BRIEFING

European Added Value in Action

European Parliament

Free movement of capital within the European Union

- To ensure openness towards other countries, all restrictions on capital movements and payments are prohibited.
- The euro area is the world's largest exporter of capital and (together with China and Japan) represents 75 % of global net savings.
- The right to buy houses, apartments and holiday properties is part of the free movement of capital. In 2015 EU residents made 225 million tourist trips of at least one overnight stay to destinations in another EU Member State; during their trips around 6.8 million EU citizens stayed in their own house, apartment or holiday property.

What is the free movement of capital?

Of the four fundamental freedoms that underpin the EU single market (free movement of people, goods, services and capital), the free movement of capital is the most recent. Until the mid-1990s it did not exist in practice in a number of Member States. Financial operations in other Member States or in other currencies within the EU were subject to prior authorisation requirements by national authorities. These controls enabled national authorities to prevent or restrict financial operations.

The free movement of capital became applicable with the 1993 Maastricht Treaty, which removed all restrictions on capital movements and payments, both between Member States and with third countries. The principle has direct effect, meaning that it requires no further legislation at either EU or Member State level.

The Treaty on the Functioning of the European Union (TFEU, 2009) does not contain an explicit definition of capital movements. In the absence of a definition, the Court of Justice of the European Union (CJEU) has confirmed a broad definition of free movement of capital, which includes:

- foreign direct investments, real estate investments and purchases;
- securities investments (for instance in shares, bonds, bills and unit trusts);
- the granting of loans and credits, and other operations with financial institutions; including personal capital operations.

Although Article 63 TFEU prohibits all restrictions on capital movements and payments, free movement of capital is not unconditional. Indeed Article 65 TFEU offers the possibility to restrict capital movements under specific conditions, for example:

- during the economic and financial crisis (which started with the sub-prime mortgage markets problems in 2007), in order to prevent an uncontrollable outflow of capital, capital controls were introduced in Cyprus (2013) and Greece (2015). Cyprus removed restrictions in 2015, while some capital controls are still in force in Greece, as of May 2018;

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- Protocol 32 to the Treaties permits Denmark to maintain existing legislation restricting the acquisition of second homes by non-nationals.[1]

A far reaching freedom...

Free movement of capital for citizens involves activities such as

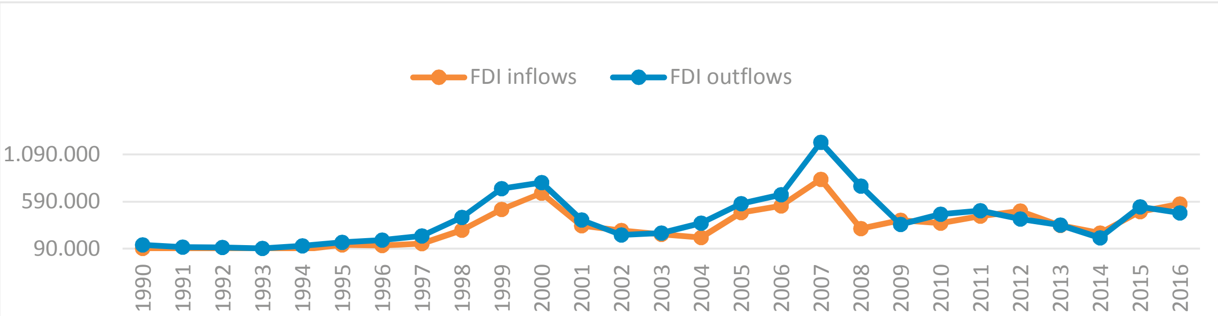
- *opening bank accounts abroad*;
- *buying shares in non-domestic companies*;
- *investing freely in other countries*. It is worth mentioning that in 2016, the euro area was the world's largest exporter of capital. The euro area plus China and Japan – two countries that have consistently generated current account surpluses – represent 75 % of global net savings. In 2015-2016, the US, together with the UK and some other advanced economies (Canada and Australia), absorbed the vast majority of these savings;
- *purchasing real estate (houses, holiday properties, investments) in another country*. In 2015, EU residents made 225 million tourism trips involving at least one overnight stay to destinations in another EU Member State, with around 3 % (approximately 6.8 million travellers) staying in their own accommodation.

For companies, free movement of capital means being able to:

- *invest in and own other European companies;*
- *seek financing where it is cheapest.*

The free movement of capital has the broadest scope of all Treaty freedoms. As the European Commission explains, it is the only freedom that goes beyond the boundaries of the EU internal market, because it includes capital flows between EU countries and the rest of the world. The EU's commitment to free capital movement has led to considerable capital flows.

Figure 1 – EU foreign direct investment (FDI) inflows and outflows (million US$)



Data source: ©UNCTAD, FDI/MNE database.

Normally FDI generates direct benefits such as additional funds invested in new innovation or production, which in turn create new jobs, which in turn boost government tax revenues. Furthermore, indirect effects are important, such as the transfer of new technology and participation in global value chains, fostering competition and innovation.

... with safeguards for the EU

EU countries are legally allowed to take precautions to ensure that foreign investments do not expose them to public security threats. The EU itself can act either in emergencies or in normal economic circumstances to restrict this freedom.

According to a 2017 European Commission communication, in some cases foreign investors might seek to acquire strategic assets that allow them to control or influence European firms whose activities are critical for security and public order. This includes activities relating to the operation or provision of critical technologies, infrastructure or sensitive information. Acquisitions by foreign state-owned or controlled companies in these strategic areas may allow third countries to use these assets to the detriment of the EU's technological competitiveness, and could also put security or public order at risk. Consequently, on 14 September 2017, the Commission proposed a new legal framework to enable Europe to preserve its essential interests. This included:

- *A European framework for screening of foreign direct investments by Member States on grounds of security or public order, including transparency obligations, the rule of equal treatment among foreign investments of different origin, and the obligation to ensure adequate redress possibilities with regard to decisions adopted under these review mechanisms.*
- *A cooperation mechanism between Member States and the Commission.*
- *Commission screening on grounds of security or public order for cases in which foreign direct investment in Member States may affect projects or programmes of Union interest. This includes projects and programmes in the areas of research (Horizon 2020), space (Galileo), transport (trans-European networks for transport, TEN-T), energy (TEN-E) and telecommunications.*

Specific case of agricultural land

EU Member States have the right to restrict sales of farmland to preserve agricultural communities and promote sustainable agriculture in accordance with EU law, and more specifically with the rules of free movement of capital. In May 2016 the Commission asked Bulgaria, Hungary, Latvia, Lithuania and Slovakia to comply with EU rules on the sales of agricultural land. In March 2017, the European Parliament asked the Commission to set a clear and comprehensive set of criteria for land market regulations to ensure a level playing field in compliance with EU law. In October 2017 the Commission published a communication that suggests to Member States how to regulate the sale of farmland, based on the case law of the CJEU.

Benefits for EU citizens and the EU economy

The most acknowledged benefit of free capital flows is the de-linking of savings and investment, which allows for more efficient global allocation of capital. Free movement of capital is necessary for economic and monetary union (EMU). Without free movement of capital, European economies would be less integrated and it would not be possible to have a single European currency. Consequently, the functioning of the European single market would be badly hampered without free movement of capital. Increased trade between the countries and better allocation of resources has contributed to higher European gross domestic product (GDP), and therefore also to job creation and increased living standards for European citizens.

The free movement of capital contributes to economic growth by increasing the production base, by boosting employment and through several multiplier effects (for instance, increased international competition results in more efficient production and/or increased quality of products/services with lower prices for consumers).

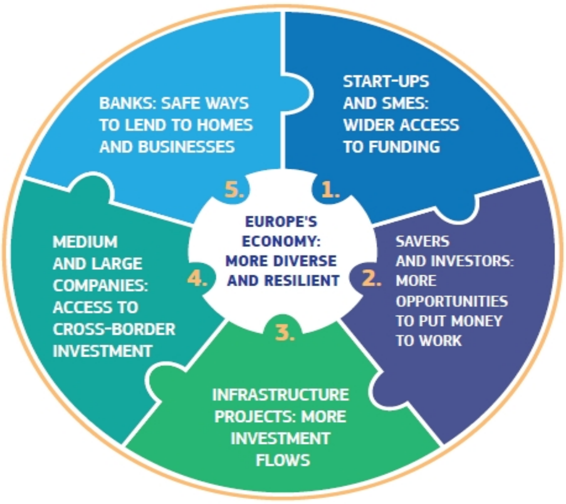
According to a 2014 EPRS study, the completion of the EU's single market will eventually generate €615 billion per annum in additional gains for the EU economy, representing 4.4 % of EU GDP. Banque de France recently quantified the cost of non-Europe, i.e. the trade-related welfare losses that would occur under different scenarios of undoing the European Union. Thierry Mayer, Vincent Vicard and Soledad Zignago found in one simulation that the single market is found to have increased trade between EU Member States by 109 % on average for goods and 58 % for tradable services. The associated welfare gains from EU trade integration are estimated to be 4.4 % for the average European country (weighted by the size of the economy). The 2008 financial crisis caused EU-28 GDP to decrease from 2008 to 2009 by 4.4 %, which was considered very significant. By comparison, the above study's results indicate that EU integration and its single market have contributed to the growth of EU GDP annually by 4.4 % and that there is still considerable potential for further increases in EU GDP by completing the single market (including capital markets union).

Capital markets union

The idea behind the capital markets union (CMU) is to support the creation of jobs and growth by removing cross-border investment barriers and thereby supporting increased long-term investment in Europe's companies and infrastructure. It consequently contributes to making the free movement of capital more concrete and more efficient.

Stronger capital markets will complement banks as a source of financing, giving businesses more options and making Europe's financial system more stable. For savers, the CMU should lead to more investment opportunities, helping people to save and plan for their retirement.

Figure 2 – Who benefits from CMU



Source: European Commission.

European Commission policy documents:

- Green paper Building a Capital Markets Union, COM(2015) 63
- Communication on an Action Plan on Building a Capital Markets Union, COM(2015) 468
- Consultation Document – Capital Markets Union Mid-Term Review 2017
- Communication on the Mid-Term Review of the Capital Markets Union Action Plan, COM(2017) 292

European Parliament resolutions:

- Resolution of 9 July 2015 on Building a Capital Markets Union
- Resolution of 19 January 2016 on Stocktaking and challenges of the EU Financial Services Regulation

ENDNOTE

[1] For a more detailed list of exceptions to the free movement of capital see the Commission website.

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