations* are very similar to the ones governing the above Code. All invisible operations (i.e. cross-border services) covered are mentioned in one comprehensive list annexed to the Code. Although this other Code does not formally deal with capital movements, two specific items of the list do not represent a service, but express a condition for establishment instead (and implicitly, for direct investment): [D/6] Conditions for establishment and operations of branches and agencies of foreign insurers; [E/7] Conditions for establishment and operations of branches, agencies, etc. of non-residents investors in the banking and financial services sector. Therefore, any reservation lodged under these two items constitute de facto a restriction on capital movement, which complements existing reservations under the Code of Liberalisation on Capital Movements.

4.1.2. Implementation by EU Member States

A review of the list of reservations lodged by EU Member States[65] shows that, as far as List A is concerned, *foreign direct investment* is by far the most affected transaction in most sectors and countries, and some capital market operations are not entirely liberalised in a few countries. Under List B, most reservations lodged regard *real estate transactions*, which appear to be restricted in about half of Member States, while short-term operations have been fully liberalised by all countries but one.

Logically, reservations in the field of *foreign direct investment* cover in priority economic sectors which either have been largely liberalised and privatised in the 1990's (television, broadcasting, energy, etc.) and/or are covered by strategic economic policies of the Community governing, in particular, investment and establishment (air transport, shipping, fishing, financial services, etc.).

With regard to the latter category, it is confusing to note that some Member States have not mirrored in the list of reservations (vis-à-vis non-EC members) the mandatory restrictions on investment existing in EU directives vis-à-vis third countries (Luxembourg being an extreme example, with no reservations lodged). Obviously, some Member State positions are inconsistent with the EU regulatory framework. Moreover, each OECD member being responsible for drawing up its reservations, the respective positions of EU Member States often fall short of the necessary harmonised wording (some sector-related reservations which should identical alternatively refer to ownership, investment, or acquisition, either in general or exclusively vis-à-vis non-EC members).

The reservations applying to economic sectors where FDI is not restricted in accordance with Community policies and legislation generally reflect the need for some EU Member States to protect strategic domestic sectors from investments originating from non-EC third countries. Presently, they usually are specific to one country's need, and apply on primary (agriculture, mining, minerals) and tertiary economic sectors (auditing, legal services, tourism, gaming).

Broadly speaking, the wording of EU Member States' reservations is at least imprecise, if not inconsistent with the EU legislation. Fundamentally, this might result from the lack of

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[65] See Annex X. Although this table is based on the reservations to the Code of Liberalisation of Capital Movements published by the OECD (as of May 2001), these are expressed in a summarised way for editing purposes, and should therefore not be confused with the binding reservations of the OECD Code.

jurisdiction body and enforcement procedures under OECD Codes. Beyond this, the list of reservations lodged by EU Member States keeps probably silent about other restrictions affecting FDI which might be justified, according to the state involved, by “public order and security” considerations. Since the Code does not prescribe clear notification requirements for these restrictions, OECD members may decide not to lodge reservations for this purpose. As far as EU Member States are concerned, the argument can be supported, in particular, by the “special rights”-related cases identified in the past years, which obviously bear on the freedom to invest. Without giving an opinion on the acceptable character of these “public order and security”-related restrictions which might be applied by OECD members, it can be argued that the Code lacks transparency on this issue.

In the field of *real estate transactions*, the scope of reservations is pretty well defined and these concern, according to the country involved, either residential or business purposes. However, as for direct investment, the list of reservations lodged seems too thin in consideration of the numerous and fairly cumbersome rules which govern real estate acquisition in most EU Member States. Even though such purchases are generally liberalised insofar as they relate to direct investment and establishment, purchases of agricultural land and secondary residences are often subject to “authorisation procedures” which impose strict conditions for potential foreign and national buyers. While these conditions are not well-defined restrictions (and are not considered as such by OECD Codes), they may lead nonetheless to administrative refusals in many cases. Again, infringement cases identified in Member States in the past years tend to support this view.

Finally, if one disregards common EU Member States’ reservations which should mirror the existing restrictions in the EU framework, the list reveals, at least formally, a contrasted use of restrictions to capital movements. At one end of the range, some countries are sparingly using the provisions of the Code (such as Luxembourg, Belgium, Germany, Netherlands, United Kingdom, etc.), while others (France, Greece, Italy, Portugal, etc.) tend to indicate more restrictions in place.

4.2. The General Agreement on Trade in Services

4.2.1. The integrated approach of the World Trade Organisation

The World Trade Organisation (WTO) is an inter-governmental treaty that entered into force on 1 January 1995. Its objective is to develop an integrated and durable multilateral trading system, and to provide a forum for negotiations on trade relations. For this purpose, it established a single institutional framework for three multilateral agreements resulting from the Uruguay Round negotiations (1986-1993): the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS), and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

These three agreements form a WTO package which has in common a set of fundamental institutional provisions, as well as a dispute settlement mechanism for ensuring that obligations are observed. Individual EU Member States are members of the WTO and its three agreements. However, negotiations are carried out by the European Commission on behalf of the EU as a whole, which is a member without a vote.

4.2.2. Structure and principles of the GATS

The GATS is the services element of the WTO, which establishes a basic set of rules for world trade and investment in services. Apart from general undertakings, members of the GATS enter into specific liberalisation commitments that are binding and subject to enforcement. Although original members submitted schedules of specific commitments for the entry into force of the GATS, this agreement is built upon the principle of progressive liberalisation. Members undertake periodic negotiating rounds aiming at improving existing commitments and thus achieving a higher level of liberalisation.

In order to take account of the particular nature of services, the GATS identifies four modes of supply on a cross-border basis, depending on the origin of the service supplier or consumer, and the degree and type of territorial presence that they have at the time of service delivery: (1) cross-border supply, (2) consumption abroad, (3) commercial presence, (4) presence of natural persons. Given the issue under consideration, 'commercial presence' must be highlighted among the several modes of supply since it is the only one which deals directly with establishment (which is a specific form of direct investment under the EU Treaty), and thereby with capital movements[66] in the host country and possible restrictions thereof.

This mode of supply means that the service supplier crosses the border to establish a commercial presence abroad through which the service is provided. This presence can materialise in any type of professional establishment in a foreign market, such as subsidiaries, branches or representation offices of the parent company. Therefore, the degree of openness, vis-à-vis third countries, of the possible ownership of service providers established in the EU can be assessed by analysing the respective commitments of the Community as a whole and EU Member States under the GATS.

4.2.3. *Community and EU Member States' commitments*

First of all, members have to select the services sectors and modes of supply which are covered by the basic commitments provided for by the GATS, i.e. 'Market Access' and 'National Treatment'. Modes of supply not benefiting from liberalisation commitments are qualified as 'unbound'. These specific liberalisation commitments complement the basic 'Most Favoured Nation' treatment obligation that applies by default to all sectors.

In a second stage, GATS members have the possibility to list in schedules the exceptions to the MFN treatment that they want to apply vis-à-vis particular sectors and/or particular members. Similarly, they can indicate for each sector the limitations affecting their liberalisation commitments with regard to 'Market Access'[67] and 'National Treatment'[68].

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[66] According to the GATS, in case of supply through a commercial presence, the corresponding capital flows directly related to the establishment also need to be liberalised.

[67] According to Article XVI of GATS, 'Market Access' undertakings may be exclusively subject to limitations in the six following areas: number of service suppliers, the value of transaction or assets, the number of operations or total quantity of output, the number of natural persons that may be employed, the nature of legal entities permitted to supply services, and the extent of participation of foreign equity in an enterprise.

[68] According to Article XVII of GATS, 'National Treatment' may be conditioned by any kind of specified discriminatory measure.

Box 3. Main provisions of the GATS Agreement

Most Favoured Nation Clause: According to this general undertaking, each GATS member must treat services and service suppliers from any other member in an identical way (non-discrimination principle). For many members, this MFN undertaking is complemented with a standstill commitment, so that liberalisation cannot be reversed (unless other members receive financial compensation in exchange).

Exceptions to the MFN Clause: The agreement gave once and for all an opportunity for members to lodge exemptions to the MFN obligation before the GATS entered into force, in order to favour specific trade partners. These exemptions have to be described in a list, and should not last longer than ten years.

Liberalisation commitments: Apart from the above MFN undertaking, any progress in liberalisation results from the commitments made by each member in the following areas:

(a) The *market access* provision covers the four modes of delivery, and provides for any member granting other members treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its schedule (under the GATS, there is no obligation to grant market access by any one of the four modes of delivery; if a member commits to grant access to its market, existing legal and quantitative limitations have to be described in its schedule; full market access is deemed to be granted when no limitations are imposed).

(b) The *national treatment* provision establishes that, once firms have been granted market access subject to the conditions mentioned under the above schedule, they may not be discriminated against within the market. This equal treatment of foreign and domestic services/service providers on the same market is called 'national treatment' (as for 'market access', any discriminatory restrictions affecting the granting of 'national treatment' to foreign services/service providers have to be described in each member's schedule).

Furthermore, for sectors where 'market access' and 'national treatment' commitments are made, the GATS stipulates that domestic regulations must be applied by a member to foreign services/service suppliers in a reasonable, objective and impartial manner (proportionality principle), so as to avoid that services market opening become illusory. For this purpose, foreign suppliers must be able to challenge administrative decisions and be informed if an application for authorisation is rejected.

Public policy considerations: The GATS provides for the right of members to adopt restrictive measures necessary to achieve public policy objectives. These measures have to satisfy the proportionality test described above, and fall under the scope of the dispute settlement provisions.

Dispute settlement: The GATS contains binding obligations on commitments from member countries. When a foreign operator considers that liberalisation undertakings are not satisfied, its government (or the Commission, for EU Member States) may decide to bring the issue to the WTO dispute settlement system. The examination of the case by a panel of experts may lead to the adoption of binding rulings by the Dispute Settlement Body (DSB). Should the offending member fail to bring inconsistent measures into conformity, compensation can be obtained through either new commitments in other areas or suspension of concessions previously granted to the offending member (both options being subject to final approval of the DSB).

A overall review of the European Community position under the above framework for mode 3 of supply (‘commercial presence’) sheds light on the scope and intensity of the liberalisation of (non-EC) foreign direct investment and establishment in the Community. Implicitly, it reveals – exclusively for the services sector – the direct link between commitments entered into by the European Community under the GATS and the existing restrictions to capital movements (mainly investment) adopted either by the Community through EC regulations and directives or independently by EC Member States in pursuance of admissible exceptions provided by the Treaty. As far as mode 3 is concerned, Community commitments vis-à-vis the GATS are ultimately conditioned by their necessary consistency with the EC regulatory framework in the field of capital movements, i.e. Articles 56 to 60 of the Treaty.

4.2.3.1. MFN exemptions

The bulk of sector-related exemptions to MFN treatment concerns *audio-visual services*. Depending on the services involved, different groups of countries (EEA countries, Parties to the Council of Europe Convention on Transfrontier Television, countries with whom cultural co-operation may be desirable, etc.) benefit from a preferential EC treatment in this sector. These MFN exemptions simply reflect the preferential provisions enshrined in the Community framework on audio-visual services.

Another sector where many MFN exemptions have been lodged is *transport*. In particular, road transport services provided on the respective territories of bilateral contracting members may benefit from a preferential treatment in consideration of its regional characteristics. For internal waterways transport, exemptions mainly result from existing EC regulations governing access on inland waterways, in particular the Rhine-Main-Danube conventions and their nationality requirements regarding ownership.

Foreign participation from all other members in the capital of companies active in *Publishing and News Agency services* are respectively subject to restrictions in Italy and France. In the field of direct non-life insurance, Switzerland is the sole country to benefit from a freedom of establishment in accordance with the bilateral agreement signed between both parties.

While the rest of MFN exemptions apply to *all sectors*, they generally result from the preferential treatment granted either by the European Community or specific EC member States through bilateral agreements with specific countries or groups of countries (e.g. Denmark gives preferential financial support to other Nordic countries in the context of the development of Nordic co-operation; Portugal waives domestic nationality requirements for the exercise of certain activities and professions by nationals of countries of Portuguese official language; France facilitates access procedures to certain activities and professions by persons originating from specific French speaking countries; etc.). Apart from these country-specific exemptions, the EC schedule contains also all sectors exemptions directly resulting from bilateral agreements concluded between the European Communities (and Member States) and certain third countries, out of which some provide for the right of establishment for legal and natural persons.

4.2.3.2. Horizontal limitations on ‘Market Access’ and ‘National Treatment’

The European Community has lodged horizontal limitations on ‘Market Access’ and ‘National Treatment’ for all sectors included in its commitments schedule. Some of these limitations are applied indistinctly by all EC Member States, and constitute therefore an

EC restrictive regime towards third countries. Others are applied by certain EC Member States in pursuance of their Treaty right to maintain certain third country restrictions. Horizontal limitations lodged by the EC relate exclusively to mode three of supply (‘commercial presence’).

As far as *EC restrictions* are concerned, ‘Market Access’ in services considered as public utilities at a national or local level may be limited for other members, insofar as these may be subject to public monopolies or to exclusive rights granted to private operators (in accordance with the provisions of Article 86 EC, dealing with competition rules). Furthermore, the EC grants ‘National Treatment’ exclusively to subsidiaries of third country companies formed in accordance with the law of a Member State and having their registered central administration or principal place of business within the Community (in accordance with the provisions of Article 48 EC, dealing with the right of establishment). However, the description of this limitation further points out that Member State have the right to extend this treatment to branches and agencies, unless such extension is explicitly prohibited by Community law. It might however be noted that such restrictions on branches can be usually circumvented by the establishment of a third country subsidiary in another Member State with branches into the Member State with the restrictions.

As to *MS restrictions*, ‘Market Access’ is limited for real estate acquisition by third country legal and natural persons in Denmark (in general) and Greece (border areas). Moreover, investments in domestic companies is subject to various types of restrictions in France, Spain, Portugal, and Italy. According to their description, these restrictions target direct investment, and are generally implemented through authorisation procedures that seem to give national authorities a large degree of discretion (objective criteria are rarely mentioned). Strangely, some restrictions on real estate acquisition are also qualified as limitations to ‘National Treatment’ in Germany, Ireland and Italy. In these first two countries, foreign persons have to obtain a prior authorisation before buying, while Italy is declared unbound for such acquisitions.

4.2.3.3. Sector-specific commitments

Under the GATS, services are classified in accordance with a nomenclature which was developed during the Uruguay Round. Members are invited to list their commitments in specific schedules relating to the categories of services defined in the nomenclature. Similarly, the absence of commitment for a specific service (‘unbound’) or any limitation to ‘Market Access’ and ‘National Treatment’ has to be mentioned in these schedules.

Although the product nomenclature is aggregated, it nonetheless lists a fairly extensive number of sectors and sub-sectors which are supposed to accommodate the respective needs of members to express specific liberalisation commitments and limitations thereof, for the four modes of supply of services. Considering the focus on capital movements openness, only existing EC commitments under mode three of supply (‘commercial presence’) will be considered. Furthermore, given the detailed character of the nomenclature and corresponding undertakings, the review of the EC position will only aim at identifying the most relevant restrictions vis-à-vis third countries (and the extent to which these are originating in the EC regulatory framework) in the eleven aggregated sectors distinguished by the GATS.

(1) Business services: This category includes an heterogeneous list of services which all provide an input to businesses (sub-categories are ‘professional’, ‘research and

development', 'rental/leasing', 'computer', 'real estate', 'other'). Given the global outreach of some industries, relating business services suppliers tend also to move across borders. In general, access to these markets under GATS is pretty liberal in comparison to other categories of services. This is especially valid for the EC market.

Only two types of services are not subject to EC commitments: services incidental to (a) manufacturing, and (b) energy distribution. For many other services, full liberalisation commitments were expressed under mode three by all EC Member States. The existing limitations are overwhelmingly in 'Market Access'. There is one horizontal EC limitation on 'Market Access' for 'rental/leasing services without operators relating to aircraft', which directly results from the Community ownership requirement laid down in the EC air transport legislation. Apart from this, 'Market Access' in some other services may be limited in certain Member States. Broadly, these restrictions tend to be more frequent in specific Member States: France, Italy, Spain, and Portugal tend to recourse more to such limitations, in particular in the field of 'professional services' (engineering, veterinary, accounting, medical and dental, etc.).

(2) Construction and related engineering services: Since the establishment of construction service suppliers near the site of construction projects is generally necessary, most commitments are on mode three. Among the two types of services which form this category, 'site investigation work' is unbound for the whole Community, while 'Market Access' for 'construction and related engineering services' is only limited in Greece, Italy, and Portugal.

(3) Educational services: 'Market Access' is free in primary, secondary, and adult education services, but subject to limitations in 'higher education services' in Greece, Italy and Spain.

(4) Financial services: For this sector, the EC chose to adhere to the 'Understanding on Commitments in Financial Services', which is a alternative option for specifying liberalisation commitments and relating reservations that goes beyond the traditional scope of schedules insofar as it contains also complementary commitments dealing with procurement rules, the treatment of new financial services, and a standstill commitment. Furthermore, commitments are based on MFN treatment.

Financial services are divided among insurance services on the one hand, and banking and other services on the other hand, which are each subject to their own horizontal commitments on mode three ('commercial presence').

All 'insurance and insurance-related services' are subject to various national restrictions which generally discriminate between the different forms of establishment of a commercial presence on the territory of EC Member States. As far as 'Market Access' is concerned, branches and representation offices do not benefit in some Member States (Austria, Greece, Spain, Sweden) from the right of establishment granted to subsidiaries. In other cases, branches may establish but cannot supply the full range of insurance services (e.g. statutory insurance services in Finland, insurance intermediation in Portugal). Apart from this, the establishment of branches may also be subject to additional technical requirements (Spain, Portugal) or authorisation procedures (Italy, Spain). With regard to 'National Treatment', Finland and Sweden apply residency requirements for, respectively, high ranking executives of foreign companies and founders. In addition, Sweden obliges foreign companies non incorporated in the country

to deposit assets for agencies established in Sweden, and taxes them on premium income instead of net results.

'Market Access' in the field of 'Banking and other financial services' is limited by a combination of EC and Member States restrictions in the various sub-categories of services. The sole EC restrictions derives from specific provisions of the UCITS Directive 85/611/EEC, which stipulates that managing unit trusts and investment companies requires the establishment of a specialised management company, while only firms having their registered office in the Community can act as depositories of assets of investment funds.

Some national restrictions may directly restrict the establishment of foreign banks, e.g. subsidiaries and branches are subject to an 'economic needs test' in Austria and Portugal, representative offices are not covered by the scope of establishment in Ireland, the acquisition of more than one third of shares is subject to an authorisation procedure in Finland. However, most national restrictions affect either the establishment of more specialised institutions or the supply of specific banking and other financial services by foreign operators. For instance, in Finland, money transfers from governmental entities are reserved for two Finnish operators. In Austria, pension funds services may only be offered by specialised companies incorporated as a stock company in accordance with national laws, and mortgage and municipal bonds may only be issued by specialised institutions licensed for this activity. In Italy, clearing and settlement of securities may only occur through the official domestic clearing system while deposit, custody and administration services for government securities is reserved for two Italian operators.

However, the largest category of restrictions by far regards trading activities for own account or for account of customers, and includes limitations lodged by most EC Member States. In particular, foreign exchange trading is subject to authorisation in Austria, and derivative trading is subject to citizenship and residency requirements for market makers and brokers. Moreover, the provision of securities trading services remains limited in a majority of Member States (Austria, Belgium, Denmark, Spain, Finland, Greece, Italy, Netherlands, Portugal, and United Kingdom). Usually, the restriction consists in an incorporation requirements for suppliers. Furthermore, a few exceptions to 'National Treatment' are retained by France, Italy and Sweden.

(5) Tourism and travel related services: The EC position in this sector is a very liberal one, and few restrictions remain. For 'hotels and restaurants', 'Market Access' is only limited in Greece, Italy, Portugal, and Spain by way of authorisation procedures designed to protect areas of particular historic and artistic interest. For 'travel agencies and tour operators services', restrictions only remain in Belgium, Italy and Portugal (usually, establishment requirements and economic needs test).

(6) Transport services: Broadly, the Uruguay Round had limited implications for the whole transport sector. The European Community commitments could not distinguish itself, since potential offers were conditioned beforehand by existing provisions of its secondary legislation imposing already restrictions vis-à-vis third country investment and establishment.

In this context, no liberalisation commitments was made by the EC for five sub-sectors (out of six) of 'maritime transport services', and no commitments were made for five sub-sectors (out of six) of 'internal waterways transport'. Due to existing investment and ownership restrictions in the Community framework governing 'air transport services',

no liberalisation commitments could be made in the sub-sectors of 'passenger transportation', freight transportation', and 'rental of aircraft with crew' ('Market Access' was only granted for air transport auxiliary services such as 'maintenance and repair of aircraft' and 'supporting services for air transport'). In the same way, no commitment was made on 'rail transport services' (although this does not derive from Community framework constraints), with a minor exception in maintenance services. In contrast, 'Road transport services' appears to be the sub-sector where liberalisation has been pretty substantial ('Market Access' is generally granted although a broad range on restrictions remains (unbound, establishment requirements, economic need test, etc.). Moreover, no commitment has been expressed for 'space transport' and 'pipeline transport'.

(7) Communication services: The scope of liberalisation of the communication sector is very contrasted insofar as the Community did not commit for four (out of five) sub-sectors, i.e. 'postal services', 'courier services', 'audio-visual services', and 'other services', while the last one, i.e. 'telecommunication services', is only limited by a few restrictions, in particular in mode three of supply.

For all sub-sectors falling under 'telecommunication services', 'Market Access' is limited in Finland by an EEA residence requirement for high ranking executives. In Greece, foreign operators are required to establish through a limited company. Finally, in France and Portugal, participation of non-EC investors in domestic firms cannot exceed, respectively, 20% and 25% of the capital.

(8) Distribution services: Although few GATS members have taken commitments so far, the distribution sector in the European Community is largely open to foreigners. Among the four sub-sectors, two are fully open on mode three of supply, i.e. 'commission agents' services' and 'franchising'. 'Market Access' in 'wholesale trade services' and 'retailing services' is essentially limited by existing monopolies on tobacco (Spain, Italy, and Portugal) and, as far as the latter is concerned, economic needs test for department stores.

(9) Environmental services: The EC market for environmental services is substantially open in general, and fully open with respect to mode three of supply (no limitation has been maintained in this particular mode).

(10) Health related and social services: The EC offer in this area has been very modest. Almost half of Member States have lodged limitations on 'Market Access' under mode three of supply in 'hospital services'. Usually, the level of medical equipment or the number of beds is curbed by public health services plans defining these thresholds on the basis of objective population needs. These criteria may be vested in authorisation procedures. 'Market Access' in 'social services' is almost fully liberalised. In contrast, the EC has not made any commitment for all remaining heath related and social services.

(11) Recreational, cultural, and sporting services: Broadly speaking, the EC offer in this area is liberal, with one notable exception. While no commitments were made for 'libraries, archives, museums', full 'Market Access' and 'National Treatment' is guaranteed by almost all Member States for the other sub-sectors. Only France and Italy are unbound for the granting of subsidies and financial support for 'entertainment services' (limitation to 'National Treatment'), while foreign equity participation in 'news agency services' is limited in France (20% for publishers, unbound for press agencies), Italy (49%), and Portugal (10%).

4.3. Multilateral and Bilateral Agreements of the European Community and Member States with Third Parties

Since the entry into force of the present regime on capital movements (1 January 1994), capital movements to and from third countries fall under the scope of the Treaty, while they were before exclusive Member States' responsibility. However, if Treaty coverage is formally indisputable, some ambiguity remains with respect to competence holding in this area.

On the one hand, Community competence on third country relations clearly derives from Articles 57(2), 59, and 60 of the Treaty, which empower the Council to adopt measures impacting on capital movements with third countries. On the other hand, Article 57(1) EC grants some residual competence on specific external capital movements to Member States insofar as it acknowledges their right to freely soften or remove restrictions existing by 31 December at the latest (without any action of the Community in this process). Furthermore, as far as investment issues are concerned, Treaty coverage does not exclusively derive from the 'capital movements' chapter, but from the 'right of establishment' chapter too (establishment being one particular form of direct investment). As the latter chapter provides for the implementation of its provisions through secondary legislation, it implicitly gives Member States rights on the adoption of appropriate measures in this area (while the freedom of capital movements is directly applicable).

For the above reasons, and as long as the Court of Justice has not pronounced on this competence issue, the Community as well as its Member States may enter into third country agreements providing for specific arrangements on capital movements between both parties.

4.3.1. European Community-Third Parties Agreements

A fairly large number of bilateral agreements have been signed between the European Community and third countries (or group of third countries). These are instruments of the external relations policy of the Community which cover, at varying degrees, various areas of Community and Member State competence.

Under these circumstances, these agreements contain specific provisions on capital movements and payments between both parties. Given that most third countries involved are (or at least were) characterised by administered capital accounts, this has necessarily been reflected in limited ambition in commitments on capital movements liberalisation in these agreements. Usually, agreements contain the following provisions:

- Investment and other capital movements: Both parties ensure the free movement of capital relating to direct investments made in companies formed in accordance with the laws of the host country (and the liquidation and repatriation of these investments and any profits stemming therefrom).

  As far as intra-EC investments are concerned, the reference to "the laws of the host country" means that third country investors will be subject to national laws of Member States involved, including transposed provisions of EC directives affecting investment in specific sectors, and directly applicable investment-related provisions from EC regulations and Treaty provisions. In other words, the formulation used is perfectly consistent with the existing Community framework on capital movements, in particular on investment. These commitments are protected by a standstill clause.

Sometimes, these commitments may be slightly more ambitious and cover other categories of capital movements such as portfolio investment or commercial/financial loans.

- Balance of payments: Where one or more Member States or the third country involved is in serious balance of payments difficulties, or imminent threat thereof, the Community or the third country involved may adopt safeguard measures to remedy the balance of payments situation.

While above provisions are consistent with the Community framework on capital movements, they nonetheless fall short of ensuring full compliance with it since safeguard measures provided for by Articles 59 (EMU clause – conscious decision not to cover where only direct investment is freed) and 60 EC (financial sanctions – covered elsewhere in all bilaterals) are missing. Such characteristics are generally present in agreements prepared before the entry into force of the present regime (1 January 1994).

All these bilateral agreements are spread between the following five categories: (1) Europe Agreements (with ten countries applying for or acceding to the European Community), (2) Stabilisation and Association Agreements (with five countries stemming from former Yugoslavia), (3) Euro-Mediterranean Association Agreements (with 13 countries located in the Mediterranean area), (4) Partnership and Co-operation Agreements with New Independent States (with nine countries stemming from the former USSR), (5) Bilateral Agreements with other third countries (ACP countries, Chile, Mexico, South-Africa).

4.3.2. Member States-Third Parties Agreements

For the present, EC Member States have approximately 750 'bilateral investment treaties' (BITs) in force with third countries, the general purpose of which is the 'promotion and protection' of investments from one contracting party in the territory of the other contracting party. These agreements, which define investments in such a way that all kinds of assets are included, generally cover three major areas:

(a) The treatment of investors (e.g. fair and equitable treatment, full protection and security, national treatment and/or most favoured nation treatment, admission),

(b) An adequate and effective compensation (in the event of expropriation),

(c) A state-to-state and investor-to-state dispute settlement mechanism.

Some of these agreements date from the pre-1994 regime of capital movements, when investment relations with third countries were primarily a matter for Member States. However, in the framework of the creation of the single market, common EC rules were progressively implemented for several economic sectors, in particular with regard to establishment. Therefore, Member States had to ensure the coherence between investment provisions of BITs concluded with third countries and relating Community rules under the previous regime on capital movements (governed until 31 December 1993 by Article 67(1) of the EEC Treaty and Directive 88/361/EEC implementing that article).

When Treaty changes extended the capital movements regime to relations with third countries from 1 January 1994 onwards, many areas of direct investment traditionally covered by BITs moved into the Community domain while some new specific third country provisions appeared: common direct investment regimes (Art. 57(2) EC), EMU

safeguard measures (Art. 59 EC), financial sanctions (Art. 60 EC). Consequently, consistence with Community rules became more demanding for Member States, in particular as Community restrictive investment regimes developed further.

For Member States, ensuring coherence between BITs and Treaty provisions on investment is not entirely evident since both instruments are differently structured and do not share exactly the same terminology. However, certain fundamental operational provisions provided for by BITs seem to roughly concord with corresponding Treaty provisions, in particular:

- The broad definition of assets is covered by the nomenclature of capital movements annexed to Directive 88/361/EEC;
- The right to invest (i.e. pre-establishment) is defined in Article 56(1), qualified by 57(1) and (2), and 43 EC;
- National treatment (i.e. post-establishment) is defined in Article 43, 48 and 56(1) EC, qualified by 57(2);
- The freedom of transfer is guaranteed by Article 56(1) and (2) EC;
- The freedom of movement of key personnel is guaranteed by Article 39 EC.

Apart from these provisions, others do not seem to have their equivalent in the Treaty: dispute settlement mechanism, expropriation and compensation, promotion of investment, diplomatic representation, etc.

Under these circumstances, full compatibility of Member States' BITs with the Community rules is a feasible but ambitious goal. For the time being, the main issues with regard to Member States' BITs are as follows:

- In spite of existing Community restrictions on investment in sectors such as air transport, maritime transport, fishing, BITs may not include the necessary corresponding carve-outs.
- In Community regimes restricting investment, ownership and control requirements apply to Community nationals. Therefore, the granting by a Member State of 'national treatment' or 'most favoured nation' treatment in BITs creates problems, unless covered by an adequate Regional Economic Integration Organisation (REIO) clause which would allow preferential treatment to be extended exclusively to its immediate partners without requiring this to be extended to the third country involved.
- A particular area of difficulty is where BITs cover 'performance requirements', which subject investments by the other party to specific requirements relating to employment of local staff, use of inputs, etc.). In this case, existing requirements on European content in the audio-visual sector and production quotas in agriculture have to be specified.
- The BITs terminology allows the granting of a specific treatment to 'investments' (i.e. the establishment in a Member State of a third country firm) and/or 'investors' (i.e. the foreign parent company). While firms established in the EC are considered as EC firms in accordance with Community rules, foreign investors cannot be regarded as such according to the same rules.

- Adequate provisions mirroring the Treaty provisions on EMU safeguards (59 EC), financial sanctions (60 EC), and balance-of-payments measures (119,120 EC) might be missing.
- An appropriate provision should ideally cover the evolutionary character of the Community framework in order to maintain full compliance of BITs in the long run. However, such a clause is generally unacceptable for the other party insofar as changes in the Community framework may constitute a step backwards in terms of liberalisation of investment (in particular through the provisions of Article 57(2) EC).

5. CONCLUSION

5.1. Community and Member States restrictions: some grey areas

Since 1 January 1994, the freedom of capital movements is provided for by the Treaty, and its provisions are directly applicable in the legal order of Member States. At the same time, the prohibition of restrictions within the Community has been extended to capital movements to and from third countries. Consequently, internal and external capital movements became exclusive Community competence, although Member States retained certain rights to define and enforce admissible exceptions.

A review of the capital movements regime shows that admissible exceptions may be classified in two groups, according to the way they are implemented. The first group consists of Treaty exceptions which necessitates a preliminary implementation at Community level (with a view to define the nature and scope of restrictions), which is further implemented in the legal framework of Member States:

- Article 57(2) EC allows the Council to adopt restrictive measures on four specific categories of transactions, which are generally inserted in EC directives or regulations covering sector-specific Community competence;

- Article 59 EC allows the Council to adopt safeguard measures towards third countries in circumstances where capital movements to or from third countries cause serious difficulties for the operation of EMU, which would be defined in a Council decision directly enforceable into the legal order of Member States;
- Article 60 EC allows the Council, in well-defined cases, to take restrictive measures against a third country with regard to capital movements and payments, which would be defined in a Council decision directly enforceable into the legal order of Member States.

The second group of Treaty exceptions does not require a preliminary implementation at Community level insofar as relevant Treaty provisions give directly Member States the right to define and apply these restrictive measures:

- Article 57(1) EC grants MS the right to either maintain, soften or remove nationally defined and adopted restrictions on four specific categories of transactions, provided these restrictions were existing by end-1993;
- Article 58 EC grants MS the right to unilaterally define and enforce discriminatory cross-border tax provisions, prudential measures, declaration procedures, and other restrictive measures justified by public policy or public security considerations.

In the absence of any implementation stage at EC level, the nature and scope of restrictions enforced in pursuance of Article 57(1) and 58 EC depend directly from the judgement of the MS involved with regard to the interpretation to be given to these provisions. In addition, given the absence of notification procedure, these restrictions may possibly be incompatible with the Treaty, if unknown. Consequently, the comprehensive list of restrictions to capital movements (admissible or not) is difficult to establish with certainty at EC level, in particular vis-à-vis third countries. However, some gaps in the identification of existing restrictions are gradually disappearing as the Commission has the right to inquire into suspected breaches of the EC legislation and possibly bring these cases to the Court of Justice in order to re-establish compliance with the Treaty.

5.2. EC and MS restrictions at international level: an imperfect identification

In the international context, the European Community has taken on binding commitments, in particular in respect of inward capital movements. Fundamentally, these commitments aim at granting third country operators the right to freely engage in capital movements with the Community. Nonetheless, in areas where the Community or its Member States are obliged or wish to limit the scope of their commitments, reservations are lodged under these international agreements.

According to the party undertaking liberalisation commitments and lodging reservations (European Community or Member States), international agreements can be classified in two groups. The first group contains agreements where the European Community, through the Commission, makes a proposal for itself and on behalf of its Member States:

- The General Agreement on Trade in Services (GATS) is a government-to-government multilateral agreement where the Community and EC Member States are parties, although the latter are represented by the EC, through the Commission, for any offer with respect to commitments or reservations;
- Bilateral Agreements between the European Community and third parties, the EC and its Member States are actually joint signatories of the agreement, and jointly agree about the nature and scope of the liberalisation offer with respect to capital movements.

In practice, this negotiation method implies that Member States convey their respective positions with regard to commitments and reservations to the EC in a preliminary stage. The consensus position which emerges from internal negotiations at EC level allows defining an EC position under the agreement involved. While bilateral agreements form homogenous EC positions in the strict sense of the term, EC GATS commitments and reservations constitute a blend of horizontal EC commitments/reservations and complementary Member States-specific commitments/reservations which reflect their strategy in the services sectors involved.

Needless to say, all Community commitments under GATS have to be consistent with the Community framework. This verification is quite easy for horizontal commitments relating to sector-specific directives and regulations (in particular provisions impacting on establishment, as far as mode three is concerned). In contrast, this is less easy for Member State-specific restrictions, which frequently stem from MS rights to apply restrictions according to Articles 57(1) and 58 EC (as explained in 5.1). Nonetheless, the need for Member States to notify under GATS domestic restrictions maintained on mode

three of supply somewhat counterbalances the lack of transparency identified at EC level (although this clarification is limited to the services sector).

Moreover, the active role of the Commission in the negotiating and drafting process guarantees the insertion in EC bilateral agreements of fairly standardised safeguard provisions covering public security and public order considerations, economic and monetary union, financial sanctions, and balance-of-payments crisis in accordance with the EC regime. Since the GATS also foresees similar safeguard clauses, the EC and Member States may apply these exceptions in accordance with the corresponding Articles 58, 59, 60, and 119/120 of the Treaty.

The second group contains agreements where Member States are parties, without any official representation of the EC as such under these agreements:

- The OECD Code of Liberalisation of Capital Movements is a liberalisation instrument stemming from the founding convention of the organisation. EC Member States are members of the OECD, while the European Commission takes part in the work of the organisation;
- Bilateral agreements concluded between EC Member States and third parties, in the context of their presumed residual competence in the area of capital movements with third countries.

Under this configuration, Member States are fully responsible for the compliance of their commitments under these agreements with Treaty rules on capital movements, since the Community – through the Commission – does not play any role in this respect. The review of Member States' reservations under OECD Codes of Liberalisation has widely shown that the list of reservations lodged by some Member States was not in line with the requirements of the Community framework (in particular restrictions stemming from Community regimes in directives and regulations). Although EC legislation always prevail by principle, these inconsistencies are problematic insofar as OECD commitments are binding. However, the absence of a dispute settlement body or compensation mechanism for OECD Codes usually does not incite EC Member States to pay much attention to these problems.

Considering that OECD Codes of Liberalisation cover all types of capital movements, the apparent incomplete character of list of reservations is regrettable insofar as – from an EC perspective – they can potentially reveal existing Member States restrictions stemming from Articles 57(1) and 58 EC. Moreover, traditional safeguard measures provided for by the Treaty (i.e. public security and order, EMU, financial sanctions, balance-of-payments crisis) are also foreseen by the standard provisions of OECD Codes.

As to bilateral treaties concluded by Member States with third countries, they cumulate all risk factors: consistency with the Treaty is the sole responsibility of MS, methodology and terminology of BITs is different from Treaty principles, sector-specific exceptions must be mentioned and any omission can lead to redress, safeguard clauses must be inserted, adequate REIO clause is necessary, etc. This explains why some of these Member States BITs are partially inconsistent with the EU framework.

5.3. Prospects of clarification of existing restrictions on foreign ownership

Since the entry into force of the current EU regime (1 January 1994), capital movements to or from third countries are Community competence. Moreover, the sole admissible

restrictions on these external transactions are the ones formally provided for by the EU regime. According to the provisions involved, either the Community as a legal person, or the Member States acting autonomously, have the right to adopt restrictions on third country capital movements and the obligation to make them compatible with the complete set of Community rules (including the jurisprudence of the European Court of Justice). Under this framework, restrictions on third country ownership of EU assets are primarily defined at EU or EU Member States level, and reflected in a second stage at international level in a set of bilateral and multilateral agreements.

In view of its operating principles, the EU regime on capital movements can neither allow a comprehensive identification of all restrictions existing in the Community on third country ownership of EU assets, nor guarantee a permanent compliance with Community rules (although the latter is achieved in the long run through the infringement procedure foreseen in the Treaty and eventual enforcement of Court decisions).

Moreover, the translation at international level of existing EU restrictions sometimes comes up against the respective weaknesses and differences in operating principles of agreements involved, in particular in the areas of methodology, terminology, and enforcement rules. These difficulties may lead to EU international positions which are partially inconsistent with Community rules, essentially in the area of restrictions defined at the level of EU Member States (stemming from either Treaty rights granted by 57(1) and 58 EC or their presumed 'residual' competence to undertake commitments). Although Member States would entirely bear the consequences of any possible dispute arising from such inconsistencies, this maintains some blur in the panorama of EU restrictions on foreign ownership.

All things remaining equal at international level, the identified lack of precision or Treaty consistence with respect to EU restrictions could be rectified (at least partially) through a further definition of the rules which are presently left for Member States' interpretation and implementation. In practice, this can happen in two ways:

- The Community might decide to further legislate (e.g. directive, regulation) in capital movements-related areas which are unregulated at EU level so far. Implicitly, this would lead to a definition of applicable rules which would remove Member States' right for interpretation of the primary law (i.e. the Treaty).

- The Court of Justice might be requested by the Commission to pronounce on the compatibility with the Treaty of third country restrictions adopted by Member States. Implicitly, by declaring specific restrictions illegal, such ECJ rulings would also clarify the interpretation that should be given to these Treaty provisions (since they become integral part of Community legislation).

The potential impact of above legislative means can be illustrated by the following examples, which are presently important areas of uncertainty with respect to the compatibility with the Treaty of restrictive measures on capital movements:

- Special control rights of Member States in privatised/private companies or economic sectors are probably among the most challenging restrictions on intra-EU investment in the past years, given their very wide scope. A lengthy discussion on the legality of these restrictions has finally resulted in three breakthrough ECJ rulings in June 2002, which have largely clarified the

admissible scope of restrictions. Following similar cases should widen the interpretation to other economic sectors of general interest.

- Discriminatory tax treatments are a very powerful, albeit indirect, impediment to direct investment and establishment, even if these are supposed to be liberalised. Such discriminations stem directly from the tax carve-out enshrined in Article 58 EC, which was inserted in the EU capital movements regime by the Maastricht Treaty. While Member States have often used this provision so far, many ECJ rulings of the past years have condemned these discriminatory tax treatments and consequently reduced the range of Member States' right to widely interpret the provisions of Article 58 EC. Considering Member States' reluctance to promote tax harmonisation in the Community through secondary legislation, it is clear that further progress in this area will largely depend on future ECJ case law.

- In view of the growing importance of institutional investors in financial markets, the definition of prudential rules applicable to the various categories of institutions exert a strong influence on the nature and structure of assets portfolios. While the principle of prudential measures is foreseen by Article 58 EC, its interpretation is left for Member States, although the Community already used this right in its own legislation (e.g. the life and non-life insurance directives). According to generally accepted prudential principles, the acquisition of foreign assets may be restricted by applying in particular currency matching provisions. Again, any uncertainty with regard to the admissible interpretation may be removed either by a clear definition of rules in Community legislation (e.g. insurance directives, proposal on voluntary occupational pension funds, once adopted) or possible ECJ rulings on presumed infringements to Treaty rules (e.g. all unregulated institutional investors at EU level, such as mandatory occupational pension funds).

Thanks to the above institutional Community instruments, substantial progress has been recorded since 1 January 1994 in the interpretation of restrictions to capital movements, and in particular foreign ownership restrictions. Although the conformity check process provided by the EU Treaty might be considered sometimes as fairly slow, it is very efficient in terms of clarification and enforcement, and compares favourably to most international agreements in this respect.

Therefore, irrespective of the commitments entered into by the Community and/or its Member States at international level, the nature and scope of restrictions to foreign ownership in the Community remain – to a large extent – accurately defined in the Community framework, including its case law.

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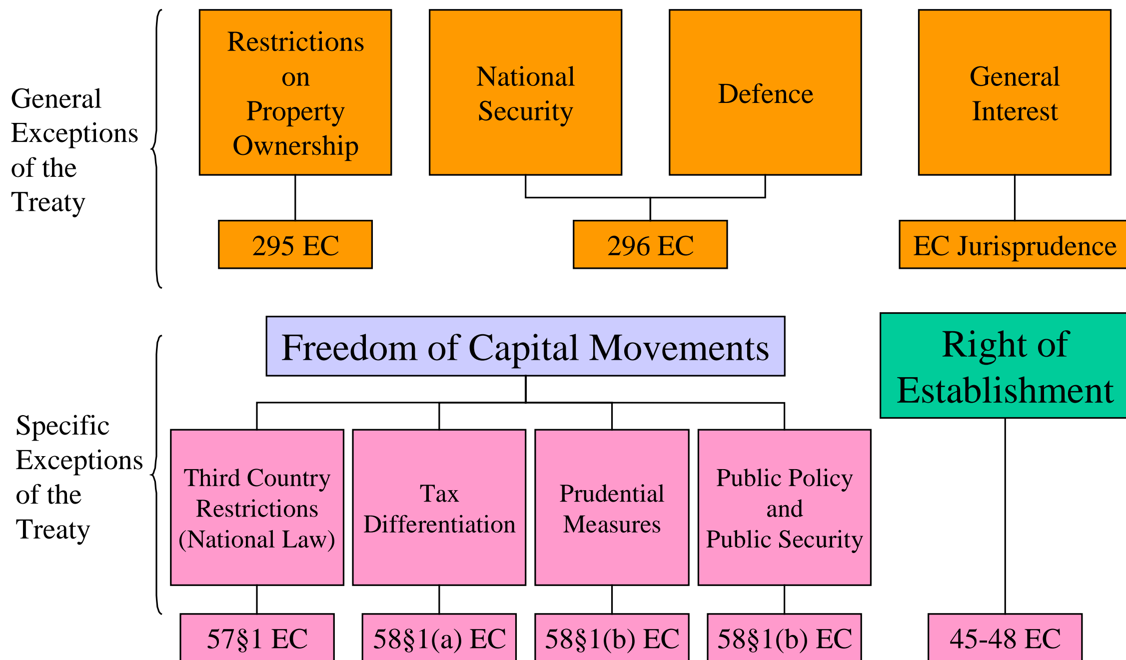
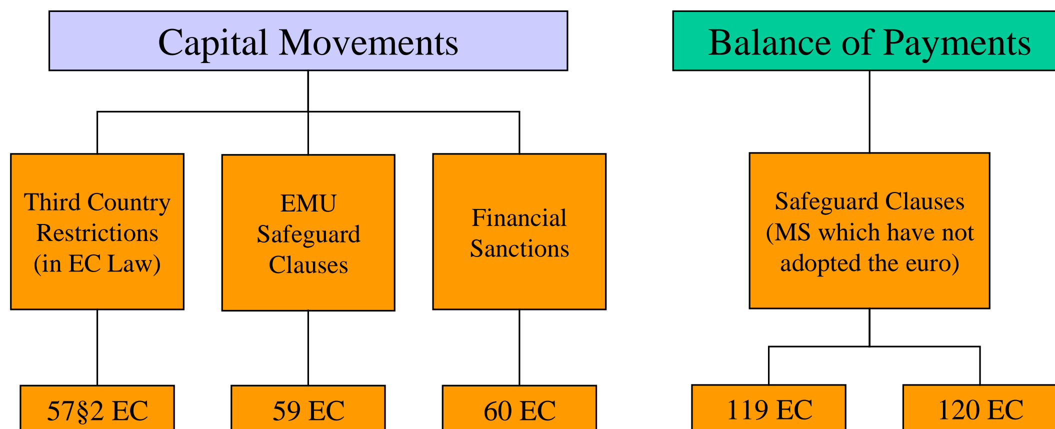
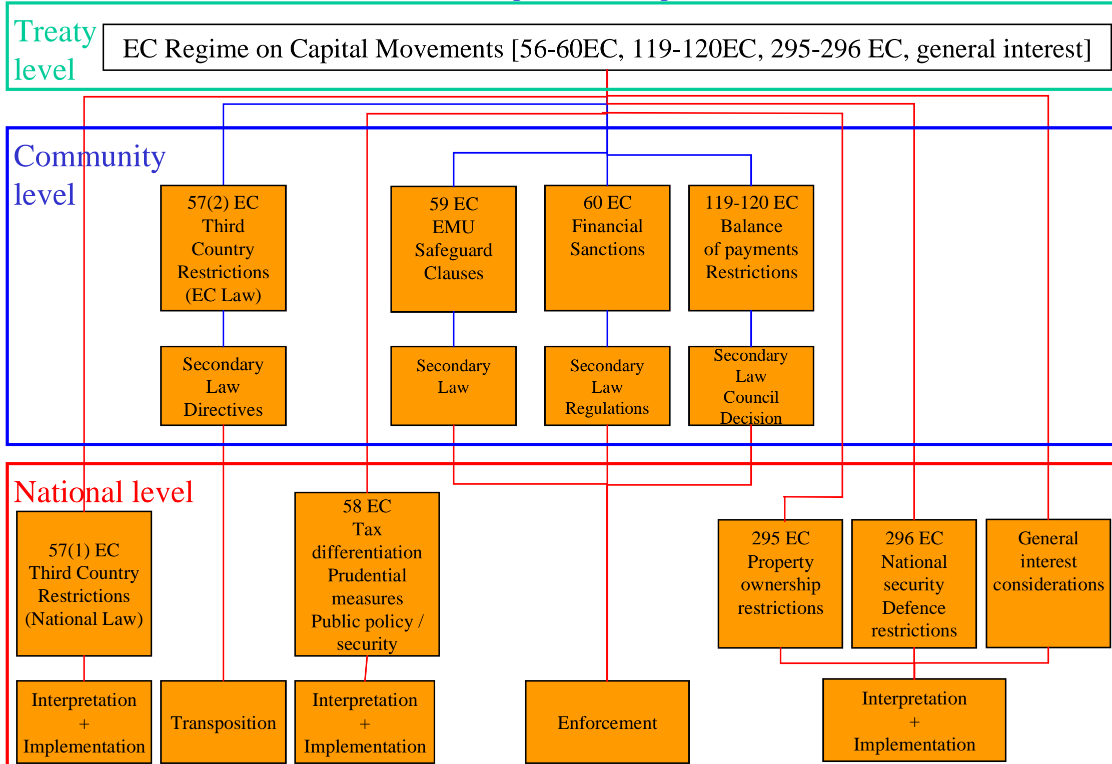
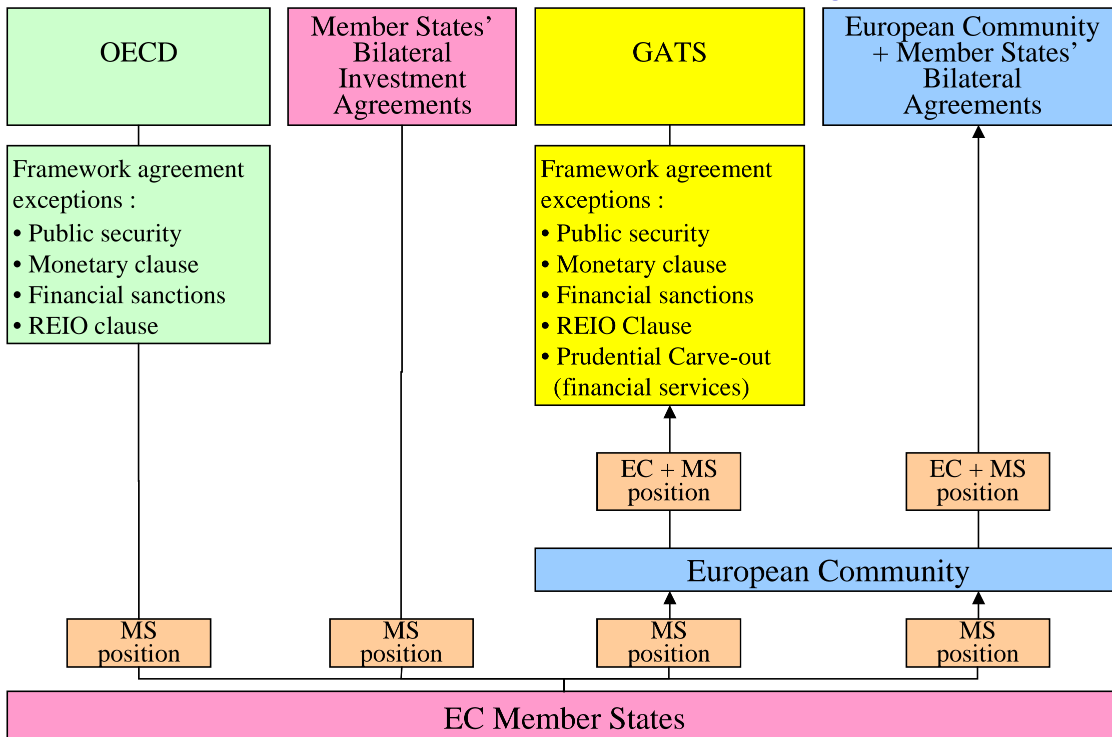
Third Country Restrictions Applicable by EU Member States
(Capital Movements)



Third Country Restrictions Applied by the European Community
(Capital Movements)




Third Country Restrictions at EC and National Levels
Channels of Adoption and Implementation
Treaty level
EC Regime on Capital Movements [56-60EC, 119-120EC, 295-296 EC, general interest]
Community level
57(2) EC Third Country Restrictions (EC Law)
59 EC EMU Safeguard Clauses
60 EC Financial Sanctions
119-120 EC Balance of payments Restrictions
Secondary Law Directives
Secondary Law
Secondary Law Regulations
Secondary Law Council Decision
National level
57(1) EC Third Country Restrictions (National Law)
58 EC Tax differentiation Prudential measures Public policy / security
295 EC Property ownership restrictions
296 EC National security Defence restrictions
General interest considerations
Interpretation + Implementation
Transposition
Interpretation + Implementation
Enforcement
Interpretation + Implementation


International EC and Member States' Commitments
Channels of Transmission to International Agreements
OECD
Member States' Bilateral Investment Agreements
GATS
European Community + Member States' Bilateral Agreements
Framework agreement exceptions :
• Public security
• Monetary clause
• Financial sanctions
• REIO clause
Framework agreement exceptions :
• Public security
• Monetary clause
• Financial sanctions
• REIO Clause
• Prudential Carve-out (financial services)
EC + MS position
EC + MS position
European Community
MS position
MS position
MS position
MS position
EC Member States