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Banking Report

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I. INTRODUCTION

The European Economic Community (EEC) was established by the Treaty of Rome (Treaty) in 1957. The EEC is composed of several European Member States which agree to govern their commercial relations according to the provisions of the Treaty. The goal of the EEC is to promote a more efficient distribution of labor, capital, and services throughout Europe. The Treaty seeks to accomplish its task by removing trade barriers and restrictions which impede the efficient utilization of resources in Europe. Although the Treaty attempts to create a single economic market, it reserves sufficient state autonomy in areas of fundamental natural concern. The EEC leaves the individual countries free to fashion their own economic policies, as long as these policies are consistent with the obligations of the Treaty.

The Treaty mandates a liberalization of restrictions on capital flows as a stepping stone to achieving its final aims. Article 2 describes the general purposes of the EEC:

> The Community shall have as its task, by establishing a Common Market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standards of living and closer relations of states belonging to it.[1]

To achieve these goals the Treaty requires a widening of markets through reduction of or, if possible, an elimination of barriers resulting in a more efficient distribution of the factors of production, labor, capital, goods, and services. Article 3(c) provides for the abolition of obstacles restricting freedom of movement of persons, ser-

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1. Treaty establishing the European Economic Community, Mar. 25, 1957, B. EUR. COMM. TREATIES II (*in force* Jan. 1, 1958), [hereinafter cited as Treaty of Rome], Part One, Article 2.

vices, and capital as part of the activities of the community.[2] Articles 67(2) and 106 recognize freedom of movement of payments, without which workers and capital are not effectively mobile.[3] These freedoms are essential to a common market and there must be an optimal allocation of capital in order to accomplish these aims.

This report examines the provisions in the Treaty relating to capital movement and foreign exchange controls, and describes the results which these provisions have achieved in promoting the underlying goals of the EEC. The Report illustrates how the treaty attempts to strike a balance between the need for the free transfer of capital throughout Europe in order to maximize the efficiency of the market and the need of the individual Member States to maintain control over their respective national economies.

II. "Capital" as used by the Treaty

"Capital" is not precisely defined in the Treaty, nor is the dividing line between capital and current payments specifically stated. However, capital movements are apparently automonous operations, whereas current payments are immediate monetary consideration for goods and services. In the case of capital there is a one way transfer of value from one Member State to another, whereas in the case of current payments a performance is usually followed by a counterperformance within a reasonably short period, so that the value flowing in each direction is equal.

The movement of capital therefore refers to the basic transaction which creates the obligation resulting in a payment. The meaning of current payments is apparently determined by the definition given in the International Monetary Fund Agreement of which all Member States are parties:

> (i) Payments for current transactions means payments which are not for the purpose of transfering capital, and includes, without limitation:
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> (1) All payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities;
>
> (2) Payments due as interest on loans and as net income

2. Treaty of Rome, Part One, Article 3(c).

3. Treaty of Rome, Part Two, Title III, Chapter 4, Article 67(2); *id.* at Part Three, Title II, Chapter 2, Article 106.

from other investments;
(3) Payments of moderate amount for amortization of loans or for depreciation of direct investments;
(4) Moderate remittances for family living expenses.[4]

These payments come within the general framework of current payments, described above as performance followed by a counterperformance within a reasonably short period, inasmuch as they flow in the opposite direction to the basic capital investment. It is useful, in cases of doubt, to consider a current payment as a movement of capital when the monetary reserves of the recipient country are strengthened.[5]

III. RESULT OF THE TREATY

A. *From Inception*

The International Monetary Fund Eighth Annual Report on Exchange Restrictions, transmitted in 1957 (the year of the conclusion of the Treaty), noted that "foreign exchange restrictions impose[d] a less serious obstacle to international commerce [then] than at any [previous period] since the outbreak of World War II."[6] The report noted that progress had been made toward generally establishing a fully multilateral system of payments, and in particular, Western Europe was singled out as having so liberalized trade and payment that they would be able to establish a general regime of full convertibility without any very significant changes.[7] Since this IMF report and the origination of the concept of integration and freedom of capital movements, however, important developments have occurred which have affected capital flows:

1) One such development is the growth of "Euro-issues", a worldwide bond market, not related to any particular capital market of the Member States, consisting primarily of loans underwrit-

4. INTERNATIONAL MONETARY FUND AGREEMENT, Dec. 27, 1945, 2 U.N.T.S. 39, [hereinafter cited as IMF].

5. This thinking appears to have been followed by the Council who in Annex II of the First Directive has listed all transactions traditionally classified as capital movements by municipal and international law. First Council Directive of May 11, 1960 For the Implementation of Article 67 of the Treaty, J.O. 1960/921; Second Council Directive of Dec. 18, 1962, Adding to and amending the First Directive for the Implementation of Article 67 of the Treaty, J.O. 1963/62.

6. IMF EIGHTH ANNUAL REPORT ON EXCHANGE RESTRICTIONS, Part I Introduction at 1 (1957).

7. *Id.* Full convertibility was in fact established for all currencies of the original six Member States.

ten by various financial institutions in a variety of European countries. These Euro-issues have been of great significance, when, as a result of the sometimes massive United States trade deficit, loans were floated to support United States borrowing.

2) In 1963 the United States, because of its high trade deficit, proposed an Interest Equalization Tax on foreign sellers of securities in the United States market.[8] This provided a good opportunity for EEC countries to utilize substitutes for the New York market and to accomodate issues usually floated in New York.

3) From 1964 until approximately 1971 interest rates of the Member States' national markets merged more closely. Thereafter a reverse trend developed, with the result that the progress toward the goal of free movement of capital began to slow. The resolutions of the Hague Summit of 1969 on an Economic and Monetary Union, and the subsequent Council Decision on Monetary and Economic Union[9] brought new prospects for progress. Unfortunately, economic difficulties intensified as a result of the energy crisis which induced most countries to extend their national economic policies.

In addition to these specific developments, other events had a substantial effect on the harmonious pursuit of an integrated market. The development in industrial production and foreign trade were similar in all six original Member States, and all had nearly full employment. However, very little similarity existed with regard to the Member States' institutional organization of their capital markets. As a result there has been an application of varying policies on the part of the Member States.

B. Present Situation[10]

Belgium-Luxembourg — Foreign capital may be freely transferred within the Belgium - Luxembourg Economic Union, without any restriction whatsoever on imports or exports from Belgium. Exportation, however, may only be accomplished at the free market rate, and not at the official rate, the former generally giving a

8. I.R.C. § 1491 (1982).

9. Hague Summit of 1969 on an Economic and Monetary Union; Council Decision on Monetary and Economic Union of March 22, 1971.

10. What follows does not constitute an exhaustive survey of the present structure of national exchange controls of Member States, but instead is an overall picture emphasizing the main impediments to the free flow of capital that still remain.

slightly better rate in terms of United States dollars. Although a unitary rate of exchange is considered desirable, the dual rate of exchange adopted by the Economic Union is authorized by the terms of Article 107 (subject always to the parameters of Article 67 and the First and Second Directives).

Repatriation guarantees are granted by the Belgium - Luxembourg Institute of Exchange to encourage foreign investment. These, however, are only granted as a precaution, since there are currently no restrictions between Belgium and the Dollar area. As a result, many dividend, interest, and royalty payments from foreign investment in Belgium flow to the beneficial owner without restriction.

Denmark — In general, substantial direct investments are subject to prior approval.[11] If the amount of the investment exceeds one million kroner, or the purpose of the investment is to finance operations outside of Denmark, then prior approval must be obtained.[12] Shares and bonds, however, which are quoted on the Danish Stock Exchange are available for portfolio investment without prior approval, in accordance with First Directive obligations.

Danish operators may borrow abroad a maximum of twenty million kroner each year provided the loan is for productive purposes on the borrowers' own commercial premises, and not for the purchase of real property. The restriction against the purchase of real property derives not from balance of payments consideration, but to ensure that Danish territory is not substantially foreign owned. The requirements of the Treaty's free capital flow provisions are generally applicable in Denmark, and usually, if the directives are more liberal than Denmark's provisions, authorization is granted.

France — France maintains a system of exchange controls which places restrictions between France and foreign countries, and within France, between residents and non-residents.

Investments in France which are classified by the French authorities as "direct investments" require a prior declaration which must be made to, and approval received by, the Ministry of Finance.[13] A "direct investment" is based on the amount of control

11. Exec. Order of Mar. 12, 1973, Section 1.
12. *Id.* Section 20.
13. Law No. 66-1008 of Dec. 28, 1966; Decree No. 67-78 of Jan. 27, 1967 as modified by

that the foreign enterprise or individual will have after final completion of the transaction. Factors such as options, loans, guarantees, and patents are taken into account, at times resulting in classification as a "direct investment" notwithstanding the small capital participation.

New rules were recently published, however, regarding takeovers of French companies by foreign investors. Whereas France had previously incurred the displeasure of Community countries by blocking nationals of Member States from taking over a French company, the authorization procedures would henceforth be simplified.[14] This action must be viewed as complementary to other procedures adopted to reduce the previously tough exchange control restrictions erected by France, and this rule in particular is likely to encourage increased foreign investment in France. No prior declaration or approval is required for participation by a foreign person in less than twenty percent of the capital of a listed company. This is not considered as a "direct investment."[15]

There are a limited number of other direct investments made by non-residents which do not require prior approval. The total amount of investments not requiring approval may not exceed five million francs[16] in any given calendar year, and are limited to:

a. increases in the capital of a French company, where foreign participation has previously been authorized, provided such increases do not result in a change in the foreign shareholding in the company.

b. increases in the capital allowance of a French company under foreign control, the creation of which has been previously authorized.

c. loans, tailored to meet specific requirements, to a French company under foreign control.

d. certain guarantees extended for the benefit of a French company by non-residents who control it.

Generally, prior approval is required for the offering and listing of all securities issued by foreign persons. This restriction is in accordance with the provisions of List C of the First Directive,

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Decrees No. 69-264 of Mar. 21, 1969 and No. 71-143 of Feb. 22, 1971.

14. *See* J.O. of Aug. 5, 1980.

15. Decree No. 67-78 of Jan. 1967.

16. This originally was 3,000,000 FF, but was recently raised to the higher figure.

which provides that Member States may maintain or reintroduce restrictions on such capital movements where such free movement may form an obstacle to economic policy objectives.[17]

Foreign borrowing by French individuals and companies also requires prior approval, and if the foreign borrowing constitutes a "direct investment" the foreign declaration procedure must be followed.[18] If there is a liquidation of a direct investment in France by foreign individuals or companies, or by local, foreign controlled companies, a declaration must be made to the Ministry of Economy.

Foreign deposits by French residents are also subject to prior authorization,[19] as are the importation and exportation of the means of payment and securities other than through an approved intermediary. Foreign intermediaries are designated by the Ministry of Economy and include most commercial banks.[20] Any foreign investment allowed to individuals must be repatriated within one month of due date, as must all payments for services.

On June 25, 1980 the French Economic Minister indicated that the government had given approval to a limited relaxation of controls, designed primarily to foster export competitiveness and to provide importers with protection against fluctuation of prices of raw materials. However, to prevent speculative moves there was no change in restrictions relating to short-term capital movements. These measure include increasing from six to twelve months the forward foreign exchange cover for new material purchases, the allowance of French exporting companies to keep foreign accounts to collect receipts instead of having to repatriate each transaction, and allowing foreign purchasers to pay for up to fifty thousand francs worth of goods by any convenient form of payment instead of the previously required bank transfer.

Germany — Although no restriction is placed on investment in Germany, in order to avoid purchases of German companies by undesirable persons, German banks, business associations, and the Federal Government are empowered to subject to prior approval the purchase of domestic securities if national security is involved.

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17. First and Second Directives For the Implementation of Article 67 of the Treaty, *supra* note 5 at List C.

18. Decree No. 67-78 of Jan. 27, 1967 as modified; Decree No. 68-1021 of Nov. 24, 1968 as modified.

19. Decree No. 68-1021 of Nov. 24, 1968.

20. *Id.* Article 5.

Moreover, to ward off the inflow of speculative funds it may demand from residents borrowing abroad to deposit a percentage of the loan with the Deutsche Bundesbank.[21]

A restriction in the form of a license is required for the following: purchase of treasury-bills, treasury notes, bills of exchange endorsed by a German bank, and short term fixed interest bearing securities. All these restrictions are in accordance with the selective liberalization process of the Treaty, in which procedures for dealing with short term funds need not be fully and immediately liberalized.

Business earnings in the form of profits and dividends and proceeds from liquidation of assets may move without restriction, however, the sale of equity interest in a German firm by a nonresident must be reported,[22] as must a limited number of other transactions.[23]

Great Britain — The Exchange Control Act[24] originally set forth a comprehensive system for exchange controls of funds flowing in and out of Britain. On October 23, 1979 it was announced that all remaining exchange controls would be lifted. The Chancellor of the Exchequer indicated that this was the final step in the progressive abolishment of controls, and that now the country would be meeting its full Community obligations. Certain previous abolishments had been made in the Budget Speech of June 12, 1979, and further measures were announced on July 18 of the same year. With the announcement of October 23, 1979, the "whole apparatus of control had been abolished at a stroke," to use the words of Denis Healey. The Exchange Control Act of 1947 was being temporarily maintained, however, while its future was reviewed.

Greece — Foreign capital brought into Greece for productive measures enjoys favorable protection and treatment.[25] To obtain approval to import foreign capital, interested parties file an application with the Ministry of Coordination, and such capital may be repatriated at a maximum of fifteen percent per annum, such repatriation beginning one year from commencement of operation.[26]

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21. Section 6a of the Aussenwirtsschaftgesetz (A.W.G.) (Foreign Trade Law).
22. *Id.* Section 58.
23. Verordnung zer Durchfuhring des Aussenwirtsschaftgesetze of Aug. 22, 1961.
24. Public General Acts and Measures 1947, Chapter 14.
25. Law 2687/1953. This law was introduced to stimulate foreign investment.
26. Law 549/1973.

Dividends may be remitted up to a maximum of twenty percent per annum of the imported equity capital,[27] and ten percent for the payment of interest on loan capital.

Ireland — There are no restrictions on the international transfer of dividends and profits, nor on the repatriation of capital appreciation. Outward direct investment associated with free movement of labor was fully liberalized in January 1975, in compliance with Treaty obligations. Although exchange control approval is necessary for a private company to issue shares to a nonresident,[28] shareholders in listed companies need not seek permission for the purchase and sale of shares and repatriation of profits. An Irish company requires exchange control authorization in order to accept loans. Such approval is routinely given where financing is for productive purposes.

Italy — As a result of the Italian balance of payment crisis[29] the Italian government restricted the transfers of funds abroad. A foreign investor should therefore register his investment in Italy in order to secure permission to transfer his profits and proceeds of liquidation.[30]

Registered foreign investments are classified either as productive or non-productive. The former classification allows dividends, profits, and proceeds of liquidations to be freely remitted abroad on a guaranteed basis.[31] The latter allows remittal of same of up to eight percent per annum of the total capital investment, save for the proceeds of liquidation which may be freely remitted after two years in any amount not exceeding that originally invested.[32]

A company in which a "productive" investment is made, may issue bonds and contract loans in Italy provided:

1. that the total domestic loans and bonds do not exceed fifty percent of the investment if no Italian capital is originally invested, and:

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27. *Id.* Article 33.

28. Exchange Control Acts 1954 to 1974.

29. During the Italian balance of payments difficulties, the Commission Decision of May 26, 1975, OJ no. L158, p.25, authorized Italy to require a deposit of fifty percent of the value of the foreign investments by Italian residents abroad. Italian rules are not currently being applied to other Member States.

30. Law No. 43 of Feb. 7, 1956 [hereinafter referred to as The Law], and regulations enacted pursuant thereto: D.P.R. No. 758 of July 6, 1956.

31. The Law, *supra* note 30, at Article 1.

32. *Id.* at Article 2.

2. if the foreign investment amounts to more than thirty percent of the total capital of the company, the aggregate of loans and bonds may exceed fifty percent, provided that the part in excess of fifty percent is financed at least partially through a foreign loan of the same nature and duration.

If the foreign equity investment is less than thirty percent of the total capital of the company, the above restrictions do not apply. An Italian company in which a "non productive" investment is made is not subject to any restrictions regarding incurring indebtedness in Italy. The main purpose of the borrowing limitations are to prevent foreign investments drawing on the local capital market, while benefitting from the guarantees intended for those introducing capital into the market.

Netherlands — The original Exchange Control Decree of 1965 has undergone major revision to permit a wide range of transactions subject to certain reporting requirements, and method of payment restrictions. Payments between residents and nonresidents must be made through authorized banks and must be reported. Payments for services such as legal fees and travel expenses are excluded. The issue of shares in Dutch corporations are not subject to any restrictions but must be reported, and the same applies to the purchase and sale of listed securities. Capital inflow through resident borrowing requires authorization unless it is not in excess of three hundred thousand guilders per year. Capital outflow exceeding ten million guilders to any nonresident or group is also subject to prior authorization. Direct guarantees, pledges and mortgages that may involve the outflow of capital are subject to approval.

IV. Conclusion

The original provisions, although drafted cautiously, were a reflection of the political and economic circumstances of the period. Foreign exchange control existed in all the original Member States in varying degrees of intensity. One year after conclusion of the Treaty Member States finally introduced external convertibility for their currencies. Member States apparently did not attach the same importance to the free movement of capital as they did to other freedoms accorded by the Treaty. These and other factors allowed the drafters only one approach; they allowed for sufficient flexibility in order to prevent a breakdown of the Treaty provisions in the event some unforseen difficulty arose.

If one compares the situation which existed prior to the conclusion of the Treaty of Rome to that which now exists, it is clear that great strides have been taken in the removal of exchange restrictions, an important step to the creation of a unified Europe. Some of the countries have completely eliminated exchange control; others have only miniscule amounts of regulations still remaining, which do not largely inhibit the free flow of funds. Finally, others do still retain substantial restrictions, but which are relatively limited in comparison to what originally existed. Most importantly, the restrictions which do remain are by and large not prohibited by the Treaty and its implementing directives. That restrictions still remain, is indicative of the fact that circumstances have not yet arisen where it would be wise to dismantle them, and the Treaty as a document of flexibility does not condemn outright such remaining restrictions.