effect that the Union and the Member States have unilaterally given third-country direct investors the right to invest in the Single Market insofar as such investment primarily constitutes establishment. As regards the post-establishment treatment of third-country direct investment in the Single Market, it is argued that a distinction needs to be drawn between the post-establishment treatment of third-country direct investment in the internal economy of a Member State and the rights of intra-EU mobility for non-EU direct investors. The internal market mechanism operates differently with respect to these two aspects of the post-establishment treatment of third-country direct investment as a result of the inward-looking nature of the freedom of establishment. The automatic granting of rights of secondary mobility to third-country direct investors will be contrasted with the absence of a comprehensive Union regime with regard to the admission and treatment of third-country direct investment in the Single Market.

I. INTERNAL MARKET INTEGRATION IN THE FIELD OF DIRECT INVESTMENT

This section looks at the constitutive features of EU legal integration so far as concerns direct investment within the Single Market. It first clarifies the terminology and analyses the integrative strategy of the Single Market in the field of direct investment. It then investigates why the free movement of capital was extended to capital transfers to and from third countries in view of the fact that the other TFEU freedoms apply only to intra-EU situations.

A. Terminology and Integrative Strategy

Article 3(3) TEU states that the Union shall establish an 'internal market'. Article 26(2) TFEU provides that the internal market 'shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties'. The Single European Act (SEA) set the Union an objective to complete European market integration by 31 December 1992 as part of the so-called Single Market programme. While the CJEU had already been using the term 'Single Market' since the early 1960s,[2] the terms 'internal market' and 'Single Market' have mostly been used interchangeably.[3] In the typology outlined by Belassa, the four freedoms of the Single European Market constitute a so-called 'common market'.[4] While a 'free trade area' and a 'customs union' are forms of regional economic integration that focus exclusively on the free movement of products, which can be traded, it is

[2] See 32/65 *Italy v Council and Commission* [1966] ECR 389, 405; 15/81 *Gaston Schul* [1982] ECR 1409, para 33.

[3] CS Barnard, *The Substantive Law of the EU, The Four Freedoms*, 3rd edn (Oxford, Oxford University Press, 2010) 12; K Mortelmans, 'The Common Market, the Internal Market and the Single Market: What's in a Market?' (1998) 1 *CML Rev* 101.

[4] See B Balassa, *The Theory of Economic Integration* (London, Allen and Unwin, 1962).

a distinctive feature of a common market that it allows for the free movement of production factors, such as labour, capital and enterprise.[5] The abolition of restrictions on direct investment is therefore an important feature of Single Market integration. Yet, there is no TFEU freedom that is exclusively devoted to direct investment.

With regard to the operation of the internal market mechanism in relation to direct investment, the European Commission has stated on the basis of the Court's case law that:

> the acquisition of controlling stakes in a domestic company by an EU investor, in addition to being a form of capital movement, is also covered under the scope of the right of establishment.[6]

Indeed, both Article 49 TFEU on freedom of establishment and Article 63 TFEU on free movement of capital are relevant for an analysis of the legal organisation of direct investment in the Single Market. It is settled case law that national provisions which apply to holdings by nationals of the Member State concerned in the capital of a company established in another Member State, giving them definite influence on the company's decisions and allowing them to determine its activities, come within the substantive scope of the TFEU provisions on freedom of establishment.[7] Furthermore, direct investment often involves a movement of capital in the sense of Article 63 TFEU. The close link between freedom of establishment and free movement of capital was first recognised by the CJEU in *Casati*, when it observed that the:

> freedom to move certain types of capital is, in practice, a precondition for the effective exercise of other freedoms guaranteed by the Treaty, in particular the right of establishment.[8]

In view of the possibilities for interaction between freedom of establishment and free movement of capital so far as concerns direct investment, the predominant purpose and underlying integrative principles of these two TFEU freedoms will be discussed in turn.

The freedom of establishment includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings under the conditions laid down for its own nationals by the law of the Member State of establishment.[9] It allows an EU investor to participate, on a stable and continuous basis, in the economic life of a Member State other than his state of origin and to profit therefrom, thus contributing to the 'economic and social interpenetration'

[5] W Molle, *The Economics of European Integration: Theory, Practice, Policy*, 5th edn (Aldershot, Ashgate, 2006) 11; D Swann, *The Economics of Europe, From Common Market to European Union*, 9th edn (London, Penguin, 2000) 171, who refers to enterprise in addition to labour and capital.

[6] Communication of the Commission, 'Certain legal aspects concerning intra-EU investment' [1997] OJ C220/15, para 4.

[7] C-196/04 *Cadbury Schweppes* [2006] ECR I-7995, para 31.

[8] 203/80 *Casati* [1981] ECR 2595, para 8.

[9] C-251/98 *Baars* [2000] ECR I-2787, para 27.

in the Union.[10] The exercise of the freedom of establishment involves the genuine and actual pursuit of an economic activity in the host Member State.[11] While Article 49 TFEU secures the freedom of establishment for nationals of a Member State on the territory of another Member State, Article 54 TFEU extends the freedom of establishment to legal persons. An EU investor thus exercises his rights under the TFEU freedom of establishment where a shareholding constitutes a lasting link with a company in the host economy and allows the investor not only to participate, but also to have a definite influence on the management of a company.[12] The freedom of establishment, moreover, applies both to the establishment of new undertakings and to the acquisition of shares in pre-existing undertakings.[13]

The freedom of establishment covers both the admission and post-establishment treatment of direct investment. So far as concerns the underlying integrative strategy of this TFEU freedom, Article 49 TFEU gives effect to the principle of non-discrimination enshrined in Article 18 TFEU by laying down an obligation of national treatment.[14] In addition, the freedom of establishment extends to instances of both direct and indirect discrimination.[15] Directly discriminatory national measures can be saved under Article 52(1) TFEU only on grounds of public policy, public security or public health. The criteria to be fulfilled by indirectly discriminatory measures are that they must be applied in a non-discriminatory way, be justified by imperative requirements, be suitable for securing the objective that they pursue and they must not go beyond what is necessary in order to attain that objective.[16] Furthermore, the rights enshrined in Articles 49/54 TFEU do not merely involve an obligation on the host Member State to treat foreign nationals and companies in the same way as nationals of that Member State. Articles 49/54 TFEU also prohibits the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation, as well as the establishment in another Member State of nationals of Member States residing on its territory.[17]

[10] C-55/94 *Gebhard* [1995] ECR I-4165, para 25.

[11] But see C-167/01 *Inspire Art* [2003] ECR I-10155, para 95, where the Court confirmed that a company which is formed in one Member State solely for the purpose of establishing in a second Member State, where its entire business is to be conducted, is capable of invoking the freedom of establishment.

[12] C-524/04 *Thin Cap Group Litigation* [2007] ECR I-2107, para 27.

[13] C-411/03 *SEVIC Systems AG* [2005] ECR I-10805, para 19.

[14] C-1/93 *Halliburton Services* [1994] ECR I-1137, para 12.

[15] C-330/91 *Commerzbank* [1993] ECR I-4017, para 14: 'the rules regarding equality of treatment forbid not only overt discrimination by reason of nationality or, in the case of a company, its seat, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result'. For a critical analysis of the Court's restriction- or obstacle-based approach, see CS Barnard, 'Restricting Restrictions: Lessons for the EU from the US?' (2009) 3 *CLJ* 575. See also E Spaventa, 'From Gebhard to Carpenter: Towards a (Non-)Economic European Constitution' (2004) 3 *CML Rev* 743.

[16] C-55/94 *Gebhard* [1995] ECR I-4165, para 37.

[17] C-446/03 *Marks & Spencer* [2005] ECR I-10837, para 31.

Direct investment is also addressed in EU law under the free movement of capital. Whereas capital mobility was long subsidiary to the other Treaty freedoms in the earlier stages of Single Market integration,[18] Article 63(1) TFEU now provides that:

> Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.[19]

In the words of Flynn, capital movements cover 'those resources used for, or capable of, investment intended to generate revenue'.[20] As such, the free movement of capital covers financial assets, such as cash, bonds and shares. The freeing up of capital transactions essentially meant that the Member States were obliged to make foreign currency available to enable these transactions to take place.[21] A principal problem was the imposition of exchange controls by Member States with the aim of safeguarding their balance of payments and to ensure domestic monetary autonomy.[22] However, the substantive scope of the TFEU provisions on free movement of capital has been interpreted widely so as to cover factors potentially affecting the optimum allocation of capital, such as tax measures.[23] Similar to the freedom of establishment, free movement of capital has been found to catch indistinctly applicable rules that are nonetheless discriminatory, unless they can be justified.[24]

The notion of capital movements relates to a wider range of economic activities than only direct investment. This can readily be observed from the nomenclature

[18] Before the Treaty of Maastricht, the Treaty provisions on movement of capital (Art 67(1) EEC Treaty) only laid down the obligation for capital movements to be liberalised 'to the extent necessary to ensure the proper functioning of the common market' and were not directly effective. See Case 203/80 *Casati* [1981] ECR 2595, para 10.

[19] The Court ruled that free movement of capital is directly effective in Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera* [1995] ECR I-4830, para 41. The freedom of payments, which is enshrined in Art 63(2) TFEU, will not be considered, since remunerations do not constitute an investment. For the distinction between capital and payments, see Joined Cases 286/82 and 26/83 *Luisi and Carbone* [1984] ECR 377, para 21.

[20] L Flynn, 'Coming of Age: The Free Movement of Capital Case Law 1993–2002' (2002) 4 *CML Rev* 773, 776.

[21] Swann, *Economics of Europe* (above n 5) 184 ff.

[22] Under Art 1(1) of the First Directive for the implementation of Article 67 EEC [1960] OJ 43/921, the Member States had to 'grant all *foreign exchange authorisations* required for the conclusion or performance of transactions or for transfers between residents of Member States in respect of . . . capital movements' such as direct investment (emphasis added). For a similar focus on the removal of exchange controls, see EEC Commission, *The Development of a European Capital Market, Report of a Group of Experts Appointed by the EEC Commission* (1966) 85–88 (Segré Report); White Paper from the Commission to the European Council on Completing the Internal Market, COM(85)310 final, 14 June 1985, Brussels, 32–34.

[23] S Kingston, 'A Light in the Darkness: Recent Developments in the ECJ's Direct Tax Jurisprudence' (2007) 5 *CML Rev* 1321.

[24] C-463/00 *Commission v Spain* [2003] ECR I-4581, para 56. For analysis, see A Emch, 'News from Luxembourg: Is the New EU Investment Law Taking Shape?' (2008) 6 *Journal of World Investment and Trade* 497, 508 ff.

enshrined in the first Annex to Directive 361/88,[25] in which 13 different types of capital movement are classified in relation to the economic nature of the assets and liabilities they concern. Direct investment constitutes the first heading in this non-exhaustive list of capital movements. The CJEU has held that capital movements include, inter alia, the granting of credit on a commercial basis,[26] the reselling of shares,[27] inheritances,[28] investments in real estate[29] and immovable property,[30] as well as direct and portfolio investments.[31] While Article 63 TFEU prohibits restrictions on capital movements, Article 64(2) TFEU provides the Council with a legislative competence to:

> adopt measures on the movement of capital to or from third countries involving direct investment – including investment in real estate – establishment, the provision of financial services or the admission of securities to capital markets.

Moreover, Article 64(3) TFEU provides that

> Notwithstanding paragraph 2, only the Council, acting in accordance with a special legislative procedure, may unanimously and after consulting the European Parliament, adopt measures which constitute a step backwards in Union law as regards the liberalisation of the movement of capital to or from third countries.

The Court has confirmed that the reference to direct investment in Article 64 TFEU does not in any way impinge on the substantive scope of Article 63 TFEU.[32] In other words, the latter provision is directly effective in relation to the economic activities that are explicitly mentioned in Article 64 TFEU.

Because EU primary law does not define the concept of 'direct investment', reference is often made to Directive 88/361.[33] The first Annex of this Directive breaks down the concept of direct investment into four categories:

> (1) [e]stablishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings; (2) [p]articipation in new or existing undertakings with a view to establishing or maintaining lasting economic links; (3) [l]ong-term loans with a view to establishing or maintaining lasting economic links; (4) [r]einvestment of profits with a view to maintaining lasting economic links.

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

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

[27] C-265/04 *Bouanich v Skatteverket* [2006] ECR I-923.

[28] C-513/03 *Van Hilten-van der Heijden* [2006] ECR I-1957.

[29] C-386/04 *Centro di Musicologia* [2006] ECR I-8293.

[30] C-451/05 *Elisa* [2007] ECR I-8251.

[31] Joined Cases C-282/04 and 283/04 *Commission v Netherlands* [2006] ECR I-9141.

[32] C-101/05 *A v Skatteverket* [2007] ECR I-11531, para 26. With reference to (now) Article 64(1) TFEU, see below n 52.

[33] C-446/04 *FII Group Litigation* [2006] ECR I-11753, para 179: 'the nomenclature of capital movements annexed [to Directive 88/361 has] indicative value, for the purposes of defining the term "movement of capital" . . . subject to the qualification, contained in the introduction to the nomenclature, that the list set out therein is not exhaustive'.

The emphasis on the establishment of lasting economic links accords with the transaction-based definition of FDI in other international instruments that liberalise cross-border capital movements. It is, moreover, absent in the definition of various types of portfolio investment in the same instrument, such as operations in securities on the capital market with purely financial aims. The focus on lasting links is also evidenced by an explanatory note in the same Annex, which defines 'direct investment' as:

> Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity. This concept should therefore be understood in its widest sense.

In view of the fact that Article 63 TFEU deals with the freedom of capital movements, the concept of direct investment in this definition presupposes a transfer of capital.[34] That a movement of capital cannot be entirely equated with the concept of direct investment is reflected in the fact that Article 64 TFEU refers to movements of capital 'involving direct investment'. In other words, the wording of the TFEU provisions on free movement of capital seems to suggest that they deal with capital transfers only *in relation to* direct investment and not with the entire transaction of direct investment.[35]

Because direct investment often involves a movement of capital, it has a prominent place in Directive 88/361. However, since the regulatory issues involved with a transfer of capital may differ depending on the economic activity that is involved, it is important to bear in mind the economic context of any movement of capital. That such a movement of capital is always linked to a specific economic activity or underlying transaction is underscored by the fact that Article 64 TFEU does not only refer to capital movements in relation to 'direct investment', but also in relation to 'establishment'. The reference to both 'direct investment' and 'establishment' in the TFEU provisions on free movement of capital suggests that 'direct investment' is not necessarily the same economic activity as the concept of 'establishment' in the light of Article 49 TFEU. Indeed, where a self-employed person establishes itself in another Member State, without there being an investment giving rise to a lasting interest, this does not constitute direct investment.[36] Furthermore, this double reference implies that the exercise

[34] Economists consider direct investment to be a specific kind, or subcategory, of capital transfers. See Molle, *Economics of European Integration* (above n 5) 126.

[35] The same picture is borne out by other language versions of the Treaty. The Dutch version speaks of capital movements 'in verband met directe investeringen'; the French version of 'movement de capitaux à destination ou en provenance de pays tiers, lorsqu'ils impliquent des investissements directs'; the Italian version refers to capital movements 'in relazione a investimenti diretti'; the German version to capital movements 'im Zusammenhang mit Direktinvestitionen'; and the Spanish version to capital movements 'que supongan inversiones directas'. But see C-174/04 *Commission v Italy* [2005] ECR I-4933, para 28.

[36] S Hindelang, *The Free Movement of Capital and Foreign Direct Investment: The Scope of Protection under EU Law* (Oxford, Oxford University Press, 2009) 86.

of freedom of establishment rights does not necessarily preclude that same activity from simultaneously involving a capital movement in relation to direct investment for the purpose of Article 63(1) TFEU. Establishment, in the form of direct investment or not, can involve a transfer of capital. However, the multifaceted economic activity of direct investment (or establishment) arguably cannot be entirely equated with such a transfer of capital.

The issue of the admission and treatment of direct investment has thus been subsumed under the TFEU provisions on establishment and capital movements. Their regulatory purposes are similarly inspired by the general principles underpinning the common market, such as the principle of non-discrimination on grounds of nationality, which requires out-of-state natural and legal persons, as well as capital, to enjoy the same treatment as their in-state equivalents. Since the enjoyment of national treatment can also be a burden for a foreign economic operator in respect of domestic economic operators, the TFEU freedoms have also been ruled to catch indistinctly applicable national rules that nevertheless hinder market access, unless they can be justified. Nevertheless, there seems to be a different regulatory emphasis between freedom of establishment and free movement of capital insofar as the free movement of capital focuses predominantly on issues of market access, while the concept of establishment deals with the admission and to a larger degree with the post-establishment treatment of direct investment.[37] This is evidenced by the much larger amount of secondary legislation with a sectoral approach in the field of establishment, which provides for harmonisation and mutual recognition rules.

B. External Dimension of Articles 49/54 and 63 TFEU

The TFEU freedoms focus on economic integration within the Single Market. Articles 49/54 TFEU is purely inward-looking, so that third-country investors seeking access to the Single Market cannot invoke the freedom of establishment. This was confirmed by the CJEU in *Opinion 1/94*, where it ruled that:

> the sole objective of [the chapter on freedom of establishment] is to secure the right of establishment . . . for nationals of Member States.[38]

The TFEU provisions on freedom of establishment, moreover, do not extend to situations that involve the establishment in a third country of a Member State national or of a company incorporated under the legislation of a Member State.[39] Neither does the freedom to provide services apply to third-country economic

[37] R Torrent, 'Derecho comunitario e inversiones extranjeras directas: Libre circulación de los capitales vs. regulación no discriminatoria del establecimiento. De la *golden share* a los nuevos *open skies*' (2007) *Revista Española de Derecho Europeo* 283.

[38] *Opinion 1/94* [1994] ECR I-5267, para 81.

[39] C-157/05 *Holböck* [2007] ECR I-4051, para 28.

operators.[40] The same applies to the free movement of goods[41] and the free movement of workers.[42] By contrast, it follows from the wording of Article 63 TFEU that the free movement of capital applies not only to intra-EU capital movements, but also to capital transfers from and into the Single Market.[43]

The free movement of capital as laid down in the Treaty of Rome was initially limited to the extent necessary to ensure the proper functioning of the common market.[44] Member States thus did not aspire to complete free movement of capital as an object in itself. It has been suggested that the Member States did not want to give up the right to restrict capital flows, because they needed that instrument for the effective control of internal macro-economic and monetary developments.[45] There was the fear that capital outflows would depreciate the currency and drive up the rate of inflation, which would require monetary measures and fiscal contraction to offset it.[46] Since the free movement of capital was initially not directly effective,[47] it was to be achieved exclusively through the adoption of secondary legislation.[48] There have been continuous efforts to progressively liberalise capital movements within the Single Market, but up to 1987 this did not result in instruments reaching beyond the stipulations of the Treaty. Not until the Treaty of Maastricht was the free movement of capital incorporated into the (then) EC Treaty as a fully-fledged fundamental freedom (the fourth freedom[49]).

(Then) Article 73b EC also explicitly extended the free movement of capital to third countries. Germany and the Netherlands were the main proponents of an extension of capital liberalisation to third countries, while France had proposed not including the free movement of capital vis-à-vis third countries in the Maastricht amendments.[50] The hesitation of some Member States to extend capital mobility to third countries was mainly grounded in concerns over the possibility of extracting similar concessions from third countries, the link between full capital mobility and the freedom to establish in the Union, as well as the possibility for

[40] C-452/04 *Fidium Finanz* [2006] ECR I-9521, para 25.

[41] See 51/75 *EMI Records* [1976] ECR 811, para 17: 'the Provisions of the Treaty on commercial policy do not . . . lay down any obligation on the part of the Member States to extend to trade with third countries the binding principles concerning the free movement of goods between Member States'.

[42] Article 45(1) TFEU: 'Freedom of movement for workers shall be secured within the Union'.

[43] This notwithstanding, Art 64(2) TFEU stipulates that the European Parliament and the Council '[endeavour] to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible' in adopting measures on the movement of capital to and from third countries involving, inter alia, direct investment.

[44] See text to n 18.

[45] Molle, *Economics of European Integration* (above n 5) 122.

[46] D Mayes and J Kilponen, 'Factor Mobility' in AM El-Agraa, *The European Union, Economics and Policies*, 8th edn (Cambridge, Cambridge University Press, 2007) 144.

[47] See 203/80 *Casati* [1981] ECR 2595.

[48] For a historical overview of secondary legislation in the field of capital movements, see JA Usher, 'The Evolution of the Free Movement of Capital' (2007–2008) 5 *Fordham International Law Journal* 1533, 1535 ff; J Snell, 'Free Movement of Capital: Evolution as a Non-Linear Process' in P Craig and G de Búrca (eds), *The Evolution of EU Law*, 2nd edn (Oxford, Oxford University Press, 2010) 547.

[49] C-463/00 *Commission v Spain* [2003] ECR I-4581, para 68.

[50] AFP Bakker, *The Full Liberalization of Capital Movements in Europe: The Monetary Committee and Financial Integration 1958–1994* (Dordrecht, Kluwer, 1995) 230–31.

positive discrimination in favour of European companies.[51] Bakker observes that these concerns prompted the Member States to allow the continuation of existing restrictions vis-à-vis third countries.[52]

Different explanations have been advanced as to why the scope of application of Article 73b EC was extended to capital movement to and from third countries.[53] At an international level the collapse of the Bretton Woods system of fixed exchange rates in 1971 propelled the lifting of monetary restrictions hindering the free international flow of capital. International financial deregulation had put new competitive pressures on national financial systems because it increased the possibilities for companies to tap into pools of capital outside their home markets. Furthermore, capital movements had already been substantially liberalised between the Member States and third countries in accordance with the OECD Code of Liberalisation of Capital Movements. Since many Member States had already liberalised extra-EU capital transfers, capital inflows and outflows could not effectively be prevented in any case. One explanation therefore focuses on the sense among the Member States that capital movements with third countries had already been liberalised to a significant extent, although this does not necessarily explain why the extension of free movement of capital to third countries had to be incorporated in EU primary law.[54]

The entry into force of Articles 73a–h EC (later 56–60 EC) on 1 January 1994 coincided with the commencement of the second stage of Economic and Monetary Union (EMU), the third stage of which was the adoption in 1999 of the euro as the common currency of 11 of the then 15 Member States. While free movement of capital is a precondition of a monetary union,[55] it is also beyond doubt that the extension of the free movement of capital to third countries is related to the establishment of EMU.[56] The objective of extending free movement of capital to third countries is linked to the need to assure the international money market as regards the availability of the euro and thus to support the credibility of the euro as an

[51] Ibid 233.

[52] Ibid. The standstill provision enshrined in (now) Article 64(1) TFEU provides that '[t]he provisions of [now] Article 63 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Union law adopted in respect of the movement of capital to or from third countries involving direct investment, including in real estate, establishment, the provision of financial services or the admission of securities to capital markets. In respect of restrictions existing under national law in Bulgaria, Estonia and Hungary, the relevant date shall be 31 December 1999.'

[53] Most extensively, see R Abdelal, *Capital Rules: The Construction of Global Finance* (Cambridge, MA, Harvard University Press, 2007) 54–85.

[54] DS Smit, 'Capital Movements and Third Countries: The Significance of the Standstill-Clause ex-Article 57(1) of the EC Treaty in the Field of Direct Taxation' (2006) 4 *EC Tax Review* 203, 204.

[55] *Report to the Council and the Commission on the Realization by Stages of Economic and Monetary Union in the Community* (Werner Report), Supplement to Bulletin II–1970 of the European Communities, 10: 'A monetary union implies inside its boundaries the total and irreversible convertibility of currencies, the elimination of margins of fluctuation in exchange rates, the irrevocable fixing of parity rates and the complete liberalisation of movements of capital'.

[56] Snell, 'Free Movement of Capital' (above n 48) 551.

international reserve currency.[57] A macro-economic incentive for extending free movement of capital to third countries is that this prevents Member States from influencing the exchange rate of the single currency by restricting transfers of capital to and from third countries.

Notwithstanding what might have been the incentive for extending (then) Article 73b EC to capital transfers to and from third countries, the CJEU has divorced its interpretation of the free movement of capital with third countries from this specific political and economic background. This is evidenced by *A v Skatteverket*,[58] which dealt with the differential taxation of inbound dividends from shares owned by A, a Swedish national, in company X, which had its registered office in Switzerland. Swedish law provided for a tax exemption on dividends received from companies established in a European Economic Area (EEA) state, but not on dividends received from companies established elsewhere. A argued that this discouraged investment in these companies. In respect of the argument that the free movement of capital in relation to third-country investments had to be interpreted in the light of the specific rationale for extending the Treaty provisions on free movement of capital to third countries, the Court held that:

> even if the liberalisation of the movement of capital with third countries may pursue objectives other than that of establishing the internal market, such as, in particular, that of ensuring the credibility of the single Community currency on world financial markets and maintaining financial centres with a world-wide dimension . . ., it is clear that, when the principle of free movement of capital was extended, pursuant to [then] Article 56(1) EC, to movement of capital between third countries and the Member States, the latter chose to enshrine that principle in that article in the same terms for movements of capital taking place within the Community and those relating to relations with third countries.[59]

In other words, the free movement of capital to and from third countries could not be interpreted more restrictively in view of the fact that the rationale for extending Article 63(1) TFEU to extra-EU capital movements differed from the objective of the liberalisation of intra-EU capital movements. Since extra-EU capital movements are placed within Article 63(1) TFEU, and insofar as the Swedish law discouraged EU investment outside the EEA, the measure was caught by Article 63(1) TFEU.

While the Court in *A v Skatteverket* divorced its interpretation of the free movement of capital with third countries from the specific political and economic background of its extension to third-country situations, it did recognise that a distinction can be drawn in respect of possible justifications for restrictions to intra-EU and extra-EU capital movements.[60] In particular, the Court noted that

[57] Usher, 'The Evolution of the Free Movement of Capital' (above n 48) 1543; K Ståhl, 'Free Movement of Capital between Member States and Third Countries' (2004) 2 *EC Tax Review* 47, 52.

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

[59] Ibid para 31.

[60] Ibid para 37.

the legal context for capital transfers to and from third countries is different from that within the Single Market.[61] In the first place, there are various derogations to be applied to such movements that may not be applied to intra-EU capital movements.[62] In addition, the Court indicated both that a wider array of public interests may be accepted in an extra-EU context and that the proportionality principle may be interpreted differently in third-country situations.[63] As a result, the Court took the view that:

> the taxation by a Member State of economic activities having cross-border aspects which take place within the Community is not always comparable to that of economic activities involving relations between Member States and third countries.[64]

In view of the third-country situation concerned, the Court considered that it could not be verified whether the tax exemption at issue would be given for the correct amount of shares and ruled that the Swedish measure was, for that reason, justified on grounds of securing the effectiveness of fiscal supervision.[65]

Some of the intervening Member States had argued in *A v Skatteverket* that compliance with the prohibition laid down in Article 63(1) TFEU would lead to the unilateral liberalisation of capital movements on the part of the Union without the assurance of equivalent liberalisation on the part of the third countries concerned.[66] The Union would thus lose an important bargaining chip and no longer be able to negotiate liberalisation of capital movements with those countries, since Article 63 TFEU would have already automatically and unilaterally opened up the Single Market.[67] They also observed that the provisions on free movement of capital in association agreements with third countries often had a more limited scope than that of Article 63 TFEU.[68] If that provision was applied in

[61] Ibid para 32.

[62] The Court pointed to Art 59 EC (now Art 66 TFEU: '[w]here, in exceptional circumstances, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of economic and monetary union, the Council, on a proposal from the Commission and after consulting the European Central Bank, may take safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary'); and Art 60 EC (now Art 75 TFEU :'[w]here necessary to achieve the objectives set out in Article 67, as regards preventing and combating terrorism and related activities, the European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall define a framework for administrative measures with regard to capital movements and payments, such as the freezing of funds, financial assets or economic gains belonging to, or owned or held by, natural or legal persons, groups or non-State entities'; see also Art 215(1) TFEU: '[w]here a decision, adopted in accordance with Chapter 2 of Title V of the Treaty on European Union, provides for the interruption or reduction, in part or completely, of economic and financial relations with one or more third countries, the Council, acting by a qualified majority on a joint proposal from the High Representative of the Union for Foreign Affairs and Security Policy and the Commission, shall adopt the necessary measures'). Unlike Art 75 TFEU, ex Art 60 EC referred exclusively to movements of capital to and from third countries. For a more elaborate discussion of these derogations in the context of the 'BITs' judgments, see chapter 3.

[63] See also F Benyon, *Direct Investment, National Champions and the EU Treaty Freedoms* (Oxford, Hart Publishing, 2010) 84.

[64] C-101/05 *A v Skatteverket* [2007] ECR I-11531, para 37.

[65] Ibid para 63.

[66] Ibid para 29.

[67] Ibid para 30.

[68] See chapter 3.

the same way in third-country situations as it was applied in an intra-EU context, those provisions would in their view be meaningless.[69] In relation to these arguments, the Court held that the loss of negotiating power and reciprocity was not a decisive consideration in determining whether a tax measure restricted capital movements to or from third countries in relation to Article 63(1) TFEU.

The potentially far-reaching effect of Article 63 TFEU on tax measures in relation to capital movements to and from third countries has prompted the Member States to include the new Article 65(4) as part of the TFEU provisions on free movement of capital. It provides that:

> In the absence of measures pursuant to Article 64(3) [allowing the Council to restrict the free movement of capital to and from third countries], the Commission or, in the absence of a Commission decision within three months from the request of the Member State concerned, the Council, may adopt a decision stating that restrictive tax measures adopted by a Member State concerning one or more third countries are to be considered compatible with the treaties in so far as they are justified by one of the objectives of the Union and compatible with the proper functioning of the internal market. The Council shall act unanimously on application by a Member State.

It seems that the politically sensitive nature of the application of the TFEU provisions on free movement of capital to tax measures in relation to capital transfers to and from third countries has propelled the Member States to reinstate a certain hierarchy between free movement of capital in intra-EU and third-country situations.[70] In principle, this would seem logical because the purpose of the extension of free movement of capital to third countries does not seem to have been to address every factor potentially affecting the optimal allocation of capital in extra-EU situations. In addition, it may be hard to identify any specific objective in respect of the internal market as regards the type of tax measures at issue in *A v Skatteverket*. In particular, it would seem difficult to argue that a tax measure that potentially restricts the free movement of capital with third countries for that reason also impedes the functioning of the internal market. Article 65(4) TFEU moreover implies that the Council can now decide by unanimity on the compatibility with the Treaties of national measures instead of the CJEU, which is an indication of the politically sensitive nature of the application of the free movement of capital to national measures in third-country situations.

To conclude this section, both the freedom of establishment and the free movement of capital are relevant to direct investment. While the freedom of establishment does not apply to third-country situations, the free movement of capital can be invoked by third-country investors when seeking access to the Single Market. Even if the incentive for extending Article 63 TFEU to third-country situations was not the same as that for intra-EU capital liberalisation, the Court has observed that the free movement of capital to and from third countries is in principle enshrined in EU primary law in the same terms as intra-EU capital mobility. As a result, the same

[69] C-101/05 *A v Skatteverket* [2007] ECR I-11531, para 30.
[70] Snell, 'Free Movement of Capital' (n 48) 573.

type of measures are covered by Article 63 TFEU in relation to intra-EU capital movements and to extra-EU capital movements. At the same time, since the legal context of extra-EU capital movements may differ from that of intra-EU capital movements, the Court has indicated that a particular restriction on capital transfers to or from a third country may be justified where it could not be in an intra-EU context.

II. ADMISSION OF THIRD-COUNTRY DIRECT INVESTMENT INTO THE SINGLE MARKET AND ISSUES OF DEMARCATION BETWEEN ARTICLES 49/54 AND 63 TFEU

Given that Article 63 TFEU applies to third-country direct investment and Articles 49/54 TFEU do not, the importance of demarcating between the freedom of establishment and the free movement of capital is readily apparent. In particular, a wide interpretation of the scope of application of Article 63 TFEU so as not merely to cover capital transfers in relation to direct investment, but to include the entire transaction of direct investment, including aspects more properly considered as constituting establishment, is tantamount to granting to third-country investors rights under the TFEU provisions on free movement of capital that they were purposely denied under the TFEU provisions on freedom of establishment.

This section analyses different ways in which this area of overlap can be dealt with on the level of the application of Articles 49/54 and 63 TFEU, which is particularly relevant in third-country situations. The section first argues that a protection-based approach to direct investment, premised upon the parallel application of Articles 49/54 and 63 TFEU, constitutes an unsatisfactory way of dealing with this area of overlap. The section then discusses the exclusive application of either the TFEU provisions on freedom of establishment or those on free movement of capital as part of the 'centre of gravity' test, which has recently been applied by the CJEU.

A. A Protection-based Approach in the Application of Articles 49/54 and 63 TFEU?

Two views have emerged in the literature on how to deal with the area of substantive overlap between Articles 49/54 and 63 TFEU in relation to direct investment.[71] While on one view a national measure that constitutes an obstacle to direct investment should be subjected to scrutiny (so far as possible) in the light of one TFEU freedom or of the other, on the other view such measures should be assessed in the light of both the freedom of establishment and free movement of capital. The

[71] Hindelang, *Capital and Foreign Direct Investment* (above n 36) 81 ff; H Fleischer 'Case C-367/98 *Commission v Portugal*, Case C-483/99 *Commission v France* and Case C-503/99 *Commission v Belgium*' in (2003) 2 *CML Rev* 493, 498 (note).