



FACULTY OF LAW
Lund University

Stefano Iuretich

The free movement of capital and the future of financial services market in the EU: recent developments in the context of Economic Monetary Union (EMU) and in light of the possible implementation of a Banking Union.

JAEM03 Master Thesis

European Business Law
30 higher education credits

Supervisor: Prof. Jörgen Hettne

Term: Spring 2013

Contents

Foreword.....	3
Summary.....	4
Abbreviations.....	5
Introduction.....	6
Methods and material.....	7
Delimitations.....	7
Main ideas and their order.....	8
1 The free movement of capital.....	10
1.1 Capital and the other freedoms: a general overview.....	10
1.2 The origins and the evolution: from the Treaty of Rome to the Treaty of Lisbon.....	11
1.3 Historical background: from the least developed freedom to a driving force towards further integration.....	14
1.3.1 The reasons behind the cautious approach: general aspects.....	14
1.3.2 Economic rationale and policy.....	16
1.4 The free movement of capital and the Court of Justice: case-law evolution.....	18
1.5 The importance of such a freedom from both a legal and economic perspective.....	21
2 What is capital?.....	24
2.1 In search of a definition.....	24
2.2 Absence of express definitions in the Treaties.....	25
2.3 Economic concept.....	26
2.4 The secondary legislation implementing the original treaty provisions from the 60s to Maastricht Treaty.....	27
2.5 Current legal basis and role of the Directive 88/361 in the present framework.....	29
2.6 Main legal issues and CJEU case-law.....	31
2.6.1 Liberalization of capital movements in general.....	31
2.6.2 Capital and payments: an outdated question.....	33
2.6.3 “Erga omnes” principle: free movement of capital and third countries.....	34
2.6.4 The concept of restriction.....	36
2.6.4.1 The (broad) answer of the CJEU: beyond the concept of discrimination.....	36
2.6.4.2 Territorial scope of the freedom.....	39
2.7 Relationship with other freedoms, with particular attention on services: an unsolved dilemma. 40	
2.7.1 Can two freedoms compete with each other or not?.....	40
2.7.2 Capital and services: the case of financial services and banking.....	43
3 Economic and Monetary Union (EMU) and the inextricable link with the free movement of capital. 46	
3.1 Introduction.....	46
3.2 The “impossible trinity”: free movement of capital, monetary policy and fixed exchange rate.. 46	
3.3 Why free movement of capital is so important for the single market and EMU (and vice-versa): a single currency as a (unavoidable?) solution.....	48
3.4 Restrictions of the freedom: capital controls.....	52
3.4.1 Definition.....	52
3.4.2 Types of controls.....	53
3.4.3 Why they have been used.....	55
3.4.4 Inefficiency of capital controls. Reasons not to resort to controls in light of historical	

experience.....	55
3.4.5 Would it be possible to revert to capital controls in the current framework? Legal and economic issues.....	57
3.5 EMU's legal framework and historical background.....	58
3.5.1 The ECB and the ESCB.....	60
4 Banking and its relationship with the free movement of capital. The need to create an integrated market in financial services.....	62
4.1 Capital and banking: how liberalization has bolstered the market of financial services and created potential dangers at the same time.....	62
4.2 Current relevant legal framework and harmonization: the Banking Directives and the “european single passport”.....	66
4.3 Oversight of banks and role of national supervisors. Critical points in the current situation: the risk of fragmentation of the market.....	68
4.4 The necessity of a supervision at European level in light of the recent crisis.....	72
5 The proposed banking union and its possible impact in the field of capital movements.....	74
5.1 Why a banking union?.....	74
5.2 Commission's proposal in detail.....	75
5.3 Criticisms on the proposal.....	76
5.3.1 The issue of subsidiarity.....	76
5.3.2 New role of the ECB.....	78
5.3.3 Eurozone countries and Member States outside: what treatment? Possible suggestions.....	79
5.3.4 Other problems (in brief): single protection of depositors.....	80
5.4 Does banking union strengthen the EMU? Towards a more unified single financial market.....	81
Conclusion.....	83
BIBLIOGRAPHY	84

Foreword

I still remember as if it was yesterday that day in March 2011, when I knew that I had been admitted to this program at Lund University and the excitement for a new adventure which, as expected, would have fulfilled all my high expectations.

Without any doubt I can say that the two years I have spent here have been among the best of my life.

I would like to say thank-you to many people: from my parents, for their support, to all those who I have met here during this time, who have helped make this experience unforgettable. But there is someone who deserves most to be mentioned and without whom probably I would not have been what I am now.

I am referring to my Grandmother, Teodora Simcic Iuretich. Three years ago, at the moment when this dissertation was to be defended, she passed away. I will never forget all the things she has done for me and how much she helped and encouraged me in difficult times.

This work is dedicated to you. I am sure you would be proud of what I have achieved so far.

Lund, May 2013

“I learned that there is no solution to economic problems without growth and that growth cannot come from bureaucratic manipulations, but only from the individual efforts of all, working in freedom that is as near as possible”

Robert Marjolin

A special thanks to Rebecca Hallquist for helping me with the language review. Good luck!

Summary

In December 2012 the Council of the European Union preliminarily approved a Commission's Proposal aimed at introducing a so-called “banking union” , namely the conferral to ECB of powers to supervise all the credit institutions – a role which has been carried out by national authorities until today. The change was deemed necessary in order to tackle the numerous problematic issues which have recently arisen and have seriously threatened the existence of the Monetary Union, even suggesting a possible break-up.

What really happened? Why has a monetary union, and the creation of a single currency been pursued? How are all these issues connected to the liberalization of capital movements? How do they influence each other?

Although at the first glance it is not intuitive to grasp the numerous links between these issues, they exist and are extremely relevant. This work will try to shed light and to answer the aforementioned questions.

Abbreviations

AG	Advocate General
CJEU	Court of Justice of the European Union
ECB	European Central Bank
EEC	European Economic Community
EESC	European Economic and Social Committee
EFTA	European Free Trade Association
EMS	European Monetary System
EMU	Economic and Monetary Union
ESCB	European System of Central Banks
EU	European Union
TEC	Treaty establishing the European Community
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union

Introduction

The evolution of the internal market in the European Union is nowadays one of the most fundamental topics in light of the long financial and economic crisis that has hit the world in recent years, although with different degrees depending on individual countries.

The decision to focus on the free movement of capital and its importance for the development of financial services market is supported by several reasons: firstly it represents the least developed of the four freedoms included in the Treaties. Capital has been set aside for a long time unlike the free movement of goods, services and lately persons, which has seen a constant and unstoppable transformation capable of influencing the behavior of both Member State and European Institutions (mainly thanks to the contribution offered by the CJEU). Despite the liberalization, which occurred more than twenty years ago, free movement of capital is still perceived almost like a stranger, if not openly opposed: the accusation against the “speculation” often heard these years appears furthermore to call into question the free market itself, at least in this field.

The amount of literature, as well as case-law, is moreover considerably lower than the material available for the other three freedoms. Comprehensive works on the topic are just a few, notwithstanding the growing importance of financial markets in the current situation.

Besides that, another reason to choose such an argument can be found in its interdisciplinary character: in order to understand the rationale behind capital liberalization, why it has been opposed for so long, and why its evolution differs to a large extent from other elements at the basis of the common market, due regard must be paid to factors outside the strict field of law.

This work wants to be a contribution to the discussion of the importance of reinforcing the experiment of internal market, seemingly under siege

during the last years, and to believe that what has been achieved so far has not been in vain.

To find a common thread between areas apparently distinct, such as the liberalization of capital, the monetary union and banking has been a difficult but at the same time extremely challenging experience.

Methods and material

Due to the interdisciplinary character mentioned above, the material used for this research has been of different natures: beside monographic works and articles focusing on the free movement of capital and its legal aspects, the study incorporates contributions from authors active in different fields, mainly economists.

Some of the topics here analyzed, in fact, has often been studied in depth rather from the economic than the legal angle in the case of EMU or the possible implementation of a banking union.

The attempt of this work is to propose a far-reaching approach, by connecting the legal and economic issues together. An operation not without risks. This author, notwithstanding his interest in economics, has a legal background and the aim of the study remains focused on legal problems. At the same time some suggestions will be put forward, with all the caution necessary when it comes to questions not entirely familiar.

Delimitations

The topics examined here are generally quite broad and would each deserve separate studies.

Some issues have been deliberately excluded for space reasons or because collateral in relation to the main questions which are the object of this work. This does not mean they are secondary or less relevant.

Many authors, on the basis primarily of the case-law of the CJEU, have addressed the problems between the free movement of capital and taxation, a field characterized by complex and numerous legal issues. This topic will not be part of the study: its peculiarity places it in a different position and requires an autonomous analysis.

The other issue excluded is the relationship between European Union and third countries as regards direct investments, due to the notable feature of free movement of capital in comparison with other Treaty freedoms, being the only case in which persons established outside the Union are granted to rely on that (as confirmed by the CJEU with some limitations). This topic will be only partially addressed and only to the extent necessary for the purposes of this work, since it may lead the discussion far from the core issues analyzed here.

For similar reasons, the discussion on banking and monetary issues will be focused only on limited points, disregarding technical and political aspects.

Main ideas and their order

The scope of this research is to present how the free movement of capital is framed nowadays, starting from its legal basis and its evolution through the rulings of the CJEU, without forgetting the historical context in which the changes have occurred. Moreover, to imagine future developments in light of the EMU and the possible move towards a tighter financial integration represented by the proposal of banking union. This paper will outline the transformations in the legal framework, since

the inception in the late 1950s to the most recent modifications, with particular attention to the process which has led to the adoption of a common currency and the relationship between monetary integration and the liberalization of capital.

Finally, the work will try to analyze whether the steps forwards in the ambit of financial services and the strengthening of ties by means of an unitary banking supervision may have a possible effect on the free movement of capital.

Chapter 1 will address the historical premises and the general aspects in favor of liberalization of capital from both a legal and economic perspective.

Chapter 2 will thoroughly analyze the issues in detail regarding the free movement of capital: the definition of capital, restrictions – with a focus on the case-law above all – as well as the relationship between free movement of capital and the other freedoms with particular attention to the freedom to provide services.

Chapter 3 will explain the legal basis of EMU, the rationale behind it and why the free movement of capital is inextricably linked to the monetary dimension.

Chapter 4 will go through the main features of the legal framework concerning banking within the European Union and the problems that have recently arisen.

Chapter 5 will finally examine the proposal of a banking union, its main features, along with the legal issues which may result, and the possible impact on capital and financial services markets.

1 The free movement of capital

1.1 Capital and the other freedoms: a general overview

The idea of European integration has been based, since the very beginning, on the establishment of a common market where goods, persons, services and capital could move free from impediments.¹ Such a process would have fostered economic growth and furthered the ties between the single member states by obliging them to cooperate fairly towards the common objective of durable development.

All of the four freedoms, which lie at the foundations of the European Union (and previously the European Community in the pre-Maastricht era) have been explicitly enshrined in the Treaties since the inception with Treaty of Rome (EEC), signed in 1957 and entered into force the following year.

However, despite everyone appearing of equal importance,² the free movement of capital has been for many years the “last” freedom not just in the order mentioned above, but also in practice.³ Unlike free of movement of goods, person and services, which has been objective of extensive case-law of the CJEU and constantly developed in order to remove progressively all the hindrances to the harmonious evolution of the common market, the treatment reserved to capital differed considerably at least until the end of the 1980s.

For several decades the free movement of capital was seen as the “poor relative” of the freedoms,⁴ whose implementation was regarded as

1 Art. 26(2) TFEU (*'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured'*)

2 Ryan Murphy, 'Changing Treaty and Changing Economic Context: the Dynamic Relationship of the Legislature and the Judiciary in the Pursuit of Capital Liberalisation' in Paul Syrpis (ed), *The Judiciary, the Legislature and the EU Internal Market* (Cambridge University Press, 2012) 275 referring to art. 3(1)(a) EEC

3 Ibid 275-276; Catherine Barnard, *The Substantive Law of the EU* (3rd edition, Oxford University Press, 2010) 559

4 Steffen Hindelang, *The Free Movement of Capital and Foreign Direct Investment: The Scope of Protection in EU Law* (Oxford Scholarship Online, 2009) 31-32

desirable but in practice not really necessary. Such an attitude, which can be identified by reading the original provisions of the Treaties, was not without grounds as it will be explained in this work, but at the same time it constituted a serious obstacle to the completion of internal market.

The decision to completely liberalize the movements of capital started the final stage of European integration which is still ongoing, namely the strategy meant to achieve a real Economic and Monetary Union by setting the premises necessary to adopt a single currency and to promote a further interdependence of the member states: a project still valid for the reasons that will be illustrated here, notwithstanding the difficult challenges posed by the financial crisis burst in 2008.

1.2 The origins and the evolution: from the Treaty of Rome to the Treaty of Lisbon.

The free movement of capital, as mentioned in the previous section, was already included in the first Treaty establishing the European Economic Community in 1957, the founding Treaty of Rome, under the original articles 67 – 73: the liberalization was deemed a part of the process which would lead to a true economic unification in Europe.

An evident difference in comparison with the other provisions concerning the movement of goods (now art. 28 TFEU), persons (art. 45) and services (art. 56) might be noted at the first glance: the Member States, to which the obligations set in the treaties are primarily addressed, undertook in the original version of the Treaty (art. 67 EEC) to '*progressively abolish*' all restrictions to the free flow of capital and only '*to the extent necessary to ensure the functioning of internal market*', accepting at the same time not to introduce new obstacles, as set out in the so-called "standstill" clause (art. 71 EEC). The feature of the latter provision was, however, to allow the states which had adopted a more

restrictive approach to retain all the capital controls existing at that time, while more liberal countries were in theory prevented from introducing similar measures. In practice, instead, the wording of the rule was not deemed imperative, since it requested only that the States “endeavor” not to introduce new restrictions, without providing for any sanction for its eventual breach.⁵ Clearly the situation could not be uniform at all.

The wording of the Treaty differed in a substantial way with regards to capital: while the provisions relative to the other freedoms had been drawn up in an imperative manner (the restrictions '*shall*' be abolished once expired the transitional period), these rules could not entail an obligation but seemed to suggest how the free movement of capital was to be postponed⁶ until an undefined moment, most likely once achieved a common market in goods and services.⁷

Moreover, such a freedom appeared to be subordinate, as if there were a hierarchy. The escape clause gave leeway to the States, by stating that free movement of capital was necessary only when it did not interfere with the freedom of trade.⁸ In other words, Member States were authorized to restrict free movement of capital when such a solution was considered suitable for their needs on the basis of internal policy choices. Another remarkable characteristic is the connection, provided for by art. 61(2) EEC (now art. 58(2) TFEU) of capital with the liberalization of the banking and financial services: the drafters made it explicit that they were to be pursued in parallel. The close connections between capital and banking services were well known by the drafters, and the choice was to limit the freedom to provide services in this specific area: if a capital movement not yet liberalized was related to a service, the rules concerning the former prevailed on the latter, barring an individual from

5 John A. Usher, *The Law of Money and Financial Services in European Community* (2nd edition, Oxford University Press, 2000) 16

6 Sideek Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (Nordsteds Juridik, 1999) 46

7 As the Spaak Report, drafted in 1956 and which posed the basis for the negotiation of the treaty of Rome the following year, openly suggested; see also Jukka Snell, 'Free Movement of Capital: Evolution as a Non-linear Process' in Paul Craig and Gráinne de Búrca (eds), *The Evolution of EU Law* (2nd edition, Oxford University Press, 2011) 574

8 Age F.P. Bakker, *The Liberalization of Capital Movements in Europe: the Monetary committee and Financial Integration, 1958-1994* (Kluwer Academic Publishers, 1996) 42-43

relying on the Treaties provisions, regardless of their direct effect.⁹

The Treaty provisions remained substantially identical until the Maastricht Treaty in 1992, in which the liberalization of the movements of capital was for the first time enshrined under art. 73(b) (and then renumbered as art. 56), thereby finally conferring to this freedom the same value granted to the others. The change did not come overnight, but it was the product of long years of discussion between the Member States and between the States and the European Institutions. It substantially mirrored the content of the Directive 88/361/EEC¹⁰ (hereinafter “the Directive 88/361”), the most relevant act enacted to implement the hitherto treaty provisions. This freedom is the only one to have undergone such a transformation.

The content of these provisions has not been changed in a significant way with the adoption of the following Treaties: free movement of capital is now provided for by articles 63 – 66 of TFEU.

It is obvious how the decision to modify the Treaty rules (primary source of law) had a precise purpose: to make it clear that the move towards a more integrated market, including that in the financial services, was deemed to be irreversible, whereas the secondary legislation may always be subject to changes depending on the political or economic situation.¹¹

The rules on capital are closely linked to those concerning EMU, which is seen as a one-way process¹² (see *infra* chapter 3).

9 Usher, *The Law of Money and Financial Services in European Community* (n 5) 17, with reference to the case C-267/86 *Van Eycke v. ASPA* [1988] ECR 4769: the plaintiff was denied the protection by the current art. 56 TFEU due to the fact that opening a saving account by a bank situated in another Member State had not been liberalized by that time.

10 Council Directive 88/361 of 24 June 1988 for the implementation of the art. 67 of the Treaty [1988] OJ L178/5

11 Usher, *The Law of Money and Financial Services in European Community* (n 5) 24

12 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 99

1.3 Historical background: from the least developed freedom to a driving force towards further integration

1.3.1 The reasons behind the cautious approach: general aspects

One might wonder why the original drafters of the Treaties, while accepting provisions framed in an imperative way as regards the other elements constituting the internal market, adopted an extremely cautious approach when it came to capital movements.

The same reasons behind such a choice are at the ground of the wary answer given by the CJEU in its early case-law on the topic and are connected to the main object of this study, namely the analysis of the close connections between free movement of capital, monetary union and financial services market.

In order to explain these links adequately, some economic concepts are also to be borne in mind, as explained in the section 1.3.2.

The free movement of capital, in fact, has a significant bearing on the monetary and financial sovereignty of the states: it is no wonder then that the complete liberalization was the fundamental condition for a Member State in order to join the EMU.

The free flow of capital, once allowed to circulate without limitations (and although some possible restrictions remain, indicating that the freedom is not absolute, as well as the other three), may have indeed alleged negative effects, such as speculative movements; in any case, it seriously affects the sphere of economic choices pursued by each government.

The original member states were not ready to accept these challenges in the beginning. They were not willing to surrender financial and monetary competences.¹³

13 Bakker (n 8) 43

First of all it is fundamental to remember the historical context in which the Treaty of Rome was drawn up: Europe was still recovering from the Second World War and it was almost taken for granted that the regime of Bretton Woods, with the Dollar as the main reserve currency and a system of fixed rates as the general rule, would have prevailed forever.

The European integration had just made its first steps and the idea of appointing an upper, supranational, body to take fundamental choices in such sensitive fields was not even conceivable. In this context it is understandable how the liberalization of capital movement was regarded as something to achieve at a future stage, leaving the states the room of maneuver for different policies as regards finances, namely how to set the interest rate.¹⁴ In absence of coordination, capital controls were viewed as an instrument of policy or anyhow the lesser evil.

Hence the original wording of the Treaty of Rome was formulated in a conditional way, leaving the implementation of such a freedom to the secondary legislation to be enacted by the Council (and therefore the Member States), as provided for by art. 69 EEC. Directives have been enacted since the 1960s, with a partial liberalization, until 1988, when a final decisive step towards full liberalization was taken and eventually incorporated in the Maastricht Treaty.

As some authors argue, this freedom is the only one where the rules laid down in the treaties were followed strictly, thus the liberalization was to occur by means of the secondary legislation without (at least in its first stages) the strong intervention of the CJEU against the lack of initiative either of European Institutions or the Member States, as it can be observed instead for the others.¹⁵

The process has proven to be particularly slow and often hampered by contingent urgencies which posed serious threats to its development: during this lapse of time several states have resorted, for different reasons, to various types of capital controls whereby the freedom of

14 Bakker (n 8) 19-21

15 Usher, *The Law of Money and Financial Services in European Community* (n 5) 19, to which Murphy (n 2) 274 expressly refers.

movement, although apparently an important element of the European legal framework, had been considerably curtailed.

The history of the free movement of capital has seen different stages. An early period, few years after the enter into force of the EEC Treaty, showed a partial liberalization, which was followed by a dramatic reverse during the 1970s, unanimously viewed as a “lost decade”. The collapse of the Bretton Woods system, the oil crises and a general political unrest put on hold the development of an integrated capital market in Europe, with many countries reverting to different type of restrictions, often unsuitable to counter the negative effect of the economic conjuncture.¹⁶

Finally, in the 1980s the necessity to resume the path towards capital integration was acknowledged with the adoption of the aforementioned Directive 88/361, prelude to the final stage begun with the Maastricht Treaty and the creation of EMU.

1.3.2 Economic rationale and policy

It is impossible to completely understand the free movement of capital, and its importance, without taking into account the economic background at its basis.

As previously mentioned, free capital may seriously impinge the notion of monetary sovereignty: if restrictions are to be abolished, financial resources can move quickly from one state to another, thereby limiting the power of governments and monetary authorities (usually Central Banks). How? Some examples can be enlightening.

A capital inflow may force the authorities to lower the interest rate to a level which might be deemed inadequate for the internal equilibrium of the state; vice-versa, an abundant outflow towards countries deemed more reliable or where more opportunities exist can suggest a higher rate

in order to avoid losing investors.¹⁷ In both cases the state sees its power to adopt a monetary policy seriously impaired. The latter hypothesis is moreover the typical scenario where the states have advocated the use of capital restraints: a massive outbound flow often feeds the fear of a drain of resources, which can impact tax revenues¹⁸ and therefore leave the state with fewer possibilities to apply its own economic policy.

Some reasons against free movement of capital are, for instance: possible speculation, undesirable outflows to third countries through states with a liberal regime, the alleged risk of tax evasion and finally the fear that the lack of restraints would entail the flow of capital towards developed and rich areas to the detriment of others in need of investments.¹⁹

At the same time a moveable capital plays a decisive role in setting the exchange rates of the single currencies, whose floating might turn out to be harmful for the national economy and not sustainable in the long term. Especially states whose public finances were not sound were afraid that possible devaluations (which eventually would be occurring despite the array of measures adopted²⁰) could have serious repercussions, such as inflationary pressure and the consequent need to adjust the interest rate in a manner contrary to that regarded as preferable at that time.

The capital liberalization is thus a powerful tool. It is one of the element of the so-called “impossible trinity”, along with fixed exchange rates and an independent monetary policy, as depicted by economists (see chapter 3). Furthermore, serious disturbances in the balance of payments may occur.

The choice to limit such a freedom, by leaving open the possibility to restore capital controls and conceding a certain margin of maneuver to the states, was therefore comprehensible in the initial stage of the process leading to European unification. It was seen as necessary that the

17 Willem Molle, *The Economics of European Integration: Theory, Practice, Policy* (5th edition, Ashgate, 2006) 120

18 Ibid 121

19 Bakker (n 8) 32

20 Ibid 102-103: the author illustrates that several downward realignments occurred throughout history, despite the attempts of the states to avoid them. French Franc was a clear example.

Member States would drive the process and not be led by market forces, mainly by enacting the secondary legislation to be fashioned on the degree of evolution reached by the internal market. The topic was too sensitive to be left without caution and in the beginning the CJEU followed suit in this approach.

1.4 The free movement of capital and the Court of Justice: case-law evolution

On the basis of the premises outlined here, it is worth looking at the stance taken by the most important institution as regards the internal market, namely the Court of Justice.

Unlike goods, services and also persons (cases such as *Dassonville*,²¹ *Reyners*,²² *Cassis de Dijon*²³ and *Van Binsbergen*²⁴ just to mention the most important) where the CJEU ruled that restrictive measures were to be regarded as inconsistent with the Community law and at the same time indicated thoroughly the only ways by means of which they could be deemed acceptable, the attitude concerning capital took since the very beginning a different inclination.

A common opinion between scholars is that the attitude of the Court in this special area is an authentic “deference” towards other Institutions, mainly the Council.²⁵ While in the aforementioned decisions the CJEU struck down national restrictions incompatible with the relevant Treaty provisions, even when a margin of discretion was conferred to Council itself, namely by ruling out that the lack of adoption of secondary legislation (the fact that the Council had remained idle where the Treaty required the enactment of directives or regulations) could prevent an

21 Case C-8/74 [1974] ECR 837

22 Case C-2/74 [1974] ECR 631

23 Case C-120/78 [1978] ECR 649

24 Case C-33/74 [1974] ECR 1299

25 Murphy (n 2) 550

individual from relying on the Treaties provisions, the approach was exactly the opposite as regards capital movements.

The case-law with regards to this freedom is way less extensive, especially during the first decades.²⁶ The landmark decision is the *Casati* judgement,²⁷ in which the Court declared (although not explicitly, but it can be easily inferred from the text and no-one has ever claimed a different reading) that the art. 67 EEC had no direct effect, thence it could not be relied on by an individual in order to set aside a national rule allegedly inconsistent with it.

Why deference? The comparison with other important rulings is helpful to this end: neither the wording of the provision, with its particular features as highlighted in the section 1.1, nor the fact that secondary legislation had to be enacted could amount to an insurmountable preclusion to direct effect.²⁸

It is true that the article is not framed in a imperative way and then it may be doubtful if such a doctrine (created by CJEU itself since the well-known decision *Van Gend and Loos*²⁹) could apply; but similar considerations did not prevent the Court from ruling in favor of a far-reaching approach, according to which the movement of goods, service and person were liberalized despite the ambiguity of the Treaty.³⁰

In this case the Court appeared to be very cautious, recognizing to some extent the importance of the economic issues behind the legislative choice and applying a sort of self-restraint:³¹ this aspect cannot be disregarded and marked a clear distinction between capital and the rest of the freedoms constituting the internal market. The CJEU refused the innovative role that it had played previously,³² thereby leaving the

26 Leo Flynn, 'Coming of Age: the Free Movement of Capital Case Law 1993-2002' (2002), Kluwer Law International, no. 39, p. 773: the authors underscores that only ten judgements were delivered during the first 35 years of the Community

27 Case C-203/80 [1981] ECR 2595

28 Snell (n 7) 549: the author analyzes thoroughly all the arguments in favor and against the Court reasoning, coming to the conclusion that none of them alone was decisive but rather the economic-political considerations; Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 60-61, with reference to case-law such as case C-33/70 *SACE* [1970] ECR 1213

29 Case C-26/62 [1963] ECR 1

30 Murphy (n 2) 60

31 Murphy (n 2) 278-279

32 Bakker (n 8) 47; Hindelang (n 4) 34

responsibility to the Council and the Member States, without taking the “driving seat”. The evolution of the free movement of capital, at least in this phase, is characterized by intergovernmentalism, an image rather unusual if compared with the other freedoms.³³ The only way to achieve a free internal market for capital was through positive integration: the Member States could either decide that directives were to be adopted or liberalize on their own.³⁴

The CJEU acknowledged how capital liberalization could undermine the economic policy of the Member States or have a negative effect on the balance of payments, thereby impairing the functioning of the internal market:³⁵ similar observations are totally absent in the aforementioned case-law concerning goods or services, where the Court rejected justifications based on economic grounds. In this case, instead, the CJEU explicitly recognized the Council as the only legitimate body to which the Treaty conferred the power to abolish capital restrictions. Capital was seen as a sensitive area, bearing policy implications; a Court's intervention would have had a striking impact that was likely deemed beyond the role conferred by the Treaties to CJEU.³⁶ Another argument is that in this field the Council had deliberately decided, by enacting directives, not to liberalize all capital movements. Unlike the case-law related to other freedoms, the Court preferred to respect such a choice without taking a strong stance in favor of the removal of barriers.³⁷ The decision left room for a different interpretation though.

The absence of a straightforward rule capable of conferring right to individuals led the CJEU to limit its role in assessing whether the Council by exercising the powers had overstepped its limits of discretion. The Court concluded that it did not occur, nor the clause included in art. 71

33 Snell (n 7) 554

34 Murphy (n 2) 278

35 Ibid 279; Bakker (n 8) 47; Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 61

36 Murphy (n 2) 274

37 Snell (n 7) 550; Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 62: the powers conferred to the Council by art. 69 EEC might be interpreted as a further obstacle to direct effect of art. 67.

EEC could have any bearing being also not framed in an imperative way³⁸ (see back section 1.2).

Such an attitude would change after the adoption of the Directive 88/361, when the CJEU would apply the stricter standards which it is associated with and rule on the direct effect of the directive itself first (case *Bordessa*³⁹) and subsequently once the Maastricht treaty had entered into force (case *Sanz de Lera*⁴⁰) (see chapter 2, section 2.6.1). Since then, the CJEU has assumed the same position it has always had in relation to the other freedoms, pushing in favor of internal market.⁴¹

1.5 The importance of such a freedom from both a legal and economic perspective

The situation analyzed thus far explains why the capital movements have been liberalized slower than goods, services and persons and the reasons behind the approach followed by the Institutions and the Member States. However, in order to understand why this freedom plays a fundamental role, it is necessary to outline its undoubted positive aspects.

An internal market without free capital risks to be nothing than an illusion: it would be pointless to ensure an unfettered access to an integrated area such as European Union if obtaining financial resources was made difficult or impossible by the single States. In the field of financial services, which is one of the main topics of this study, an individual would be deterred from looking for providers located outside its country of origin if there were restrictions on the possible operations (for example, getting a loan assisted by mortgage),⁴² especially in the

38 John A. Usher, 'The Evolution of the Free Movement of Capital', *Fordham International Law Journal* May, 2008 31 *Fordham Int'l L.J.* 1533 1536

39 Joined cases C-358/93 and C-416/93 [1995] ECR I-361

40 Joined cases C-163/94, C-165/94 and C-250/94 [1995] ECR I-4821

41 Snell (n 7) 552

42 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 89; Usher, *The Law of Money and Financial Services in European Community* (n 5) 17

banking sector.⁴³ In order to ensure a real open market, the same degree of liberalization is to be applied to all the freedoms enshrined in the Treaties.

Free movement of capital is ancillary and a natural complement of all the other freedoms. The impossibility to raise barriers to trade would be frustrated (if not even circumvented) were restrictions to capital movements to be admissible, since this freedom facilitates the exercise of the others.⁴⁴

Such an awareness returned to the surface during the 1980s, in particular with the White Book drafted in 1985,⁴⁵ where the need to complete the internal market required to take a step further in direction of a tighter integration. The capital movements had the lion's share.

It was clear that the process had been slowed down too much in the past, often by adopting solutions which had proven ineffective and unsuitable to address the main economic issues. Member States had extensively used capital controls in order to protect their own exchange rates and their monetary policies. The original drafters had adopted a minimalistic approach, which almost excluded any monetary consideration in light of the historical context.⁴⁶ Being absent any means to deal with monetary issues, the free movement of capital had to be set aside until the completion of internal market, whose development might have been undermined by capital flows exerting pressure on interest rates and currencies.

A decisive shift was required after the dramatic changes occurred in the 1970s. The completion by means of liberalization of the capital markets could not be postponed any further: the decision to resume the process of integration is likely to have been suggested by the choice of some member states, most notably Great Britain, which had opted for the

43 Natalia Białek, Arkadiusz Bazyłko, 'Free Movement of Money in European Union – The Role of the European Court of Justice in the Formation of Free Movement of Capital and Payments' (2011), *Financial Internet Quarterly "e-Finanse"*, vol. 7, no. 2, www.e-finanse.com 58

44 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 63

45 Bakker (n 8) 161

46 Ibid 53

removal of all restrictions paving the way for a similar development in other countries. A positive economic conjuncture made it possible to lean towards “deregulation”.

From an economic point of view, capital integration has many advantages. It allows a better allocation of the resources⁴⁷ and it reduces distortions. An area such as Europe is not affected by disturbances which instead may occur in a smaller market. The supply of capital increases, because investors may find the most favorable conditions and therefore savings are mobilized.⁴⁸ More investments are the natural consequence.

It may then encourage a free and open competition,⁴⁹ thereby causing positive effects for consumers and fostering economic growth. It permits direct investments, opening the market to foreign investors and rendering the Common Market more attractive.

The free movement of capital ensures that market actors can find the resources necessary for their investments at the best conditions possible⁵⁰ and tailored to their needs: in such a way savings from a country might be available for those seeking investors in other Member states, with the effect to reduce the cost for capital itself and therefore make an economic activity more profitable.

It is true (as it can be also noted nowadays) that free capital flows may cause speculation, but at the same time the cost for not liberalizing is higher than that required to thwart possible negative effects (on the inefficiency and lack of effectiveness of capital controls see section 3.4.4 *infra*).

47 Białek, Bazylko (n 43) 57

48 Molle (n 17) 121

49 Ibid 121

50 Thomas Horsley, 'The Concept of an Obstacle to Intra-Eu Capital Movement in EU Law' in Niamh Nic Shuibhne and Laurence W. Gormley (eds), *From Single Market to Economic Union: Essays in Memory of John A. Usher* (Oxford Scholarship Online, 2012) 1

2 What is capital?

2.1 In search of a definition

In the previous chapter the history of the free movement of capital has briefly been outlined, explaining why it differed deeply from the other three freedoms despite being it a fundamental element as well for a working open market. However, the meaning of “capital” is often hard to describe with precision and it seems to be comprising different kind of situations.

While goods and persons (or workers) are concepts well defined or however tangible and services are instead identified in a residual way, namely as anything not belonging to the other categories (art. 57 TFEU), to identify what capital exactly means is less intuitive.

As if it was not difficult enough, the european legislator has introduced, alongside capital, the figure of “payments” without providing express criteria to distinguish between them. Although such a distinction has progressively lost the importance it used to have, from a theoretical point of view the two concepts are still different and therefore it is important to avoid ambiguity by describing their respective key features. See section 2.6.2 *infra*.

Again, it must be borne in mind that several connections between the legal and the economic field exist, but at the same time that does not entail a complete overlap or an interchangeability of the notions at stake. For the purpose of this study, the definition of capital drawn from the economic sphere will be shortly described, along with that used by the CJEU and the legal sources which are relevant on the point.

2.2 Absence of express definitions in the Treaties

The first problem for each legal scholar is to identify the scope of the provisions regarding capital.

Since the enactment of the Directive 88/361 and the Maastricht Treaty in 1992, the complete liberalization implies that all the restrictions to free movement are prohibited (now art. 63 TFEU): the provision is clear, precise, unconditional and it does not require any implementing measure, thus it is deemed to be directly effective. All capital movements, and payments, cannot be restricted save in case of possible exceptions (which can be express or based on the so-called rule of reason test, see *infra* 2.5.4). Unlike the first decades of European integration, this freedom has now the same value of the other three.

Once said that, the main question remains: what constitutes a capital movement? The answer is extremely important also in order to decide whether a situation is to be regulated under the rules analyzed here or by those concerning goods, persons and services. It must also be remembered that the Treaty protects the “movement”, namely the transfer and not the capital as such.⁵¹

The Treaty provisions are not very helpful. Some figures such as “direct investment” or “financial Services” are mentioned (art. 64, with regards to possible restrictions) but without further explanations.

The Court itself has never relied on the Treaty rules in order to find a solution. The case-law offers nevertheless a guidance: in numerous occasions the CJEU has not fashioned an autonomous notion of capital movement but has simply referred to the Directive 88/361, more specifically to its Annex known as the “Nomenclature”.⁵² The long list provided indicated several possible operations, even though it cannot be considered exhaustive, as its preamble states; a further element in favor

51 Hindelang, (n 4) 48-49

52 Horsley (n 50) 158

of this interpretation, widely accepted, is the existence of a residual category named '*other*', indicating that even operations not mentioned could doubtless fall within the scope of the freedom.⁵³

Some examples are securities such as transactions on the capital markets, financial loans and credits, import and export of financial assets.

With the entry into force of the Maastricht Treaty and the modifications occurred in the field of capital, as described in the first chapter, the Directive 88/361 has been repealed but it still maintains its indicative value. The CJEU, in fact, constantly refers to it such as in the case *Trummer & Mayer* (whose main point revolved around a loan assisted by a mortgage taken abroad and its registration),⁵⁴ notwithstanding the only legal provisions to be taken into account nowadays are those set out in the TFEU.

One remarkable aspect is that, despite the different typologies mentioned in the Directive 88/361, the CJEU has always refrained from formulating a univocal positive definition as to what constitutes a capital movement, preferring often to address the individual problems for each situation and thereby offering *ad hoc* solutions. The necessary features, which must be present in order to apply the relative rules,⁵⁵ have never been outlined with precision. A practice that has often led to doubts as to the qualification to give in cases where the boundaries between capital and services, establishment or even goods (typical case coins and other means of payment which are not legal tender⁵⁶) are blurred, as it will be explained in section 2.7.

2.3 Economic concept

The notion of capital is drawn from the economic field, as widely known.

53 Klaus J. Hopt, Eddy Wymeersch (eds), *European Company and Financial Law* (4th edition, Oxford University Press, 2007) 435
54 Case C-222/97 [1999] ECR I-1661
55 Horsley (n 50) 158
56 Case C-7/78 *R. v. Thompson* [1978] ECR 2247

However, such a definition is necessarily broad and encompasses various figures. A distinction may be made between “financial” capital, defined as any potential input for a future production, and capital as all the factors of production.⁵⁷

The drafters of the Directive 88/361, as well as CJEU, have always seemed to be aware of the difficulty to give one definition capable of covering all the possible meanings of the term “capital”, therefore they opted for an open list bearing in mind that the evolution in financial markets could introduce figures unknown before.⁵⁸

The numerous types of capital movement described in the Annex reveal the breadth of the category; the Treaty itself, even after Maastricht, continue to adopt a general definition in order to maintain a certain flexibility in the rules at issue.

One main distinction is between portfolio investments, aimed at obtaining a revenue and those investments whose purpose is instead to take over or gain a decisive influence over an undertaking. If the former category falls obviously within the scope of the free movement of capital, the latter is more problematic and it may entail an overlap with the freedom of establishment (art. 49 TFEU).⁵⁹ See section 2.7 *infra*.

2.4 The secondary legislation implementing the original treaty provisions from the 60s to Maastricht Treaty

A little summary is useful at this point, before going into further details. As previously mentioned, the free movement of capital, mainly due to economic and political issues, did not follow the same path of the other freedoms, where the CJEU exercised a strong role in order to remove all

57 Hindelang (n 4) 46

58 Ibid 43-44

59 Horsley (n 50) 158: according to the author, the acquisition of shares granting the investor a “definite influence” in the management of the undertaking concerned is not caught by the rules on capital, with reference to case C-436/00, *X and Y v. Skatteverket*, [2002] ECR I-10829

the hindrances to the development of the internal market (even though it meant superseding the role conferred to the Council and therefore the Member States); the liberalization thus was to occur by means of positive integration, namely through directives, and it was to be gradual in order not to impinge the competences in the monetary and financial field left to the Member States until the Maastricht Treaty.

There were constant ebb and flows, characterized by different degrees of freedom, owing to the influence of external circumstances which exerted a strong strain over the integration process.

In the 1960s two directives were enacted.⁶⁰ The method used consisted of a list of operations subject to different treatments, ranging from a complete liberalization, to a partial or no liberalization at all (four lists, from A to D, were provided). A further review occurred in 1986,⁶¹ after that in the previous decade the process had substantially stopped: as acknowledged, the state of capital movement was less free at the beginning of the 1980s than it used to be few years after the sign of the Treaty of Rome. A state of facts which convinced Member States to launch the program for the completion of the internal market as it can be read in the White Book mentioned before.

The Directive 88/361 was instead a huge leap forward. Although the wording of the Treaty did not change, the effect was striking. All the movements of capital were completely liberalized. No ambiguity could be possible: the debate as to whether the art. 67 EEC might have direct effect and consequently being relied on by individuals against the state, resolved by CJEU in the negative sense, was no longer actual. The new main provision (art. 1 of the Directive 88/361), which was to be incorporated finally in the Maastricht Treaty few years later, removed all doubts, as confirmed later on by the Court (see next section); at the same time, as already anticipated, the Annex attached to the Directive 88/361

60 Council Directive 60/1/EEC of 11 May 1960 for the implementation of Article 67 of the Treaty, OJ 1960; Directive 63/21/EEC of 18 December 1962 adding to and amending the First Directive for the implementation of Article 67 of the Treaty, OJ 1962 9/62 at 5; see also Usher, *The Law of Money and Financial Services in European Community* (n 5) 17

61 Council Directive 86/566/EEC, OJ L332/22

provided clear indications as to what could be deemed capital movement. A noteworthy aspect is the inclusion of the investments in the real estate, which beyond doubt fall within the scope of art. 63 TFEU, although from an economic point of view they do not constitute capital:⁶² an evident note that the notion of capital is to be construed in an extremely broad way and not limited to financial operations, but encompassing all kind of investments intended to generate a possible revenue.

2.5 Current legal basis and role of the Directive 88/361 in the present framework

The rules currently in force are included in the Chapter 4 of the Title IV of the TFEU, from the art. 63, former art. 56 TEC (art. 73(b) before the adoption of the Treaty of Amsterdam), which reproduces in substance the content of the art. 1 of the Directive 88/361. Apart from being renumbered, no other significant changes have occurred in recent years.

The free movement of capital is placed among the other provisions of the Treaties, then on the top of the hierarchy, without the original limitations. Besides what has already been explained in the Chapter 1 (the intention to confer to this freedom the same value enjoyed by the other three) other reasons suggested the incorporation of the rule provided by art. 1 Directive 88/361 in the legal text of the TFEU: although a provision of a directive can be precise enough to have direct effect, such a possibility is residual and surrounded by limits such as the failure of a Member State to implement it or its inadequate implementation, the exclusion of the horizontal effect (impossibility to plead it against another private individual), arguments that cannot be put forward in relation to rules stemming from primary law.⁶³ However, for the sake of completeness it must be said that no rulings over the possible horizontal direct effect of

62 Hindelang, (n 4) 46

63 Usher, *The Law of Money and Financial Services in European Community* (n 5) 25

art. 63 have been delivered so far and the issue is still debated.⁶⁴ However, it has been established that in the fields of services the relevant Treaty provisions can be relied on against private persons (such as trade unions or professional associations), therefore according to some scholars the same should hold true with regards to capital movement, being absolutely conceivable the conduct of financial institutions making the transfers more difficult.⁶⁵

The articles from 64 to 66 introduce some limitations and possible restraints to the freedom, which is still viewed with suspicion as it can be inferred from the text: apart from the so-called grandfather clause under art. 64(1) (not really actual), it clearly appears that the caution of the drafters, albeit diminished, has not disappeared completely. Especially in the field of taxation (a topic excluded by this work) the question is still sensitive (the controversial distinction between residents and non-residents based on art. 65(1)(a)); moreover, other restrictions may be temporarily reintroduced in case of serious disturbances to the monetary dimension, showing once more the unavoidable connections between free movement of capital and monetary issues, whose details will be addressed in Chapter 3.

The Directive 88/361 is no longer in force, but the CJEU still refers to the “Nomenclature”, as plain demonstrated by the case-law since the beginning of the nineties.

One of the most peculiar aspects, which makes this freedom unique, is that the liberalization has been pursued not just in the intra-Union context but also towards third countries (art. 63(2)). Although the complex relationship between the Community (now Union) and third countries as regards capital movements is not the object of this work and would deserve a separate dissertation due to the numerous problems which may result, some aspects cannot be disregarded: besides the economic

64 Barnard (n 3) 566-567; Usher, *The Law of Money and Financial Services in European Community* (n 5) 27 seems to support this thesis.

65 Usher, *The Law of Money and Financial Services in European Community* (n 5) 27; Hindelang (n 4) 210-212: according to the author, horizontal direct effect is conceivable only against private persons with state-like powers and only as last resort.

rationale (the intention to create a market as open as possible for foreign investors and make European Union a competitive area on the global scenario), the openness is necessary in the light of the EMU, specifically in relation to the adoption of the single currency (the Euro). The topic will be illustrated in Chapter 3. It can be said here that in light of the project aimed at establishing a monetary union and a single currency, such a choice is recommended so as to assure the international investors as to the availability of Euros, to grant an access to market with the certainty that no costs will be imposed on the reimportation of capital invested and finally with the aim to establish Europe as a global financial center.

2.6 Main legal issues and CJEU case-law

2.6.1 Liberalization of capital movements in general

One of the paramount points after the changes outlined in the previous paragraphs is the legal value of the art. 63 TFEU.

The *Casati* judgement, in fact, excluded the direct effect of its predecessor, namely the art. 67 EEC given its formulation (see Chapter 1); the situation was however bound to change after 1988 and the Directive 88/361.

The response of the CJEU showed, as predictable, a complete turnaround of the approach followed until then by the European judges. The decision in the case *Bordessa* is exemplary: the CJEU ruled that the art. 1 of the Directive 88/361 required all restrictions to capital movements be abolished and the provision might be relied on by any individual. Some scholars remark how the Court's decision was based on the secondary legislation and thus it did not modify the nature of the corresponding

Treaty provision⁶⁶ (not yet changed and characterized by the safeguard clause that liberalization should have been progressive and limited to what necessary to ensure the functioning of the internal market). Such an observation helps to understand why the incorporation in the Treaty was necessary, as it happened afterwards. A change of policy, in fact, might have reversed the choice to liberalize capital movements simply by repealing or modifying the Directive itself,⁶⁷ whereas the Treaty required unanimity and more complex procedures to be amended.

In the case *Sanz de Lera*, which came few years later from Spain, as well as *Bordessa*, besides being based on almost identical facts, the CJEU confirmed the same outcome by referring this time to the relevant Treaty provision.

Since then, the Court has never departed from such a conclusion; furthermore, besides this change, the attitude of CJEU has remarkably changed. The deference shown in the first years, in stark contrast with the rulings delivered as regards goods, persons and services, seems to have completely vanished. The main reasons can be found, alongside the changed wording of the Treaty, in a different economic context and a new political scenario, much more favorable towards capital free circulation.⁶⁸ The caution that the CJEU showed in the *Casati* case was grounded on concerns whose importance was seriously diminished.

The CJEU has regained its role in favor of the internal market, by striking down several national measures deemed inconsistent with the modified legal framework and with a strong attention on the application of the proportionality test. Even when a restriction might have been justified, the Court has stressed the duty not to limit the free movement more than necessary, by adopting a quite strict approach.

66 Murphy (n 2) 283

67 Ibid

68 Ibid 292-293

2.6.2 Capital and payments: an outdated question

Another issue to which the CJEU has been called to provide a solution regards the somewhat confused relationship between capital and payments.

An historical premise is again necessary: whereas movements of capital were only partially liberalized, and in any case on the basis of secondary legislation, payments were instead freed since the beginning (art. 106 EEC).

The question is nowadays outdated given the current legal framework, where capital and payments are placed on equal footing and subject to the same treatment (art. 63(2) TFEU). The only reason to distinguish these two figures lies in the different treatment conferred to capital in contrast to the other freedoms for what concerns third countries. While free movement of capital applies also when one party is located outside the EU, the same cannot be held for goods or services for example (see *infra* section 2.7).

The criterion that has been used can be found in the case *Luisi & Carbone*.⁶⁹ The CJEU draws the distinction in the following terms: a payment, unlike a movement of capital, is the consideration in a synallagmatic relationship. In other words, what is given in return of goods and services, while a movement of capital is characterized rather by an investment than remuneration. Such a solution has been heavily criticized by the doctrine for its ambiguity,⁷⁰ making it hard to decide whether it falls within one category or the other.⁷¹

The problem arose due to the different treatment illustrated above. Being in force the rules pre-Directive 88/361, only a payment could be performed freely, where if the operation was regarded as a movement of

69 Joined cases C-286/82 and C-26/83 [1984] ECR 377

70 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 51

71 Usher, *The Law of Money and Financial Services in European Community* (n 5) 12: the distinction is hard to trace, for instance, with life insurance where part of the premium is intended partly to cover expenses and to pay the insurance itself (then a payment), but on the other hand also with an investment purpose (thus a capital movement).

capital it was subject to the restrictions existing at that time.

Once removed all obstacles, the problem is way less important, if not totally superfluous, even though the concepts are different and thus it may be worth being aware of that.

2.6.3 “*Erga omnes*” principle: free movement of capital and third countries

The most distinguishing feature of the freedom object of this work is its extension to third countries. Capital movements have been liberalized also when they are directed to, or are originated from, countries which are not part of EU. The effect is “*erga omnes*”.

This choice has been the outcome of long and complicate discussions between the Member States, with some of them afraid of the possible negative effects caused by eventual massive inflows or outflows of capital from or towards countries extraneous to the integration process.⁷²

However, such a decision has an economic rationale. First it permits and facilitates direct investments which can be beneficial to Union's economy: any investor knows that reimporting the capital will not be subject to restrictions or limitations, which should increase the attractiveness of the European area. Then if such a rule did not exist, it would be easy to enter or exit the Union via the most liberal state,⁷³ a situation which may create distortions and impairing the common level playing field to the detriment of single Member States, if not leading to a race to the bottom in order to become more interesting for the investments.

Finally, in the view of establishing a monetary union and a single currency, the liberalization towards third countries is an essential assumption to reassure the economic community as to the complete

72 Bakker (n 8) 230

73 Snell (n 7) 564

availability of Euros.⁷⁴ The monetary relevance of this choice is underscored by the safeguards included in art. 66 TFEU, conferring to the Council the power to introduce restrictions to be applied in relation to third countries when serious difficulties for the functioning of economic and monetary union arise. Similar powers are provided for by art. 64(2) and 64(3), allowing a step backwards in certain circumstances or by art. 65(4): such a provision is quite interesting, since it empowers the Council to assess the legality of a national measure restricting the free movement to and from third countries (even though only for tax purposes), a role which is generally incumbent upon the judicial body, the CJEU, and not the executive. All these cautions show how the matter is still viewed as sensitive and therefore the “*erga omnes*” principle, although accepted in theory, remains surrounded by suspicion and it is less categorical than it may appear.

The CJEU has proven quite liberal in this field, by ruling that the provision on the free movement of capital may be relied on also by those outside EU, thereby conferring direct effect in their regard. At the same time it is not relevant, as ruled in case *Sanz de Lera* mentioned before, where the capital are directed given this peculiarity (in the case at issue third countries such as Switzerland and Turkey). However, despite this general assertion, the safeguards have not been completely ignored by the CJEU: in the ruling *A v. Skatteverket*⁷⁵ the Court first affirmed that the national legislation (of Sweden in this case) was inconsistent with art. 63 TFEU, which can be relied on regardless of the person invoking it resides inside or outside the Union, then it signaled that due to the difference of context the outcome might be different in third country situations. In practice, the CJEU tends to accept justifications for the restrictions which probably would not be deemed acceptable within the EU, like those of economic nature.⁷⁶

74 Snell (n 7) 564; Usher, *The Law of Money and Financial Services in European Community* (n 5) 22-23; Usher, 'The Evolution of the Free Movement of Capital' (n 38) 1543

75 Case C-101/05 *A v. Skatteverket* [2007] ECR I-11531

76 Snell (n 7) 566-567

2.6.4 The concept of restriction

2.6.4.1 The (broad) answer of the CJEU: beyond the concept of discrimination

The liberalization implies the prohibition of restrictions to capital flows. As a general rule, it may be worth referring to the famous “*Dassonville* formula” and its impact: not just explicit and actual restrictions, but also those merely potential.⁷⁷

In the field of capital the case-law of CJEU has been quite scarce for many years, as a consequence of the low degree of liberalization, and still now it is not as extensive as in other areas. In any case, some common features can be identified, bearing in mind that differences in the approach might occur and a clear rule such as that aforementioned has never been affirmed.⁷⁸

Since the enactment of the Directive 88/361, the Court has taken a rigid stance, more in compliance with its attitude in favor of the internal market. In most cases, a restriction has been described in an extremely broad way: any measure capable of deterring, or making less attractive a possible investment (in general one of the operations included in the Nomenclature, although the list is open and not exhaustive) is to be forbidden.⁷⁹ At the same time all derogations are to be narrowly applied and never conceal economic ends.⁸⁰

The Court has often used words such as '*liable to dissuade*', '*liable to impede*' or has found to be inconsistent rules capable of imposing additional costs.⁸¹

77 Flynn (n 26) 783

78 Steve Peers, 'Free Movement of Capital: Learning Lessons or Slipping on Spilt Milk?' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Hart Publishing, 2002) 342

79 Snell (n 7) 555

80 As it can be inferred from Case C-54/99, *Eglise de Scientologie* [2000] ECR I-1335, see Barnard (n 3) 585-586; Flynn (n 26)

797

81 Hindelang (n 4) 119-121; Flynn (n 26) 780

Such an interpretation might be welcomed by all those who consider the free movement of capital a pillar of the common market, but at the same time it is not immune from criticisms. Firstly, instead than affirming a clear rule, the CJEU has preferred again to follow an incremental approach, namely by adding different hypotheses where the provisions of capital apply, with *ad hoc* judgements addressing individual situations.⁸²

Some striking examples are drawn from the tax field. Once adopted this approach, any additional burden imposed on an individual might discourage him from seeking an investment and therefore be not acceptable. The case *Sandoz*⁸³ seems to suggest this outcome:⁸⁴ a stamp duty imposed on loans taken abroad, irrespective of where the lender was established and although indistinctly applicable was regarded as a restriction of the free movement of capital (eventually the measure was upheld since it complied with the derogation provided for by art. 65(1) (b)). The conclusion which can be drawn from this case is that every fiscal burden, in order to be upheld, has to be justified.⁸⁵

Nevertheless, it is obvious that in such a way the fiscal competence, which is still a competence of the Member States, might be considerably curtailed, even though the justification put forward (by Austria in this case) was accepted. Probably that has triggered protests which may have had an influence over the Court; the approach in recent cases appears more cautious, as some scholars have noticed, at least in the field of taxation where the prerogatives of the Member States have not been transferred to the Union yet.⁸⁶

Furthermore, the CJEU has never developed a distinction between discriminatory measures and other types of restrictions. The Court seems to have overlooked the problem, and the analysis of the case-law confirms such a view:⁸⁷ the focus is always on the possible deterrent

82 Peers (n 78) 342-343
83 Case C-439/97 [1999] ECR I-7041
84 Peers (n 78) 343
85 Flynn (n 26) 779
86 Snell (n 7) 567-573; Barnard (n 3) 577
87 Flynn (n 26) 782

effect without assessing if there is a discrimination, either direct or indirect, or the measure is applicable without distinction. The approach could be deemed flawed, since even the Treaty mentions the concept under art. 65(3), by stating that the express derogations therein provided '*shall not constitute a means of arbitrary discrimination*'. However, in a handful of cases the Court mentions the concept of discrimination or refers to it.⁸⁸

As known, according to CJEU, while non-discriminatory restrictions may be justified by the existence of legitimate overriding interests, the so-called rule of reason test⁸⁹ (and provided that the measure is suitable and proportionate, thus not more restrictive than necessary), if the discrimination occurs the State can exclusively rely on the express derogations (and again respecting the principle of proportionality).⁹⁰

The Court should perhaps clarify its stance, still too ambiguous. It is evident that in the field of capital to trace a line between discriminatory restrictions (both direct and indirect) and those indistinctly applicable may be an arduous task. Unlike the origin on goods, for instance, or the nationality of the provider of a service, to assign a provenience to an investment might be extremely complicate.⁹¹ Notwithstanding that, the absence of criteria is hardly acceptable for the sake of a market based on clear rules;⁹² moreover, not having clarified such an aspect might lead to an abuse of the rule of reason test, with states invoking mandatory unexpressed requirements in order to justify limitations which actually discriminate, thereby curtailing the free movement of capital. The strict application of the proportionality test cannot be a surrogate, being conceptually different (it is not to be applied to the nature of the restricting measure, but only on whether the measure itself is suitable and

88 Hindelang (n 4) 142-143: the cases C-302/97 *Konle* [1999] ECR I-3099 and C-423/98 *Albore* [2000] ECR I-5965 are among those. According to the author, on the basis of the existing case-law it is almost impossible to draw a clear line between an approach based on a non-discrimination test and the general tendency of the Court to refer to a more general assessment based on a restriction.

89 Ibid 261-268

90 Also in the field of capital movements, see again cases *Konle* and *Albore*, see note 88 above, cited in Peers (n 78) 347

91 Ibid 344

92 Ibid 347-348

not excessive).

On the other hand, the adoption of a broad concept of restriction allows to comprise several types measures, even those having different aims such as the “golden-shares” rules.⁹³

Other authors⁹⁴ propose to apply either a test based on the market-access (as for goods, like in the cases *Commission vs Italy*⁹⁵ as regards trailers or *Mickelsson & Ross*⁹⁶) or based on a more general “adverse effect”.⁹⁷ Although the first idea may sound intriguing, it does not seem to fit to capital markets; while a market-access approach works well with goods, it is hard to conceive a financial market with the same features. To explain it clearly: if free movement of capital is necessary to allocate better the resources, not all the capital providers compete in the same scenario. A capital seeker might need some resources tailored to its specific needs, unlike a good or a service which can be to varying degrees interchangeable.⁹⁸ Then the concept of access to a market might not make any real sense.

The “adverse effect” appears a more suitable criterion. Following this approach, any measure whose effect is to deter or make less attractive a capital movement is deemed prohibited, regardless of possible discrimination or the scope of the measure itself.

2.6.4.2 Territorial scope of the freedom

In order for the rules on free movement of capital to be applied (or invoked), the practical situation must fall within their scope.

A cross-border element is then essential, having the Treaty rules no

93 Barnard (n 3) 572 in which one of the “golden shares” cases is mentioned: case C-367/98 *Commission v. Portugal* [2002] ECR I-4731. The Court claims that the scope of art. 63 'goes beyond the mere elimination of unequal treatment, on grounds of nationality, as between operators on the financial market' (par. 44)

94 Horsley (n 50) 170-174

95 Case C-110/05 [2009] ECR I-519

96 Case C-142/05 [2009] ECR I-4273

97 Peers (n 78) 345

98 Ibid

bearing in case of wholly internal situations.⁹⁹

The case-law shows how this concept has been construed broadly as well, by excluding only cases where no extraneous elements were present at all. It may appear as a further indication of the CJEU's attitude post-Maastricht, as an attempt to review the legality of as many measures as possible. A cross-border border situation, in fact, may occur even when both the provider and the recipient are located in the same country.¹⁰⁰

2.7 Relationship with other freedoms, with particular attention on services: an unsolved dilemma

2.7.1 Can two freedoms compete with each other or not?

The absence of an express definition of capital, along with the lack of clarity by CJEU leads inevitably to a problem as to the qualification to give in doubtful cases.

The notion of movement of capital, and the consequent application of the relevant rules, may often overlap with other situations covered by other provisions in the EU legal framework.

The most evident example is offered by the relationship between capital and freedom of establishment (art. 49 TFEU): the acquisition of shares in a company, for instance, can represent either a portfolio investment (where the investor's aim is to obtain a profit in terms of dividends) or the intention to take over an undertaking, by gaining influence over the management.¹⁰¹ Admitted that, in theory, both freedoms seem to be applicable, which one prevails? Or is the situation to be analyzed from both angles?

99 Hindelang (n 4) 60-63

100 Case C-67/08 *Block v. Finanzamt Kuafbeuren* [2009] ECR I-883, see Barnard (n 3) 564

101 *Ibid* 568

The freedom to provide services is to be taken into account as well. To qualify the circumstances in an appropriate way is not always an easy exercise.

Before going into details as regards the relationship between services and capital, which will be the object of the next section, the first question is to be answered, namely whether two freedoms may compete with each other or not. If the answer were the latter, it would then be reasonable to set out the criteria to decide in a predictable manner which one takes over.

That being so, it must be disappointing to find out how the solutions provided by CJEU are not satisfactory. The Court, in a similar way to that described before concerning the definition of capital, prefers to address the issue with *ad hoc* solutions, sometimes even sidestepping it.

In the *Svensson*¹⁰² case the Court conclude that both rules on services and capital are to be applied, while in *Sandoz* it relied only on the latter.¹⁰³

Such an approach is attacked by AG Tesouro in the case *Safir*,¹⁰⁴ by suggesting in his opinion that the two concepts should be kept separated by adopting a narrower concept of capital (but the Court eventually resorted only to art. 49 TEC, now art. 56 TFEU).

From AG's point of view, when two freedoms apparently collide, i.e. both may be invoked, it must be assessed the nature of the restrictive measure. In other words, whether it consists of an intrinsically monetary restraint, affecting capital, or whether the restrictive effects are only an inevitable consequence of the limitations of another freedom.¹⁰⁵ Such an approach resembles the Court's decision in the *Bachmann*¹⁰⁶ case, a judgement delivered pre-Maastricht and pre-Directive 88/361, where it was affirmed that rules on free movement of capital did not prohibit restrictions which resulted indirectly from restrictions of other freedoms.¹⁰⁷ The ruling

102 Case C-484/93, *Svensson & Gustafsson v. Ministre du Logement* [1995] ECR I-3955

103 Snell (n 7) 568

104 Case C-118/96 [1998] ECR I-1897

105 Flynn (n 26) 778 and 791

106 Case C-204/90 [1992] ECR I-249

107 Peers (n 78) 338

remained an isolated case though.

The assessment of a national measure on the basis of its alleged nature, so-called “centre of gravity” attitude, is a questionable judgement; every member state could simply conceal the measure at issue, by framing it with a particular language, and thereby escaping the stricter Treaty rules.¹⁰⁸ On the other hand the suggestion has the merit to draw a hypothetical line in cases where the qualification is unsettled.

However, recent case-law shows the inclination of the CJEU to privilege one freedom,¹⁰⁹ or to require that the case be examined under one and only if the first turns out to be inappropriate take into account the latter.

As of today, no solution has prevailed. The decision to apply one (and only one) is questionable. According to some authors, the Treaties seem to suggest a parallel application,¹¹⁰ given the fact also that all the freedoms are fundamental principles of the internal market and therefore it is hardly comprehensible why one should be sacrificed being absent more express criteria.¹¹¹ The wording of the Treaty seems to suggest this approach, given for example the cross references between art. 49(2) TFEU (*'... subject to the Chapter relating to Capital'*) and art. 65(2) (*'The provisions of this chapter shall apply without prejudice to the applicability of restrictions on the right of establishment...'*): by applying the exclusive approach, these references would become totally superfluous.¹¹² A primacy cannot be inferred in favor of one freedom.¹¹³ All freedoms cover different aspects of the economic activities, therefore to limit the assessment of national measures allegedly inconsistent on the basis only on one might reduce the effectiveness of EU law and, with regards to to capital in particular, seriously risk to nullify the “*erga omnes*” principle by opening the way to unjustified restrictions when

108 Hindelang (n 4) 100

109 Barnard, (n 3) 568

110 Snell (n 7) 110

111 Flynn (n 26) 787: the author seems to view the freedom to provide services as subordinate though.

112 Snell (n 7) 569

113 Hindelang (n 4) 89

third countries are involved¹¹⁴ (see next section).

At the same time, especially in cases involving third countries, the free movement of capital should be the correct reference¹¹⁵ due to its peculiarity, whichever approach were adopted.

2.7.2 Capital and services: the case of financial services and banking

For the scope of this study, the freedom to provide services (art. 56 TFEU) gains prominence.

The sector of banking and financial services, in fact, may fall within the scope of both. As written in the first chapter, the free movement of capital is necessarily complementary, given that its absence would impair seriously the freedom to provide services. It is hard to conceive a common market in the financial services with capital restrictions still in force, since most of the financial operations involve movements of capital.

The two freedoms are therefore deeply intertwined, as also confirmed by art. 58(2) TFEU: the liberalization of banking services connected with capital movement are to be pursued in parallel with the liberalization of capital. Considering that such a provision has been included since the very beginning, it must be inferred that the European legislator has always been aware of that.

For legal purposes, however, knowing which rules are to be applied is equally important to ensure a fair level playing field for all competitors, eliminating the grey areas which may be dangerous for a harmonious development of the market itself. As the recent crisis has demonstrated, nothing causes more harm than uncertainty.

The most relevant case is without doubt the *Fidium Finanz* ruling:¹¹⁶ the CJEU ruled that a company providing financial services whose seat was

114 Ibid 111

115 Snell (n 7) 569 572

116 Case C-452/04 [2006] ECR I-9521

located outside EU (Switzerland) is not entitled to rely on the free movement of capital because the freedom to provide services was the only relevant. Eventual restrictions on capital were a secondary effect and since the extension to third countries does not apply for services, the plaintiff was denied the protection of the Treaty provisions.

The decision was controversial and sparked off criticisms.¹¹⁷ The Court noted that both freedoms were affected but, by analyzing the content of the national measure at issue, it eventually ruled that free movement of capital was secondary, being the adverse effect occurred nothing than an unavoidable consequences of the restriction on services. The compatibility with art. 63 was not addressed. The CJEU took in any case a clear stance by stating that, notwithstanding the apparent “hierarchy” which would place the freedom to provide services on the bottom due to its residual character (art. 57 TFEU states that “services” are to be deemed such '*insofar they are not governed by the provisions relating to freedom of movement of goods, persons and capital*'), such an interpretation cannot be accepted.¹¹⁸

The question remains substantially open. The relevant cases examined in the previous section, such as *Svensson* or *Safir*, do not seem to give a clear guidance. Other rulings appear even contradictory: while in the already mentioned *Trummer & Mayer* the CJEU asserted that a mortgage fell within the scope of art. 63 (at that time art. 56 TEC) although it was connected to the grant of a loan (a service) and so it ruled, in the case *Ambry*¹¹⁹ a financial security included in the Nomenclature was instead assessed under art. 49 TEC.¹²⁰

It has been suggested that the shift in the approach is grounded on economic reasons, namely the unwillingness of the Member States to

117 Hindelang (n 4) 99: the author attacks the approach followed by the CJEU by defining it “fuzzy and vague”; at p. 96, he also reports the words of the AG Stix-Hackl '*if reliance on art. 56 [now 63] in relation to undertakings in third country were automatically to be ruled out whenever another fundamental freedom is involved because of the subject matter in question, the guarantees provided by the free movement of capital would be meaningless*' (par. 74)

118 Snell (n 7) 569

119 Case C-410/96 [1998] ECR I-1897

120 Usher, *The Law of Money and Financial Services in European Community* (n 5) 98; Peers (n 78) 339-340

permit the extension to third countries of the Treaties freedoms via the backdoor of the free movement of capital.¹²¹

Five areas can be identified nowadays where the CJEU applies the rules on capital alone: property purchase and investment, currency and other financial transactions, loans, investment where those affected do not have a dominant interest in the company, the “golden shares” cases.¹²²

121 Barnard (n 3) 568-569
122 Ibid

3 Economic and Monetary Union (EMU) and the inextricable link with the free movement of capital

3.1 Introduction

This study has been focusing in the first two chapters on the free movement of capital by illustrating its fundamental characteristics along with its unavoidable peculiarities, which make it absolutely unique among the freedoms laid down in the Treaties.

One of the aspects mentioned several times has been the close connections with the monetary dimension and the impact that the liberalization of capital may have (and which have had) in the sphere of the economic policies of the Union and the Member States.

The EMU, which stands for “economic and monetary union” (and not “european monetary union”) is a project launched at the same time of the decision to step forward and confer to the free movement of capital the value that it could not enjoy until then. As said, there is a rationale behind it still visible today, even though the project itself has constantly been under stark criticisms, especially in the last years of turbulences.

This chapter will try, on the basis of the notions previously outlined to address these issues and explain why the links between capital and monetary dimension are extremely tight and are to be seriously taken into account in the pursuit of a more efficient integrated market.

3.2 The “impossible trinity”: free movement of capital, monetary policy and fixed exchange rate.

The liberalization of capital has been a complex process, highly

influenced by economic and political considerations and generally speaking often seen more as a danger to stability than an opportunity. However, despite a vivid debate, it has been acknowledged how the development of internal market, if not the European project globally considered, would have reached a stalemate in absence of such a move.

The best way to understand the terms of the question lies once again in the economic field, first and foremost in a figure which has been thoroughly analyzed: the “impossible trinity”. What is it?

According to economists, three element cannot be combined at the same time: free movement of capital, an independent monetary policy and fixed exchange rates. At least one of them has to give in if the others are to be pursued.¹²³

Without spending too much words on the topic, which can be extremely complicate and knowing that a certain degree of approximation is inevitable, the monetary policy deals with the setting of the interest rate. As explained in the Chapter 1, some Member States (France has been one of them, while Germany or the Netherlands for example have usually had a more liberal approach) have contrasted capital liberalization putting forward different kind of arguments and fears. One argument is that, in presence of free flow of capitals, the power to set an autonomous interest rate would have been irremediably compromised. Inbound and outbound flows force, in fact, the Central Bank of a country to adjust it,¹²⁴ leading to results not always seen as the best choice by governments (for instance, a high rate renders loans less affordable with an impact on the economy, but not adjusting it may lead to inflation, which might be even more dangerous). To prevent such an effect, the Member States have advocated the use of capital controls. By impeding capital to leave the country (in search of better yield abroad) or by stopping massive inflows capable of having destabilizing effects, a margin of maneuver remains to the detriment of a more efficient allocation of resources, which is instead

123 Charles Wyplosz, 'EMU: Why and How It May Happen' (Fall 1997), *Journal of Economic Perspectives*, vol. 11, no. 7, p. 3 3-4
124 Hindelang (n 4) 21

one of the main goals of capital liberalization.

The exchange rate is the other element of the triad. Until the demise of Bretton Woods system, the currencies were all pegged to US Dollar with fixed rates. The existence of such an agreement is one of the cause, as mentioned, of the caution adopted by the original Treaty drafters with regards to capital movements, along with the omission of rules concerning monetary aspects. Nobody in 1957 could predict that less than twenty years later the system would be abandoned due to changed economic conditions.

If currencies are not fixed, they float freely, but this situation has never been accepted by European governments, especially those of Member States whose public finances are not sound. The main problem with floating is that it harms certainty, thereby it may seriously impair the functioning of the internal market: floating currencies means transaction costs, imbalances within the Community (before it became Union) and distortions in competition, being absent an identical level playing field, and in the long run such problems were seen as unsustainable.¹²⁵

3.3 Why free movement of capital is so important for the single market and EMU (and vice-versa): a single currency as a (unavoidable?) solution

All these reasons have been pleaded to justify the maintaining of capital controls, notwithstanding it was questioned whether they were beneficial. Member States wanted to retain a margin of maneuver in the monetary field, in order to apply the policies considered more suitable for each single country, and at the same time avoiding excessive if not dramatic tensions on the exchange rates. The monetary competence had been for centuries one of the prerogatives of sovereignty, therefore its surrender

125 Wyplosz (n 123) 4: the author mentions the trade wars which were among the causes of the Second World War.

has become acceptable only in recent years. In light of these assumptions, the free movement of capital had been set aside for long.

However, different other plans were devised. The most important was the establishment of the “snake” and the European Monetary System in the 1970s, with a possible oscillations of the single currencies part of it within a limited range, with room for some derogations. It is remarkable to note, however, that a first project of monetary union already appears in that decade: the original schedule set the 1980 as the year for the launch (see section 3.5 *infra*).

The idea was shelved due to many reasons, mainly political, but it demonstrates that the EMU has roots which date back in the past.

With the decision to resume the market integration and the choice to finally liberalize capital movements, the problem returned to the surface: one of the remaining elements of the “trinity”, either the monetary policy or the fixed exchange rate, was to be abandoned. The choice fell on the latter, which explains why the EMU project, which would have eventually led to the single currency (the Euro), was commenced together with the Directive 88/361.

The idea of leaving the currencies floating was never considered. It was thought that such a situation would have create enormous problems, especially in connection with the free movement of capital. Once accepted that capital can move without obstacles, the strain on exchange rates may become unbearable (one of the causes of the crisis in 1992, which hit seriously two member countries such as United Kingdom and Italy, was in fact that all capital movement had been liberalized¹²⁶). It must be borne in mind that in the previous directives, by means of which the first attempts to liberalize capital were carried out, while some operations were allowed, a prohibition had remained for short-term movements since they were viewed with extreme suspicion and fruit of speculation. There are furthermore serious doubts as to a possible

compatibility between free-floating currencies and an area without borders,¹²⁷ as EU aims to be: protectionist measures are likely to be adopted in that case.¹²⁸

The historical context clarifies some aspects. Unrest in the exchange rates had occurred in the previous years, despite the EMS. The system was probably ill-devised, since it fixed the rates but not completely,¹²⁹ the choice is, in fact, either a permanent fixing, with no oscillation at all, or free floating. Intermediate solution proved ineffective and the resort to capital controls did not solve the problems (on the effect of controls see *infra*). Currency crises continued to repeat.

On the other hand, over the course of the years Germany had imposed as the strongest and more stable economy of Europe; many other states were compelled to follow the policy pursued by its central bank, the Bundesbank, known for its independence from the government¹³⁰ and its strong focus on price stability. By adopting the same interest rate, the states which did so substantially renounced to their monetary autonomy.¹³¹

It appeared clear how the completion of internal market, or at least a huge step forward towards a tighter integration capable of bolstering economic growth,¹³² required alongside the liberalization of capital a strategy aimed at thwarting the possible negative effects which might have ensued.¹³³

As mentioned above, such an awareness was present since the inception of the Community, but the conditions necessary to implement an ambitious project such as EMU were lacking. The positive conjuncture in the 1980s, after the turmoils of the previous decade, made it finally possible.

127 The EESC warned that the liberalization of capital was to be taken in parallel with other measures, including those concerning the monetary dimension, see Usher, *The Law of Money and Financial Services in European Community* (n 5) 20

128 Wyplosz (n 123) 18; Fabrizio Saccomanni, 'Verso una Vera Unione Economica e Monetaria? [Towards a Real Economic and Monetary Union?]', speech held at the Conference in memory of Gaspare Scaruffi, Reggio Emilia (Italy), 10th January 2013 4

129 Mohamed, *European Financial Services Law* (n 126) 81-82

130 Bakker (n 8) 218-219: the author suggests that the EMU as it has been conceived was also a reaction of France to the domain of Bundesbank in setting the interest rate for Europe as a whole.

131 Wyplosz (n 123) 5-6

132 An analysis of the advantages of monetary integration can be found in Molle (n 17) 269

133 Wyplosz (n 123) 6

The capital and monetary dimensions are thus interwoven.¹³⁴ That appears in the wording of the rules governing the former, as shown in the previous chapter: the decision to liberalize the movements also with third countries, the existence of safeguard clauses in case of disturbances. But also the CJEU itself recognized that in the landmark *Casati* ruling.

The free movement of capital has a strong bearing on monetary sovereignty and its implementation has led to the start of the EMU. Although the judgement on the process can vary depending on the author, there is unanimity as to the connection between these two dimensions.

As known, one of the main points of the EMU was the introduction of a single currency (the Euro). The purpose of this work is not to take a stance as to whether such an idea has been a success or not, nor to examine the political reasons in favor or against it. It must be noted that this final passage is not necessarily related to the free movement of capital:¹³⁵ a monetary union can be achieved simply by permanently fixing the exchange rates. While a single currency presupposes a permanent parity, its adoption is not an automatic consequence but rather a political choice.

However, the adoption of a single currency may bring strong advantages.¹³⁶ Firstly, it removes the transaction costs typical of the currency conversion, thereby favoring the movements between member states; secondly, it also removes the risks connected to exchange rate which often prompt the investors to hedge their investments.¹³⁷ When such a need is no longer actual, the effect might be a further downward pressure of the cost of capital. Due to lesser needs to hedge, the amount

134 John A. Usher, 'The Evolution of the Economic and Monetary Union – Some Legal Issues' in Anthony Arnall, Piet Eeckhout, and Takis Tridimas (eds), *Continuity and Change in EU Law: Essays in Honour of Sir Francis Jacobs* (Oxford Scholarship Online, 2009) 297-298; Hindelang (n 4) 19: free movement of capital is described as a part of the “magic square” made up of the Common Market and the establishment of EMU which contributes to the attainment of the goals set out in the Treaties.

135 Peers (n 78) 337

136 Molle (n 17) 269: the author seems however not to distinguish between monetary union and the adoption of a single currency, probably considering the latter the most likely outcome (as it appears from page 271); Mohamed, *European Financial Services Law* (n 126) 91 views the single currency as a deterrence against turmoils of exchange rates.

137 Andrew Gamble, 'EMU and European Capital Markets: Towards a Unified Financial Market' (1991), Kluwer Law International, no. 28, p. 319-320

of savings at disposal is bound to rise.¹³⁸

Lastly, but not less important, it consolidates the EMU itself, a process which is deemed irreversible and surely the replacements of the national currencies with a new one make it way harder to step back.

Other implications, such as the debated questions as to the need to move towards an economic-political union are not the object of this study, but of course are not to be underestimated.

In any case, some points are to be remembered: the free movement of capital requires a change in the paradigm linking the monetary sovereignty to the state,¹³⁹ on the other hand a Monetary union without the free movement of capital is hardly conceivable, regardless of a single currency is to be adopted or it consists only of fixing the respective exchange rates.¹⁴⁰

3.4 Restrictions of the freedom: capital controls

With all these things in mind, once understood why capital controls have extensively been used in the past until the advent of EMU, this section will explain what they actually are, being a category which comprises different solutions.

3.4.1 Definition

The term “control” is common in the literature, but it is quite general. The CJEU, as seen in the Chapter 2, prefers to use “restrictions”, namely all measures liable to dissuade, deter, impede an individual (regardless of

138 Kerk Phillips and Jeffrey Wrase, 'Monetary Union and Market Integration: Capital and Goods Market Issues Pertaining to the Launch of the Euro' (2001), *International Finance Review, European Monetary Union and Financial Markets*, vol. 2, p. 3-7

139 Barnard (n 3) 592

140 Art. 116(2)(a) TEC, repealed by Lisbon Treaty. It was a legal precondition of entry into the second stage of EMU, see also Murphy (n 2) 293

natural or legal person) from seeking capital outside the state where he resides. It is also important to remember that neither the Treaties nor the Court have defined with precision what a restriction can be.

In any case the two terms are not synonyms, although they may overlap: a restriction can be even a measure whose aim is not to interfere with the movement of capital, but despite that affecting it. The “golden shares” cases are a perfect example: the reason why states wish to retain control, or have powers which could not be exercised in absence of the special rules, over state-owned or co-owned undertakings may in fact be many and not motivated by monetary or financial concerns (for example, maintaining influence over certain industrial sectors whose important is deemed strategic). It might be inappropriate to refer to them as “capital controls” but they are doubtless restrictions and then they are caught by the rules of the Treaties.

The distinction in practice does not have a real relevance. Whatever is the ground for introducing limits to the free circulation of capital, the current framework forbids them unless they can be objectively justified, with the grounds for this exception interpreted narrowly by CJEU.

3.4.2 Types of controls

Admitted that all restrictions are prohibited in general, the present section will try to outline the different kind of controls which have been used in the past for the purposes above explained, in light of the “impossible trinity”.

An exhaustive list cannot be drawn up.¹⁴¹ The case-law in this area, but also as regards goods, services and persons shows that the ways to impose restraints are basically infinite.¹⁴² Some recurring features are to be identified though.

141 Andrew Yianni, Carlos de Vera, 'The Return of Capital Controls' (Fall 2010), 73 *Law and Contemporary Problems*, <http://scholarship.law.duke.edu/lcp/vol73/iss4/23> 358

142 A thorough description can be found in Bakker (n 8) 11-14

One of the most common controls is the request of authorization to carry out an operation. The CJEU had to deal several times with this type of control: the famous cases *Bordessa* and *Sanz de Lera*, mentioned in Chapter 1 and 2, both regarded a prosecution of individuals for having allegedly smuggled money in form of banknotes outside the country at issue (Spain) without having been previously authorized.

The Court, besides ruling over the direct effect of the relevant provisions (the art. 1 of the Directive 88/361 and art. 56 of TEC respectively applicable) also stated that the authorization regime, even though it was justified by mandatory requirements, was excessive and thus in breach of the principle of proportionality; it went on to say that a declaration could have been more suitable. Such decisions triggered the debate as to whether requiring an authorization is always deemed unacceptable.¹⁴³ In other cases the CJEU clarified its stance, by adding that in some limited cases an authorization could be saved, but only if certain criteria were provided, more specifically the possibility for any individual to know in advance the situations where such a request is necessary.¹⁴⁴

Other measures often adopted, and brought to the Court's review, are related to taxation: limits to deductions, impossibility to avail of allowances. They discourage investors and thereby hinder capital flows.

The State could also impose that, in order for some operations to be performed, certain fees have to be paid or guarantees be provided.

In some cases the restriction is explicitly aimed at curb the flow of capital, while in other the approach followed is more subtle and the measures are “covert”.

143 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 102: the author criticizes, in light of *Bordessa* and *Sanz de Lera* rulings, the approach followed by CJEU by expressing doubts as to the effectiveness of a mere declaration to contrast crimes such as money laundering for instance.

144 Barnard (n 3) 583, with reference to one of the “golden shares” cases, C-367/98 *Commission v. Portugal* [2002] ECR I-4731

3.4.3 Why they have been used

It has been explained and clarified why Member States have been so keen to maintain such controls for a long time. Capital controls have been for long an instrument of monetary policy, enabling the states to pursue their own choices, i.e. an autonomous policy, in conditions which would not have been possible in presence of free capital flows. It must be said that, although controls have been used by all states throughout time, the degree of restriction differs considerably between countries more liberal (Germany or the Netherlands) and others more favorable to them (France *in primis*).¹⁴⁵

Many further reasons have been put forward, such as the need to contrast speculation or the fear that free movement of capital would have entailed a drain-off of the national resources in favor of other countries, with a consequent impact on tax revenues (see Chapter 1).

Despite their general prohibition, capital controls are suggested in order to avoid phenomena such as “bank runs”, namely when the depositors withdraw their money with the effect that the banks often go bankrupt for lack of liquidity. The Cyprus case seems to be particularly actual for this purpose (but also Iceland, which is outside EU, resorted to capital controls in 2009 to prevent a collapse of its own currency, still in force despite their alleged negative effects on the economic growth¹⁴⁶).

3.4.4 Inefficiency of capital controls. Reasons not to resort to controls in light of historical experience.

Capital controls have proven inefficient on the basis of the experience.

145 Mads Andenas, Christos Hadjiemmanuil, 'Banking Supervision, the Internal Market and European Monetary Union', in Mats Andenas, Laurence Gormley, Christos Hadjiemmanuil, Ian Harden (eds), *European Economic and Monetary Union: the Institutional Framework* (Kluwer Law International, 1997) 379-380

146 Yianni, de Vera (n 141) 368; see also Mattias Mauritzon, 'Islands stora utmaningar kvarstår [Iceland big challenges remain]' *Dagens Industri* (Stockholm, 5 March 2013)

Although their extensive use, many reasons suggest to avoid resorting to them again in the future unless in extreme circumstances.

Capital controls are potentially harmful, because they may generate distortions and therefore a misallocation of resources. Besides that, they have a cost to adopt and make them work, since administrative measures are required (such as issuing authorizations or ascertaining that the provisions are not circumvented); the evolution in the field of technology, moreover, renders controls much more difficult if not even pointless.¹⁴⁷

Secondly, they entail a higher cost for the capital itself. If investors or undertakings are precluded from seeking the best return because of the restrictions, they will thus be forced to pay more for obtaining the capital, which may cause several negative consequences such as the loss of competitiveness or a diminution of profits. These effects may have a repercussion on fiscal revenues, a further downward pressure on the exchange rate which may call for tighter restrictions and so on in a vicious circle.

Lastly, capital controls may have negative effect on fiscal discipline and delay the adoption of important reforms.¹⁴⁸ It is easier to restrict capital flows than to tackle the economic issues which constantly arise.

As said, their use have been invoked against the speculation, especially that involving currencies and the exchange rate. The idea was to prevent turbulent swings but most of the time they occurred despite the attempts to curb the speculative attacks, therefore their effectiveness has been seriously questioned.¹⁴⁹ The introduction of controls may furthermore reinforce the negative opinion of the market actors towards a certain state, thereby triggering tensions on its exchange rate and leading the investors to seek safe harbors with the inevitable consequence to worsen the economic situation more than what would have happened in absence of them.¹⁵⁰

147 Bakker (n 8) 188

148 Yianni, de Vera (n 141) 359

149 Hindelang (n 4) 20

150 Hindelang (n 4) 21-22

3.4.5 Would it be possible to revert to capital controls in the current framework? Legal and economic issues

The history of free movement of capital have had different phases. The initial momentum, dating back in the 1960s, was not maintained.¹⁵¹ Only in 1988, and subsequently in the Maastricht Treaty, the liberalization became definitive. Following this shift, the CJEU abandoned the deference shown in the first decades and started to apply for capital the same tests it had been using in relation to the other freedoms laid down in the Treaties.

Steps back are hardly conceivable: safeguards are provided only with regards to third countries (see back section 2.6.3), while it does not seem possible to reintroduce capital controls between the Member States.¹⁵²

However, as known only a certain number of States have joined EMU and adopted Euro (as of today, 17 out 27): are the “outs” to be treated differently? The answer is clearly no. Although they retain monetary policy, they are subject to the rules of the Treaties, including those regarding capital. They could never be assimilated to third countries.¹⁵³

The main difference is represented by the powers which they may avail of in case of serious disturbances in the balance of payment, however surrounded by numerous cautions.¹⁵⁴

That being so, it is impossible at the moment (spring 2013) to know whether and how the CJEU will assess the restrictions introduced by Cyprus' government in March 2013 in order to deal with its bank crisis, being it the first time in history where a country which does not have its own currency resorts to capital controls.¹⁵⁵

151 Ibid 34-35

152 Bakker (n 8) 261-262: the author lists legal, economic and political reasons against them, mentioning also their “placebo effect” (257); Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 99

153 John A. Usher. 'Legal Background of the Euro', in Paul Beaumont and Neil Walker (eds), *Legal Framework of the Single European Currency* (Hart Publishing, 1999) 29-30; Usher, *The Law of Money and Financial Services in European Community* (n 5) 203

154 Art. 143-144 TFEU

155 According to Murphy (n 2) 298-300 the CJEU should return to the self-restraint it used to have before 1988 in situations of crisis, given that the choices are mainly political and not legal.

3.5 EMU's legal framework and historical background

The idea of monetary union is not a product of the last twenty years.¹⁵⁶

The Spaak Report, drafted at the beginning of the integration experience, already highlighted the connections between free movement of capital and the establishment of such an union as a necessary consequence.¹⁵⁷

The CJEU, by adopting its self-restraint in the *Casati* ruling, implicitly agreed with this view.

A first concrete step occurred between the end of the 1960s and the beginning of 1970s: the Werner Report, published in 1971, suggested a move towards a monetary union by indicating some fundamental passages which were to be followed. The Institutions then prepared a preliminary plan according to which the launch of the EMU should have taken place in 1980, approximately ten years later. One of the relevant aspects was, of course, the liberalization of all movements of capital.

The main problem with such a plan was that it became soon outdated. The collapse of the Bretton Woods system and the subsequent tensions in the exchange rates, which started to float freely, contributed to its failure. The idea of the Werner Report to build a monetary union in a smooth way was grounded on unstable foundations, namely the existence of the system of fixed rates which had been prevailing until then.

Less ambitious plans were proposed subsequently, based on the awareness that exchange fluctuations were detrimental to an economy already afflicted by serious troubles (such as the oil crisis, to mention the most remarkable): first the so-called “snake”, in 1972, whose idea was resumed few years later (1978) with the establishment of the EMS. In both cases, narrow margins of fluctuation were set, usually around 2.25% save exceptions (the Italian Lira was granted a broader swing equal to 6%).

156 The history of EMU from an economist's point of view can be found in Molle (n 17) 271-274

157 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 62; Usher, *The Law of Money and Financial Services in European Community* (n 5) 171

The system, although some economists are more indulgent,¹⁵⁸ proved ineffective and several realignments occurred during the first years.

As already pointed out previously, the 1980s saw many changes and a more positive attitude towards free market (likely influenced by conservative governments such as that headed by Margaret Thatcher in the United Kingdom). The liberalization of capital, in 1988, led to the reopening of the EMU discussion and finally to the Delors Report, in 1989, which provided various suggestions as to how monetary union would have to be.

Moreover, the CJEU acknowledged in its Opinion 1/91 (dealing with a possible agreement with EFTA) that the introduction of EMU was a goal set out in the existing Treaties.¹⁵⁹ The scholars agree that EMU helps the Union attain the objectives listed under art. 2 TEU.¹⁶⁰

The scope of this study does not leave too much room for explaining all the different stages by which EMU has been implemented. From a legal point of view, monetary union has been achieved through a mix of “soft-law”, especially during the first years after the sign of the Maastricht Treaty,¹⁶¹ and “hard-law”, with the incorporation instead of binding rules in the Treaties (with the exception of the Member States which have chosen to remain outside, subject to a different system). The core of the monetary policy lies in the current art. 119(2) TFEU (former art. 4(2) TEC), where the objectives are expressly listed, such as the establishment of a single monetary policy aimed primarily at maintaining price stability.¹⁶²

To narrow the topic on the issues relevant for the purposes of this dissertation, one of the outstanding aspect is the legal framework behind the European Central Bank (ECB) and the European System of Central Bank (ESCB), which is of paramount importance also in light of the

158 Molle (n 17) 272

159 Usher 'Legal Background of the Euro' (n 153) 8

160 Hindelang (n 4) 19-20

161 Francis Snyder, 'EMU – Integration and Differentiation: Metaphor for European Union' in Paul Craig and Gráinne de Búrca (eds), *The Evolution of EU Law* (2nd edition, Oxford University Press, 2011) 693-696

162 Usher, 'The Evolution of the Economic and Monetary Union' (n 134) 308

possible evolution towards a banking union (see Chapter 5).

3.5.1 The ECB and the ESCB

The shift to EMU has staggered one of the most long-standing principles, which sees the monetary competence as a sign of state power.

Nowadays, for at least 17 countries of EU, the central bank in charge of monetary policy is the ECB. The status of this organ is peculiar:¹⁶³ it has legal personality but it was not deemed an European Institution until the adoption of the Lisbon Treaty,¹⁶⁴ where it is currently listed under art. 13 TEU alongside the others; it is entitled to an action for the annulment of an act (art. 263(3) TFEU) when its prerogatives are affected. On the other hand, its acts or omissions are subject to judicial review (art. 263(1) TFEU).¹⁶⁵

The provisions relative to the institutional status of the ECB are the art. 282 to 284 of TFEU. It can be noted how this authority has been modeled on the German Bundesbank, characterized by strong independence and accountability.

The main task of ECB is the price stability and the conduct of the monetary policy, therefore the control of inflation, as provided for by art. 127 to 133 TFEU, whereas other tasks such as the support of the policies pursued by the EU are deemed secondary.¹⁶⁶

As of today, the ECB is part of the ESCB, comprising all the other Central Banks (including those of states not part of EMU) which are to be independent as well. The oversight is responsibility of the national Central Banks, an issue which has lately been called into question and could be radically changed once launched the banking union (see Chapter

163 Jakob de Haan and Laurence Gormley, 'Independence and Accountability of the European Central Bank', in Mats Andenas, Laurence Gormley, Christos Hadjiemmanuil, Ian Harden (eds), *European Economic and Monetary Union: the Institutional Framework* (Kluwer Law International, 1997) 338-344; Usher, *The Law of Money and Financial Services in European Community* (n 5) 216-223

164 Snyder (n 161) 702: the authors signals how the ECB raised objections on the ground that this "new" status could affect its independence.

165 Usher, *The Law of Money and Financial Services in European Community* (n 5) 229

166 de Haan, Gormley (n 163) 342

4 and 5).

4 Banking and its relationship with the free movement of capital. The need to create an integrated market in financial services.

4.1 Capital and banking: how liberalization has bolstered the market of financial services and created potential dangers at the same time

To create a fully functional internal market, as stated since the beginning of the present dissertation, different elements are to be considered. On such an assumption, the four freedoms of the Treaties have been conceived: although they are distinct concepts, the goal of a true integrated area can be attained only if all the elements enjoy the same degree of liberalization.

In the section 1.5 of Chapter 1 it has been illustrated, even though while limiting the research on free movement of capital, how the different freedoms are a natural complement of the others and the curtailment of one may have a serious impact on the internal market as a whole.

After having outlined the main features of the free movement of capital, along with its paramount importance, it is time to adopt a broader view capable of not just considering it as such but rather pointing out its role in what has been defined the “financial single market”.¹⁶⁷ A particular regard, in this context, will be given to the most relevant actor, namely the banking sector.

The historical background is worth being remembered once again. During the 80s, with a radical shift towards a market-based approach, the Member States decided to leap forward after the stagnation of the previous decade and started an ambitious program aimed at completing

¹⁶⁷ Mikita Malgorzata: 'EU Single Financial Market: Prospects of Changes' (2012), *Financial Internet Quarterly*, Vol. 8, Issue 1, <http://hdl.handle.net/10419/66762> 54-55

the internal market. One of the most noteworthy aspect was the choice to liberalize the capital movements, along with the launch of the EMU.

In this scenario, the underlying idea was to create and strengthen a market of financial services (mainly banks and insurances) which would have fostered the economic growth by facilitating the transactions and reducing their costs, as well as favoring an optimal allocation of the resources.

The financial market consists of services which are often connected to capital movements; the banks are the undisputed protagonists in this field. At the same time it regards the freedom of establishment:¹⁶⁸ once services and capital movements are free from constraints, the opportunities increase considerably and the providers might want to expand business by setting up branches or subsidiaries in another Member States with the intention to conquer new markets. Although it has been observed how the majority of banks exclusively work with the domestic market, a free market area permits the creation of cross-border conglomerates and a diversification of the activities pursued.¹⁶⁹

Three are the pillars of single financial market, namely the complete liberalization of capital, services and the freedom of establishment.¹⁷⁰ If, moreover, the EMU project removes the uncertainties related to exchange rates, hence possible additional costs, the incentives to expand across borders are even more evident.¹⁷¹

In order to attain such goals, besides what has been listed here, the Union (and before it the Community) has repeatedly intervened with its legislation with the aim to regulate the banking activities.

It would go beyond the scope of this study to carefully analyze the legal framework regulating banking, but some rules are to be borne in mind for a clear understanding.

168 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 181-182

169 Martin Čihák, Jörg Decressin, 'The Case for a European Banking Charter' (July 2007), IMF Working Paper No. 07/153, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1007922 5: the authors underscore that the current situation is probably the result of the fragmentation of the European legal framework in banking.

170 Mohamed, *European Financial Services Law* (n 126) 201

171 Ibid 211

During the first years many attempts to harmonize the field were bound to fail: the art. 61(2) EEC (now art. 58(2) TFEU), by requiring to liberalize the banking services in parallel with capital, along with art. 57(2) EEC, which prescribed an unanimous vote to adopt secondary legislation whose aim was to harmonize the field, make it extremely difficult to create a common legal framework.¹⁷² The capital movements were not free at all, while the latter requirement was exposed to vetoes. The latter provision was amended only with the adoption of the Single European Act, entered into force in 1987, introducing the qualified majority to replace the unanimity required until then.¹⁷³

Directives have however been enacted throughout the years, the first one in 1977 known as First Banking Directive¹⁷⁴ and whose importance is deemed minimal (besides the existence of capital controls, the directive aimed at achieving a complete harmonization, which proved politically impossible),¹⁷⁵ then the more relevant Second Banking Directive,¹⁷⁶ entered into force in 1993, now repealed and replaced by the Directive 2006/48/EC.¹⁷⁷

While referring to the next section as regards the examination of the aforementioned legislation, few other things are to be added.

The main point to notice is that the idea of financial services market is based on a series of connections and links. It is not a case that a provision such as art. 58(2) TFEU (former art. 61(2) EEC and 51(2) TEC) was drafted and never repealed:¹⁷⁸ to offer services without restrictions presupposes the free movement of capital;¹⁷⁹ such a liberalization requires to take appropriate monetary measures in absence of which

172 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 188

173 Andenas, Hadjiemanuil (n 145) 381

174 First Council Directive 77/780/EEC on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions [1977] OJ L322/30

175 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 189-190

176 Second Council Directive 89/646/EEC of 15 December 1989 on the co-ordination 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 [1989] OJ L386

177 European Parliament and Council Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) [2006] OJ L177

178 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 184

179 Ibid 183

serious disturbances could occur and lead to the demise of the project itself; a monetary union is a viable way to address such problems¹⁸⁰ but its implementation also requires several adjustments, including in the banking area. Economists have pointed out other elements, which are object of debate nowadays, such as the need to converge towards an economic union if not a real political federation. These last aspects will not be addressed here, but it is fundamental to be aware of them.

Although scholars have often identified problems and possible shortcomings, most choices have become unavoidable following practical experience. The liberalization of capital, in its various stages, caused as expected currency upheavals with detrimental effects on the economy, unveiling the potential risks alongside its undeniable advantages. That pushed in favor of the monetary union, being clear that tensions in the exchange rates could have been lethal to many economies within the EU. After 2008 and during the recent financial crisis the EMU has been under serious strain, and even a possible break-up was figured, due to the distress of the banking sector which had excessively grown after the liberalization and prone to moral hazard.

All this premise is necessary to understand that free movement of capital (and services), the monetary dimension, the banking field and the legal framework behind all of them are not to be seen from a static point of view, but rather as different parts of a dynamic process, whose connections are sometimes hard to unravel.¹⁸¹

The proposal of a banking union, whose details and most important legal and economic issues will be explained in Chapter 5, is one of the first steps suggested to remedy possible existing defects and favor instead a new start for financial services market.

180 Andenas, Hadjiemmanuil (n 145) 375

181 Usher, *The Law of Money and Financial Services in European Community* (n 5) 20

4.2 Current relevant legal framework and harmonization: the Banking Directives and the “european single passport”

The legal sources to take into account for the purposes of this study are the Banking Directives, as mentioned in the previous section.

The Second Banking Directive was enacted in 1989. It can be immediately noticed that its introduction is contemporary to the liberalization of capital and the launch of EMU.¹⁸² The principles therein included have been maintained in the successive Directive 2006/48/EC, currently into force with no significant changes.

Unlike in the past, the Member States have opted for a minimum harmonization, which means that a comprehensive set of rules regulating the banking field has not been drawn up.¹⁸³ The reason for avoiding drafting a common rulebook is mainly political.¹⁸⁴ the Union is made up of countries with traditions and practices which differ greatly, therefore it was thought more suitable to establish a minimum standard and leave the single Member States the possibility to continue adopting their own rules, which might often be stricter.

The most important of the common provisions, along with the requirement of minimum capital endowment, is the institution of the so-called “single passport” or “home-state control”. The Directive provides also a narrow definition of credit institution as '*an undertaking whose business is to receive deposits or other repayable funds from the public and grants credit for its own account*'.¹⁸⁵

A premise will clarify the terms of the issue. Banking activity is surrounded by safeguards and prudential rules to comply with in each country. To set up a credit institute such rules are to be followed, but that

182 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 190-191

183 Such a choice has been criticized on the ground that it does not lead to a real unified market, see Andenas, Hadjiemmanuil (n 145) 383-384

184 Ibid 382

185 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 193: the author argues that such a narrow definition is not compatible with the broader meaning conferred to freedom to provide services in the Treaties, then it is likely to restrict the free flow of capital.

might be cumbersome and resource consuming for all banks which intend to expand their activities outside the country where they have the seat. Moreover, banks are subject to oversight by an independent body, often the Central Bank of the state (in some countries, such as Germany and Belgium, the supervision tasks are conferred to a separate institution, in order not to impinge the independence of the organ entrusted to carry out the monetary policy; other implications will be analyzed further and are one of the most debated questions related to banking union).

Given the absence of rules at Union level and the different standards between Member States, a single financial market would be hampered and banks might prefer to remain within their jurisdiction. However, by doing so the benefits granted by the liberalization of capital and services, as well as establishment, would be seriously curtailed.¹⁸⁶

The Banking Directives provide a solution to this issue, by allowing a credit institute authorized in a Member State to provide the same services, for which it is authorized in the home-state, in another one by means of branches. The prudential rules and the supervision are responsibility of the home-state.

It is thus said that once a bank obtains the authorization in one of the Members, it gets a “passport” for the whole EU. The rules at issue, as mentioned, concern only the establishment of a branch without separate legal personality, whereas setting up a subsidiary requires the same compliance which would be necessary to start a new bank in that state. While a branch calls upon the home bank's deposit fund, a subsidiary is comparable to an independent institution,¹⁸⁷ with its own assets; supervision and assistance to depositors are provided by the host state.

In order to avoid a race to the bottom or lax requirements, the Directives set out minimum standards to be respected, such as the minimum capital to be held.¹⁸⁸

186 Bakker (n 8) 209

187 Philip Booth, Alan Morrison, 'Promoting a Free Market by Ending the Single Market – Reforming EU Financial Regulation', *Economic Affairs*, 32 24

188 Andenas, Hadjiemmanuil (n 145) 384

The limitation to branches has been criticized on the basis that asymmetries might occur, thereby leading to a possible fragmentation of the market¹⁸⁹ (see *infra* Chapter 5). Not only, because the idea itself of “single passport” has been under scrutiny:¹⁹⁰ according to some scholars, to maintain different prudential regimes throughout the Union may constitute a serious hindrance capable of frustrating the free market of banking services.

4.3 Oversight of banks and role of national supervisors. Critical points in the current situation: the risk of fragmentation of the market

Even after the launch of EMU, and the subsequent establishment of ECB and ESCB, the supervision of banks has remained national. For the countries members of the Eurozone (17 as of now) the ECB is the only competent body as regards the monetary policy, while the single Central Banks or other entrusted bodies are responsible for monitoring all banks and subsidiaries present in their national territory, together with the branches taken up in other member states pursuant to the principle of “home control”.

A series of fundamental tasks, such as the authorization to carry out banking activities or acting as lender-of-last-resort, remain therefore incumbent upon each single state.¹⁹¹ The ECB is not a lender-of-last-resort,¹⁹² mainly due to the strong opposition of Germany during the discussions which would lead to the EMU: it was assumed that, by conferring such a role to ECB, moral hazard would have been inevitable and could have caused a constant threat to the stability of the Eurozone.

189 Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (n 6) 193

190 Booth, Morrison (n 187) 25

191 It must be borne in mind, however, that prudential supervision and lender-of-last-resort intervention, although sharing the aim of maintaining stability, are to be kept distinct: while the latter is carried out *ex post*, as a remedy in case of systemic risks, supervision is by nature *ex ante*, in order to ensure the stability of the banking system..

192 Andenas, Hadjiemmanuil (n 145) 406

The current state of affairs, as demonstrated during the recent crisis, is not satisfactory and risks to undermine the single market and to favor a misplacement of the resources which runs counter the liberalization of capital movements.¹⁹³ At the same doubts on the EMU sustainability have sharply arisen.

The main problem regards the supervision and the role played by Central Banks (or the other bodies in charge of it).

In a monetary union the volume of transactions tends to increase due to the reduction of transaction costs and the fact that capital can move freely (basic assumption underpinning it). At the same time, the national regulators view the interest of the single country as paramount, notwithstanding the area to take into account should be the EU as a whole (including those states who have not joined EMU).

The interest of a single state is likely to conflict with the need to preserve the integrity of a single market, especially in time of crisis. The free flow of capital, a single currency and the possibility to take up branches within the Union without complying with additional rules are a powerful incentive towards the growth of the financial sector; by contrast, the risks to be assessed remain on a national plan. This asymmetry may cause problematic imbalances.¹⁹⁴

Despite their independence, the supervisors might be prone to accept greater risks taken by national banks during positive cycles, while during crises the state of mind could be the opposite: a single state is much less inclined to assume the burden for operation carried out by branches abroad or subsidiaries of foreign banks within the state itself. It must be borne in mind, furthermore, that even though a deposit protection is required (in 2010 the threshold has been raised to cover deposits up to € 100.000¹⁹⁵), such a guarantee is to be provided by the single state which

193 Booth, Morrison (n 187) 25: the authors quote Mervyn King, Governor of Bank of England, who says that banks are 'global in life but local in death'.

194 Thorsten Beck, 'Why the Rush? Short-term Crisis Resolution and Long-term Bank Stability', in Thorsten Beck (ed), *Banking Union for Europe: Risks and Challenges* (Centre for Economic Policy Research, 2012) 39: the authors refers to the famous "tragedy of the commons", where everyone would like to rely on the others in sharing the burden.

195 Gerard Hertig, Ruben Lee, Joseph A. McCahery, 'Empowering the ECB to Supervise Banks: A Choice-Based Approach'

is the only responsible, in absence of a common protection at EU level. Although some authors have suggested that the obligation to afford a protection may act as a disincentive for the Member States to adopt lax policies,¹⁹⁶ the reality seems to have proven the opposite: such a situation strengthens the link between public finances and the banking system on one hand and on the other, with the supervisors more keen to protect their own country, it may exacerbate the fragmentation. The existing architecture does not seem to be compatible with an open market.¹⁹⁷

The depositors are less informed by investors, then a situation of uncertainty is likely to cause either a “bank run” or at least a drain of resources. If the protection of depositors is linked to the public finances, the state itself could have difficulty in ensuring it, thereby creating another vicious circle where the banks may go bankrupt and create additional burden for the country (whose sovereign bonds are, furthermore, often held by the banks).

When a bank crisis occurs, the regulator of that state will suggest, although informally, to repatriate resources held by the subsidiaries in another member country, while the latter will have interest to keep them; accordingly, the latter will discourage the banks subject to its control (for instance, the subsidiaries) to transfer funds to the parent bank, so called “ring-fencing”,¹⁹⁸ or to lend money or invest where the crisis is ongoing.¹⁹⁹ These tactics, often based on moral suasion, have the effect to stop the capital flows between Member States, thereby aggravating the troubles.²⁰⁰ Savings generated in a Member State do not move towards other areas of the internal market; following that, the banks in one Member country might need the intervention of the State; if the public

(August 2009), ECGI Working Paper Series in Finance, Working Paper N°. 262/2009, <http://ssrn.com/abstract=1327824> 7

196 Andenas, Hadjiemmanuil (n 145) 385

197 Various Authors, *A Banking Union for the Euro Area* (IMF Staff Discussion Note, February 2013) 7

198 Čihák, Decressin (n 169) 9-10: the authors point out that, so long as the supervisors are accountable to the national legislator, they will be inclined to maximize the assets of the national banks while trying at the same time to minimize the costs, which would likely fall on taxpayers.

199 Daniel Gros, 'The Single European Market in Banking in Decline – ECB to the Rescue?', in Thorsten Beck (ed), *Banking Union for Europe: Risks and Challenges* (Centre for Economic Policy Research, 2012) 53

200 Ibid 51: the author uses the word “balkanize”.

finances are not sound, or if the amount of liquidity necessary is considerable (the Ireland crisis is an outright example), the burden of the sovereign debt becomes hard to bear.

The final outcome is represented by a complete market fragmentation, with the single Member States progressively isolated in the financial market.²⁰¹ That frustrates the aim pursued by the Treaties and poses serious threats to EMU,²⁰² whose eventual collapse would likely entail the end of the free movement of capital as the first effect, despite the imperative provisions laid down in the Treaties.

Why there is an incentive to act in such a way? The answer is articulate. Firstly, the single regulators are not well informed as to the credit institutions established in other jurisdictions²⁰³ (even though collaboration is required in a monetary union, the regulators might conceal important information in order to prevent panic from spreading); secondly, in case of necessary intervention, the state is not interested in assisting banks, and therefore depositors, not subject to its own control. National supervisors thus act to protect the home stability, instead than that of the Eurozone as a whole.²⁰⁴ Political reasons might be put forward,²⁰⁵ first and foremost the necessity to protect taxpayers' money. All these hypothetical scenarios, already foreseen at the inception of the EMU, have proven real in the last years and suggested the European Institutions to take appropriate measures. It is absolutely remarkable to notice, as said, the dynamic integration of aspects apparently distinct and separate, what the art. 58(2) TFEU seemed to beckon since the very beginning.

The monetary integration has been a powerful tool for the growth of the financial sector, but such an expansion has created systemic risks where

201 Pedro Gustavo Teixeira, 'The Regulation of the European Financial Market After the Crisis', in Pompeo Della Posta, Leila Simona Talani (eds), *Europe and the Financial Crisis* (Palgrave MacMillan, 2011) 10-12

202 Jean Pisani-Ferry, André Sapir, Nicolas Véron, Guntram B. Wolff, 'What Kind of European Banking Union' June 2012, Bruegel Policy Contribution, Issue 2012/12 3

203 Čihák, Decressin (n 169) 7

204 Gros (n 199) 52

205 Čihák, Decressin (n 169) 9

banks involved in cross-border activities might also become “too big to fail”, causing further uncertainty (for instance, which state is supposed to intervene in case of troubles) which can be extremely harmful for a functioning market.²⁰⁶

4.4 The necessity of a supervision at European level in light of the recent crisis

Besides the liberalization of capital movements, the Delors Report and other scholars pointed out that a sustainable monetary union required also a stable banking system.²⁰⁷

In order to attain such a goal, which is fundamental to reach an integrated market in the financial services, the proposal to shift the oversight of the credit institutions from the national to the European level is not a new idea.

Already during the first years of EMU, before the financial crisis staggered many certainties, the discussion as to how to avoid the fragmentation of the market was an argument of debate,²⁰⁸ since it was questionable whether to leave the supervision at the national level could be sustainable in a monetary union. However, any project clashed most of the times against the lack of political will, the same which prevented for many years the completion of internal market from becoming reality.

Many contributions have been written,²⁰⁹ also with comparisons with other legal systems (the United States above all²¹⁰). Some common

206 Booth, Morrison (n 187) 25

207 Hindelang (n 4) 19; Gamble (n 137) 326

208 Hertig, Lee, McCahery (n 195) 2; Wim Fonteyne, 'EU: From Monetary to Financial Union', Finance and Development, vol. 43, no. 2, June 2006 5; Andenas, Hadjiemmanuil (n 145) 386

209 Dirk Schoenmaker, 'Banking Supervision and Lender-of-last-resort in EMU', in Mats Andenas, Laurence Gormley, Christos Hadjiemmanuil, Ian Harden (eds), *European Economic and Monetary Union: the Institutional Framework* (Kluwer Law International, 1997) 436; Jean Pisani-Ferry, 'The Euro Crisis and the New Impossible Trinity' January 2012, Bruegel Policy Contribution, Issue 2012/01 10 quoting Eichengreen and Wyplosz, who suggested that banking supervision would have been a more effective policy than the fiscal constraints.

210 Larry D. Wall, María J. Nieto, David Mayes, 'Creating an EU-Level Supervisor for Cross-Border Banking Groups: Issues Raised by the U.S. Experience with Dual Banking' (March 2011), Federal Reserve Bank of Atlanta, Working Paper 2011-06

features can be observed and have become part of the official proposal issued by the Commission.

Some effects of the absence of common supervision may be observed in practice. Activities such as those described, either “ring-fencing” or induced restrictions (and not caught by the rules on capital) cause a drop in the interbank lending, as well as a halt in the investments (with remarkable consequences on the intra-Union balance of payment²¹¹).

A single supervisor instead would not be penalizing cross-border lending as the national ones do nowadays.²¹²

211 Jean Pisani-Ferry, André Sapir, Nicolas Véron and Guntram B. Wolff, 'What Kind of European Banking Union', Bruegel Policy Contribution, Issue 2012/12, June 2012 3

212 Gros (n 199) 54

5 The proposed banking union and its possible impact in the field of capital movements

5.1 Why a banking union?

One of the strategies devised to tackle the problems here analyzed and capable of restoring the confidence in the EMU first, but consequently in the EU as an internal market, is represented by the Proposal for a Banking Union.²¹³ According to the Commission itself, the launch of the project should be already in July 2013, but most likely such a deadline will be postponed (to 2014 or later).

The banking union is the first step towards a further integration of the financial market. Other fundamental aspects will be the introduction of a common protection for depositors along with a system of bank crisis management.²¹⁴

By reading the comment enclosed to the official documents, its implementation should be possible on the basis of the current legal framework, without requiring modifications of the Treaties.²¹⁵

The idea has sparked off a lively debate and has met oppositions; at the same time it gives rise to legal issues which are the object of the section 5.3 and are seriously to be taken into account.

It has been observed that as of today there does not exist an identical level playing field.²¹⁶ National interests still collide with the need to achieve a common market in the financial services, which is a

213 Proposal for a COUNCIL REGULATION conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, Brussels, 12.9.2012 COM(2012) 511 final

214 The common opinion among commentators is that the single supervisory alone can do little if the other steps are not put into practice, see Various Authors (n 197) 12

215 Communication from the Commission to the European Parliament and the Council, 'A Roadmap Towards a Banking Union', 12.9.2012 COM(2012) 510 final

216 Vasso Ioannidou, 'A First Step Towards a Banking Union', in Thorsten Beck (ed), *Banking Union for Europe: Risks and Challenges* (Centre for Economic Policy Research, 2012) 88-89: the banking union could provide a level playing fields by removing the perverse incentives for the national regulators to side with its own bank, thereby leading to market fragmentation; Čihák, Decressin (n 169) 8

fundamental requirement for a working market of goods and persons.

In Commission's words, instead, the single market and the banking union are mutually reinforcing.²¹⁷

5.2 Commission's proposal in detail

The Commission delivered the proposal on a banking union in September 2012 to be submitted to the Council, where an agreement were found in December of the same year.²¹⁸

As anticipated, it is assumed that the current framework provides for the legal basis for its adoption without being necessary Treaties amendments, which require as known unanimity and therefore are highly subject to the risk of vetoes.

The solution suggested lies in the art. 127(6) TFEU, enabling the Council acting unanimously to confer to ECB further competences when it is deemed necessary (*'specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings'*).

Pursuant to this provision, the Commission identifies the tasks to be transferred to ECB from the national regulators, either Central Banks or other bodies in charge of banking oversight, among which the authorization to set up a credit institution, to ensure compliance with safety and soundness and, in extreme cases, to shut down a credit institution.²¹⁹

Although the aforementioned provision is framed in a broad way, there are doubts as to whether it is really possible to entrust the ECB with such

217 Communication from the Commission to the European Parliament and the Council, 'A Roadmap Towards a Banking Union', 12.9.2012 COM(2012) 510 final 4

218 Various Authors (n 197) 13

219 Ioannidou (n 216) 88; Communication from the Commission to the European Parliament and the Council, 'A Roadmap Towards a Banking Union', 12.9.2012 COM(2012) 510 final 7

extensive powers: the rule at issue permits that “specific”, then limited tasks, can be transferred, but probably on the assumption that the prudential supervision remains within the national authorities. It cannot be excluded at the outset that actions for annulment on the grounds of the lack of competence may be brought to the CJEU²²⁰ (the ECB in fact may enact regulations having binding nature, art. 132 TFEU, therefore subject to judicial review, as laid down in art. 263 TFEU).

Given the importance of independence and accountability incumbent upon ECB, several safeguards are provided as well as checks and balances, such as the reinforced role of the Parliament in the process (the entire Chapter IV of the proposed Regulation deals with the matter).

Another remarkable thing to underscore is that the Commission has chosen to include all the banks of the Eurozone, regardless of their size or the type of activities they carry out, pointing out how the financial market is to be seen as one and that even small-size or local banks might undermine stability. With regard to states outside the EMU, the Proposal does not affect their position but leave the possibility to opt-in, and then join the banking union, while continuing to retain an independent monetary policy (other solutions were viewed as politically unviable, see section 5.3.3 for further details). The idea at the ground is that a common regulator is a stronger guarantee for the whole EU.

5.3 Criticisms on the proposal

5.3.1 The issue of subsidiarity

From a legal point of view, the first problem to address regards the compatibility of the proposal, which aims at conferring greater powers to ECB by transferring it from the national regulators, with the principle of

220 Various Authors (n 197) 24

subsidiarity.

Such a principle is one of the cornerstones of the EU and it is enshrined in the TEU (art. 5(3)). According to it, the Union and its Institutions can be conferred a power only when the same objective cannot be attained at the local level or it is preferable that the issue is addressed at the Union level. Prudential supervision is an area where the competence of the EU is shared with the Member States and therefore subject to such a principle.²²¹

The current situation, in fact, seems to reflect perfectly the principle, with the division of competences between ECB and national regulators. The assumption is that the national authorities are more well equipped, since they have developed expertise and know better the local scenario than the ECB. At the same time, this division of powers is one of the causes of the distortions that are likely to happen and which seriously impair the functioning of the internal market, by fragmenting it.

The objection cannot be disregarded. The CJEU has ruled several times that the violation of the general principles of EU law is ground for an action of annulment.

Therefore, the Regulation by means of which the ECB is empowered to perform tasks previously responsibility of the Member States might be, in theory, exposed to such an action, brought by one of the Member States.

A judicial review grounded on the subsidiarity principle is, however, conceivable but its concrete application has never been defined with precision. To prove the infringement appears highly unlikely.²²² Even those who foresaw a possible emergence of the problem eventually came to the conclusion that the necessity to have an unanimous vote renders the question more academic than real.²²³ Moreover, it would be quite odd that a State first votes in favor of the conferral of new powers to ECB (and in this case there cannot be dissenting votes) and later on it

221 Andenas, Hadjiemmanuil (n 145) 408-411

222 Paul Craig, Grainne de Burca, *EU Law: Text, Cases and Material* (5th edition, Oxford University Press) 98-99: approximately 20 cases have been decided by the CJEU, while the Regulations issued by EU throughout the years have been thousands.

223 Andenas, Hadjiemmanuil (n 145) 410

challenges the same regulation:²²⁴ the action could be easily dismissed, given that any remark might have been raised in the previous stage.

In any case, it is also true that the implementation of a banking union does not deprive the national bodies of all the powers related to bank oversight, then they would still play a relevant role albeit diminished. The amended framework would maintain a role for the national authorities, also because it is acknowledged how the latter may work in a more efficient way with regards to the collection of data and other fundamental information.

5.3.2 New role of the ECB

Another possible objection regards the position of ECB once empowered to perform the new tasks.²²⁵

It might be asserted that the combination of powers concerning monetary policy on one hand and monitoring and oversight, on the other, creates conflicts of interest within the ECB itself, thereby rendering it unfit to carry out them appropriately.

In order to avoid such a conflict, it has been suggested to create a new body, separate from ECB and responsible for the oversight. The solution would have the merit to dispel doubts as to any possible interference capable of affecting the independent position of the ECB and the effectiveness of the monetary policy, but it seems quite obvious that finding a legal basis other than the aforementioned art. 127(6) TFEU could be an arduous task. It is not impossible, but probably it requires that the Treaties be amended, with all that it means in practice.²²⁶

An intermediate suggestion is the separation, within the ECB, of the functions in order to avert conflicts.

224 Craig, de Burca (n 222) 98

225 Jean Pisani-Ferry (n 202) 11

226 Sideek Mohamed, 'A Legal Analysis of the Global Financial Crisis from an EU Perspective' (September 2009), SIEPS European Policy Analysis, issue 10 5

However, the opinions on the topic are various.²²⁷ Others believe instead that the ECB is the best solution,²²⁸ given also its status of independence from all governments. Moreover, already now the ECB cooperates with the national authorities, therefore the staff would be prepared to perform the new tasks without further complications. The possible conflict between monetary policy and financial stability would seem more apparent than real.²²⁹

5.3.3 Eurozone countries and Member States outside: what treatment?

Possible suggestions

The debate has also touched the treatment to reserve to those countries which are part of EU but outside EMU, by virtue of special opt-out protocols (United Kingdom and Denmark) or for other reasons (the most common not meeting the convergence criteria regarding inflation target or sovereign debt). Should they be part of the banking union?

Some premises will clarify the issue: although the EMU was launched with the aim to facilitate the market integration, especially in the field of capital movements which has a strong bearing on monetary sovereignty and whose freedom may exert strong pressure over the exchange rate, some Member States decided not to join, while others were not deemed eligible (for economic reasons) or have postponed their entry. Notwithstanding that, the rules of the Treaty with regards to free movement of capital apply to all the 27 (soon 28) Member countries.

The Proposal for a banking union is addressed to the states within Eurozone, since the stability of the banking sector is of utmost importance for a stable single currency. In order to remove the vicious incentives that lead to fragmentation and, consequently, to disruptions to the functioning of the EMU, these states are necessarily part of the

227 A thorough analysis of benefits and disadvantages can be found in Andenas, Hadjiemmanuil (n 145) 386-394
228 Ioannidou (n 216) 90; Hertig, Lee, McCahery (n 195)
229 Andenas, Hadjiemmanuil (n 145) 415-416; Ioannidou (n 216) 93

project. It would be also quite logical to establish the ECB not just as the main actor in the conduct of the monetary policy but as the supreme guarantee over the banking stability.

Although among the economists doubts have been raised as to the effectiveness of a banking union not comprising all the Member States,²³⁰ the Commission has preferred to leave the “outs” to choose whether or not to confer the powers to ECB by joining the banking union.

5.3.4 Other problems (in brief): single protection of depositors

To solve the numerous problems which affect EU at the moment might appear a daunting task. The banking union is a possibility and only time will tell whether it has been a wise choice or not.

The Commission and the other EU institutions, however, along with commentators and financial experts agree upon that its introduction is only the first necessary move towards stabilization and other initiatives are to follow suit, otherwise the Banking Union's alleged benefits would be rendered pointless.²³¹

One of the most sensitive points is the introduction of a common safety net for the protection of the depositors, a means intended to rule out any risk of “bank run” and to break the connections between banks and public finances: situations that might instead call for the reintroduction of capital controls, openly conflicting with art. 63 TFEU.

The issues to be addressed are mainly economic and would fall outside the scope of this work. What is important to bear in mind is that the banking union, although it can be a tool towards a further financial integration, cannot be alone the “final solution” but just an unavoidable first step.²³²

230 Pisani-Ferry, Sapir, Véron, Wolff (n 202) 7: a banking union embracing all the EU states would be the best solution, but it is seen as politically difficult.

231 Report by President of the European Council Herman Van Rompuy, 'Towards a genuine Economic and Monetary Union', 26.6.2012, EUCO 120/12 4

232 Luca Marcolin, 'L'Unione bancaria avvicina l'Europa al *redde rationem* [Banking Union is leading to *redde rationem* in

5.4 Does banking union strengthen the EMU? Towards a more unified single financial market

At the time this dissertation was being written, it was still uncertain the destiny of the Proposal delivered by the Commission and preliminarily approved by the Council. There were many doubts as to whether the Regulation would enter into force as here described or it would undergo deep modifications.

A point of departure for any analysis, however, is that the EMU suffers of some “birth defects” which had been hidden for long but eventually came out after the burst of the financial crisis in 2008. One of these defects regards the stability of the banking system and how to prevent future crises from happening again.

Banks play a fundamental role in the financial field. The liberalization of capital movements has permitted them to dramatically increase their business. At the same time, it has exposed the system to huge risks with spillovers throughout the EU. As it is not conceivable a monetary union where capital controls have not been abolished completely, such an union cannot be stable without a sound banking system.

The relationships between these different areas may be defined as “symbiotic”,²³³ where one directly influence each other and the system, namely the financial market, is sustainable only if all the pieces are stable and do not create disturbances.

To introduce a banking union would push in an irreversible way towards a further integration, with no possibility to distinguish between services, capital or banking and provide different degrees of liberalization: all must move at the same pace. That does not entail that different types of

Europe]' (2012), Limes – Rivista Italiana di Geopolitica, <http://temi.repubblica.it/limes/lunione-bancaria-avvicina-leuropa-al-redde-rationem/41093> 2: the author views the banking union as a complex project made up of four pillars (common rules, single supervisor, depositor protection and crisis management tools) and argues that the absence of the last two may seriously undermine the proposal; on the same line see Various Authors (n 197) 19

233 Hindelang (n 4) 21: the authors refers to capital and monetary union, but the adjective is suitable also with regards to the financial services market globally considered.

integration cannot exist (the EMU comprises only 17 states, the banking union would likely regard only them), but only that it is no longer acceptable to privilege one aspect to the detriment of others, otherwise the integration itself would halt.

The answer to the question is therefore not easy. This work tries to shed some light on the most important problems and points to consider in this difficult path.

Conclusion

The internal market is a complex reality. It is not just the sum of different elements, as it could have appeared in the beginning of the integration process. The decision to liberalize a sector, regardless of which one, has always an impact, not just in the economic sphere but also as regards the policies. The more the market is integrated, the harder is to step back, despite any possible negative effects or spillovers.

The free movement of capital has had a tormented history and its application has required a long time before being recognized for the value it bears. But like a river it has washed away certainties and obliged to confront new challenges. Despite the scant case-law, or the number of publications focusing on it, this freedom is important nowadays as never before. One of the main pillars of the financial services market, an area whose development is fundamental for the economic growth, especially in a difficult moment such as that Europe was experiencing when this paper was written (mid-2013).

The connections between capital, its relative markets, the monetary dimension and the single currency, as well as the stability of the banking sector are self-evident at a more careful glance. The mutual influence they have on each other is a matter of fact that requires a far-reaching approach where different knowledges are to be combined.

No easy solutions exist. The process is bound to continue by means of trial and errors, and the benefits deriving are likely to be in the long run way more than any possible side effect.

European integration has come a long way, but much has yet to come.

BIBLIOGRAPHY

Note: articles contained in works edited by other authors are listed under category “articles”, while “books” includes only monographic studies.

Books

Bakker, Age F.P. *The Liberalization of Capital Movements in Europe: the Monetary committee and Financial Integration, 1958-1994* (Kluwer Academic Publishers, 1996)

Barnard, Catherine *The Substantive Law of the EU* (3rd edition, Oxford University Press, 2010)

Craig, Paul and de Burca, Grainne *EU Law: Text, Cases and Material* (5th edition, Oxford University Press, 2011)

Hindelang, Steffen *The Free Movement of Capital and Foreign Direct Investment: The Scope of Protection in EU Law* (Oxford Scholarship Online, 2009)

Hopt, Klaus J. and Wymeersch, Eddy (ed), *European Company and Financial Law* (4th edition, Oxford University Press, 2007)

Mohamed, Sideek *European Community Law on the Free Movement of Capital and the EMU* (Nordsteds Juridik, 1999)

Mohamed, Sideek *European Financial Services Law* (Juridiska Fakulteten Skrifterien – Stockholms Universitet, no. 68, 2001)

Molle, Willem *The Economics of European Integration: Theory, Practice, Policy* (5th edition, Ashgate, 2006)

Moens, Gabriël and Trone, John *Commercial Law of the European Union* (Ius Gentium, Comparative Perspectives on Law and Justice 4, Springer Science, 2010)

Usher, John A. *The Law of Money and Financial Services in European Community* (2nd edition, Oxford University Press, 2000)

Articles

Andenas, Mads and Hadjiemmanuil, Christos 'Banking Supervision, the Internal Market and European Monetary Union', in Mats Andenas, Laurence Gormley, Christos Hadjiemmanuil, Ian Harden (eds), *European Economic and Monetary Union: the Institutional Framework* (Kluwer Law International, 1997)

Beck, Thorsten 'Why the Rush? Short-term Crisis Resolution and Long-term Bank Stability', in Thorsten Beck (ed), *Banking Union for Europe: Risks and Challenges* (Centre for Economic Policy Research, 2012)

Białek, Natalia and Bazylko, Arkadius 'Free Movement of Money in European Union – The Role of the European Court of Justice in the Formation of Free Movement of Capital and Payments' (2011), *Financial Internet Quarterly “e-Finanse”*, vol. 7, no. 2, www.e-finanse.com

Booth, Philip and Morrison, Alan 'Promoting a Free Market by Ending the Single Market – Reforming EU Financial Regulation', *Economic Affairs*, 32: 24 – 31

Čihák, Martin and Decressin, Jörg 'The Case for a European Banking Charter' (July 2007), IMF Working Paper No. 07/153, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1007922

de Haan, Jakob and Gormley, Laurence 'Independence and Accountability of the European Central Bank', in Mats Andenas, Laurence Gormley, Christos Hadjiemmanuil, Ian Harden (eds), *European Economic and Monetary Union: the Institutional Framework* (Kluwer Law International, 1997)

Flynn, Leo 'Coming of Age: the Free Movement of Capital Case Law 1993-2002' (2002), *Kluwer Law International*, no. 39, p. 773

Fonteyne, Wim 'EU: From Monetary to Financial Union', *Finance and Development* (June 2006), vol. 43, no. 2, <http://www.imf.org/external/pubs/ft/fandd/2006/06/fonteyne.htm>

Gamble, Andrew 'EMU and European Capital Markets: Towards a Unified Financial Market' (1991), *Kluwer Law International*, no. 28, p. 319

Gros, Daniel 'The Single European Market in Banking in Decline – ECB to the Rescue?', in Thorsten Beck (ed), *Banking Union for Europe: Risks and Challenges* (Centre for Economic Policy Research, 2012)

Harden, Ian 'The Fiscal Constitution of EMU', in Paul Beaumont and Neil Walker (eds), *Legal Framework of the Single European Currency* (Hart Publishing, 1999)

Hertig, Gerard Lee, Ruben and McCahery, Joseph A. 'Empowering the ECB to Supervise Banks: A Choice-Based Approach' (August 2009), ECGI Working Paper Series in Finance, Working Paper N°. 262/2009, <http://ssrn.com/abstract=1327824>

Horsley, Thomas 'The Concept of an Obstacle to Intra-Eu Capital Movement in EU Law' in Niamh Nic Shuibhne and Laurence W. Gormley (eds), *From Single Market to Economic Union: Essays in Memory of John A. Usher* (Oxford Scholarship Online, 2012)

Ioannidou, Vasso 'A First Step Towards a Banking Union', in Thorsten Beck (ed), *Banking Union for Europe: Risks and Challenges* (Centre for Economic Policy Research, 2012)

Malgorzata, Mikita 'EU Single Financial Market: Prospects of Changes' (2012), *Financial Internet*

Quarterly, Vol. 8, Issue 1, <http://hdl.handle.net/10419/66762>

Marcolin, Luca 'L'Unione bancaria avvicina l'Europa al *redde rationem* [Banking Union is leading to *redde rationem* in Europe]' (2012), *Limes – Rivista Italiana di Geopolitica*, <http://temi.repubblica.it/limes/lunione-bancaria-avvicina-leuropa-al-redde-rationem/41093>

Mohamed, Sideek 'A Legal Analysis of the Global Financial Crisis from an EU Perspective' (September 2009), *SIEPS European Policy Analysis*, issue 10

Murphy, Ryan 'Changing Treaty and Changing Economic Context: the Dynamic Relationship of the Legislature and the Judiciary in the Pursuit of Capital Liberalisation' in Paul Syrpis (ed), *The Judiciary, the Legislature and the EU Internal Market* (Cambridge University Press, 2012)

Peers, Steve 'Free Movement of Capital: Learning Lessons or Slipping on Spilt Milk?' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Hart Publishing, 2002)

Phillips, Kerk and Wrase, Jeffrey 'Monetary Union and Market Integration: Capital and Goods Market Issues Pertaining to the Launch of the Euro' (2001), *International Finance Review*, European Monetary Union and Financial Markets, vol. 2, p. 3

Phillips, Kerk and Wrase, Jeffrey 'Historical Overview of the Transition to Monetary Union in Europe' (2001), *International Finance Review*, European Monetary Union and Financial Markets, vol. 2, p. 13

Pisani-Ferry, Jean 'The Euro Crisis and the New Impossible Trinity' January 2012, *Bruegel Policy Contribution*, Issue 2012/01

Pisani-Ferry, Jean Sapir, André Véron, Nicolas and Wolff, Guntram B. 'What Kind of European Banking Union' June 2012, *Bruegel Policy Contribution*, Issue 2012/12

Saccomanni, Fabrizio 'Verso una Vera Unione Economica e Monetaria? [Towards a Real Economic and Monetary Union?]', speech held at the Conference in memory of Gaspare Scaruffi, Reggio Emilia (Italy), 10th January 2013

Schoenmaker, Dirk 'Banking Supervision and Lender-of-last-resort in EMU', in Mats Andenas, Laurence Gormley, Christos Hadjiemmanuil, Ian Harden (eds), *European Economic and Monetary Union: the Institutional Framework* (Kluwer Law International, 1997)

Snell, Jukka 'Free Movement of Capital: Evolution as a Non-linear Process' in Paul Craig and Gràinne de Búrca (eds), *The Evolution of EU Law* (2nd edition, Oxford University Press, 2011)

Snyder, Francis 'EMU – Integration and Differentiation: Metaphor for European Union' in Paul Craig and Gràinne de Búrca (eds), *The Evolution of EU Law* (2nd edition, Oxford University Press, 2011)

Teixeira, Pedro Gustavo 'The Regulation of the European Financial Market After the Crisis', in Pompeo Della Posta, Leila Simona Talani (eds), *Europe and the Financial Crisis* (Palgrave MacMillan, 2011)

Usher, John A. 'Legal Background of the Euro', in Paul Beaumont and Neil Walker (eds), *Legal Framework of the Single European Currency* (Hart Publishing, 1999)

Usher, John A. 'The Evolution of the Economic and Monetary Union – Some Legal Issues' in Anthony Arnall, Piet Eeckhout, and Takis Tridimas (eds), *Continuity and Change in EU Law: Essays in Honour of Sir Francis Jacobs* (Oxford Scholarship Online, 2009)

Usher, John A. 'The Evolution of the Free Movement of Capital' (2008), *Fordham International Law Journal* May, 31 *Fordham Int'l L.J.* 1533

Wall, Larry D. Nieto, María J. and Mayes, David 'Creating an EU-Level Supervisor for Cross-Border Banking Groups: Issues Raised by the U.S. Experience with Dual Banking' (March 2011), Federal Reserve Bank of Atlanta, Working Paper 2011-06

Wyplosz, Charles 'EMU: Why and How It May Happen' (Fall 1997), *Journal of Economic Perspectives*, vol. 11, no. 7, p. 3

Yianni, Andrew and de Vera, Carlos 'The Return of Capital Controls' (Fall 2010), 73 *Law and Contemporary Problems*, <http://scholarship.law.duke.edu/lcp/vol73/iss4/23>

Other references

Communication from the Commission to the European Parliament and the Council, 'A Roadmap Towards a Banking Union', 12.9.2012 COM(2012) 510 final

Mauritzon, Mattias 'Islands stora utmaningar kvarstår [Iceland big challenges remain]' *Dagens Industri* (Stockholm, 5 March 2013)

Proposal for a COUNCIL REGULATION conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, Brussels, 12.9.2012 COM(2012) 511 final

Report by President of the European Council Herman Van Rompuy, 'Towards a genuine Economic and Monetary Union', 26.6.2012, EUCO 120/12

Various Authors, *A Banking Union for the Euro Area* (IMF Staff Discussion Note, February 2013)

Case-law of CJEU (in chronological order)

Case C-26/62 *Van Gend and Loos* [1963] ECR 1

Case C-33/70 *SACE* [1970] ECR 1213

Case C-2/74 *Reyners* [1974] ECR 631

Case C-8/74 *Dassonville* [1974] ECR 837

Case C-33/74 *Van Binsbergen* [1974] ECR 1299

Case C-7/78 *R. v. Thompson* [1978] ECR 2247

Case C-120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* [1978] ECR 649

Case C-203/80 *Casati* [1981] ECR 2595

Joined cases C-286/82 and C-26/83 *Luisi and Carbone* [1984] ECR 377

Case C-267/86 *Van Eycke v. ASPA* [1988] ECR 4769

Case C-204/90 *Bachmann* [1992] ECR I-249

Joined cases C-358/93 and C-416/93 *Bordessa* [1995] ECR I-361

Case C-484/93, *Svensson & Gustafsson v. Ministre du Logement* [1995] ECR I-3955

Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera* [1995] ECR I-4821

Case C-118/96 *Safir* [1998] ECR I-1897

Case C-410/96 *Ambry* [1998] ECR I-1897

Case C-222/97 *Trummer & Mayer* [1999] ECR I-1661

Case C-302/97 *Konle* [1999] ECR I-3099

Case C-439/97 *Sandoz* [1999] ECR I-7041

Case C-367/98 *Commission v. Portugal* [2002] ECR I-4731

Case C-423/98 *Albore* [2000] ECR I-5965

Case C-54/99, *Eglise de Scientologie* [2000] ECR I-1335

Case C-436/00, *X and Y v. Skatteverket*, [2002] ECR I-10829

Case C-452/04 *Fidium Finanz* [2006] ECR I-9521

Case C-101/05 *A v. Skatteverket* [2007] ECR I-11531

Case C-110/05 *Commission v. Italy* [2009] ECR I-519

Case C-142/05 *Mickelsson & Ross* [2009] ECR I-4273

Case C-67/08 *Block v. Finanzamt Kuafbeuren* [2009] ECR I-883