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CAPITAL MOVEMENTS AND INVESTMENTS IN THE EU

COMMISSION SERVICES' PAPER ON MARKET MONITORING

CAPITAL MOVEMENTS AND INVESTMENTS IN THE EU

This document is a working document of the services of the European Commission for information purposes. It does not purport to represent or pre-judge any formal position of the European Commission on the issues set out therein.

EXECUTIVE SUMMARY

The nature and sources of this report

As one of its 'four freedoms', the free movement of capital is at the heart of the Internal Market. This freedom is the basis for integrated, open, competitive and efficient European financial markets and services, and, as an important tool, brings about crucial advantages to our economies and our societies at large.

This working document reports on capital movements with a particular focus on Foreign Direct Investment (FDI) in the EU during the period from 2010 through 2011[1]. It concerns the application of the general principle on the free movement of capital as set out under Articles 63-66 of the Treaty on the Functioning of the European Union (TFEU). This document reflects the results of the latest examination of capital flows and payments carried out by the Economic and Financial Committee of the Council (EFC) as required under Article 134 TFEU.

In agreement with the EFC, this Commission services' report is a new initiative intended to share the main findings with the broader public. The intention is to continue providing such public Commission services' reports in the future (see section 1 below).

The main findings over the reporting period were:

Developments in capital flows

- There was a slight recovery in international capital flows from a global perspective. Globally, FDI also recovered by 10% over the period in question in comparison to the previous year. This modest increase concerned inward FDI to regions outside Europe: the USA, Asia and Latin America. Also notable was the fact that Brazil, Russia, India and China (commonly referred to together as the "BRIC" countries) saw the level of inward FDI increase. Moreover, developing countries take an increasing share of global FDI inflows (see section 2.1 below).

- In the EU, by contrast, following the modest recovery in 2009 there was a substantial fall (75%) in inward FDI from third countries in 2010 wiping out the modest turnaround of the previous year. EU FDI outflows showed a similar trend to inflows and declined sizeably by 62% over the previous year.

- Intra-EU27 flows compensated slightly for the reduction in extra-EU flows over 2009-2010. It seems that during the crisis EU direct investment flows may have been reoriented from outside the EU to inside the EU. Nevertheless, in absolute terms, the level of intra-flows remains depressed (see section 2.2 below).

Policy developments, monitoring and enforcement of Single Market law

- The Commission is responsible for ensuring that EU law, including the freedom of capital movement, is properly applied. It tries to pre-emptively address situations which could develop into infringements or, when faced with infringements already in existence, act (informally or formally depending on

[1] For some of the areas reviewed, where available, figures for the first months of 2011 have been added in this report.

circumstances) against a Member State to bring an infringement to an end (see section 3.1 below).

- There were fourteen ongoing formal infringement procedures at the end of November 2011. One infringement case was opened and five closed during the reporting period. The most common types of cases are those relating to privatisation and special rights of the state in privatised companies and amount to over a third of the total number. The other types of cases concerned bilateral investment matters, strategic foreign investment control, real estate law, collective investment, and regulatory restrictions (see section 3.1 below).

- On the basis of the Accession Treaties, seven Member States of the EU continue to have transitional derogations from the free movement of capital rules insofar as they relate to the acquisition of agricultural land. Among these seven, and during the reporting period, the Commission granted extensions on the restrictions relating to the acquisition of agricultural land in Hungary, Latvia, Lithuania and Slovakia until 30 April 2014 (see section 3.2 below).

- On the other hand, no derogation is provided, either in the Accession Treaties or elsewhere, for the continuing application of the Bilateral Investment Treaties between EU Member States, which cover a number of internal market issues (see section 4.1 below).

Intra-EU Bilateral Investment Treaties

- In the context of international investment protection Bilateral Investment Treaties (BITs) are a prominent feature. In 2010, the Commission adopted a proposal for a Regulation of the Council and the European Parliament, which is aimed at establishing transitional arrangements for BITs concluded by Member States with third countries[2]. Discussions with the Council and European Parliament on this Commission proposal are ongoing. The relationship of BITs between Member States ("Intra-EU BITs") with EU law remains a cause for concern. With the accession of new Member States in 2004 and 2007, a number of former third country BITs became Intra-EU BITs. In February 2011 there were 176 such agreements in total within the EU. The Commission has repeatedly explained its view that Intra-EU BITs are incompatible with EU law particularly because they appear discriminatory as between investors and from different Member States and because they can lead to parallel jurisprudence through arbitration procedures on matters covered by EU rules without the Court of Justice of the EU (CJEU) being able to exercise its functions of guardian of the EU legal system. The Commission is ready to work with Member States and industry to resolve the matter expeditiously whilst safeguarding the protection of investments as effectively as possible. However, the Commission is ready to take action to ensure compatibility with EU law whenever the issues cannot be remedied by mutual agreement (see section 4.1 below).

[2] COM(2010) 344 final; http://trade.ec.europa.eu/doclib/docs/2010/july/tradoc_146308.pdf

1. INTRODUCTION

The general principle of the free movement of capital as set out under Articles 63-66 of the TFEU is at the heart of the Internal Market and is one of its 'four freedoms'. Article 63 stipulates that

"…all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."

This Internal Market freedom enables integrated, open, competitive and efficient European financial markets and services - which bring many advantages to citizens, business and the societies at large. For citizens it means the ability to do many operations abroad, such as opening bank accounts, buying shares in non-domestic companies, investing where the best return is, and purchasing real estate. For companies it principally means being able to invest in and own other European companies and take an active part in their management.

This document reports on capital movements and investments in the EU covering developments during the year 2010 through, in certain cases, 2011. It is based on the results of the latest examination under Article 134 of the Treaty on the Functioning of the European Union (TFEU).

Article 134 of the TFEU requires the Economic and Financial Committee of the Council (EFC):

"to examine, at least once a year, the situation regarding the movement of capital and the freedom of payments, as they result from the application of the Treaties and of measures adopted by the Council; the examination shall cover all measures relating to capital movements and payments; the Committee shall report to the Commission and to the Council on the outcome of this examination."

The findings in the EFC Report result from work of the Commission services carried out with regard to the application of the general principle on the free movement of capital as set out under Articles 63-66 of the TFEU. In fact, in carrying out its annual examination and preparing its report, the EFC draws to a large extent upon input from the Commission services. The information which the Commission services provide in this report also includes the results of an annual study which is carried out for the Commission by an external contractor and which encompasses descriptions, analyses and empirical evidence of direct investment stocks and flows (including mergers and acquisitions) within the EU and in the context of the global economy. The data used comes primarily from Eurostat, the European Central Bank and the United Nations Conference on Trade and Development and, in the case of this report, the data used covers the period up to the end of 2010.

In addition, the Commission services provide the EFC with the results from the ongoing daily work of monitoring developments on capital movement and investment issues in Member States, and the handling of complaints received from stakeholders. This information too is reflected in this paper. The EFC report itself is exclusively presented in the Council framework and is not published. Only the annual study carried out by an external contractor for the Commission has been published on its website (see section 2 below).

The purpose of this Commission services' report, which is the first of this kind, is to share the Commission services' findings that underpin the EFC examination with a broader public, in agreement with the EFC. The Commission services believe it would bring a real benefit to both business and the public at large by communicating the results of its monitoring of markets and investment flows with reference to the application of Treaty rules and by further developing, on this basis, informal dialogues with Member States and all stakeholders.

It is envisaged to follow up this initial report with regular annual public Commission services' reports in the future.

2. DEVELOPMENTS IN CAPITAL FLOWS

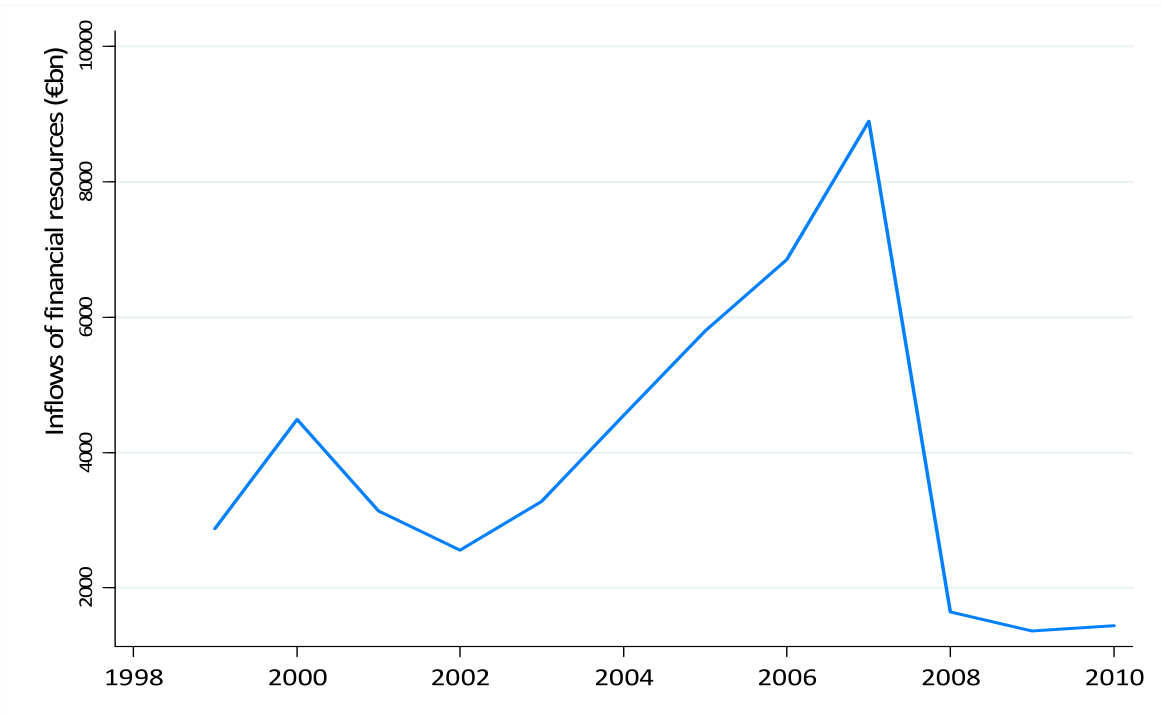
The analysis in this section is based on a study carried out for the Commission by *London Economics* (*"Analysis of development in the field of direct investment and M&A"*). Tables and figures are also taken from the study. This study is published on the Commission's website: http://ec.europa.eu/internal_market/capital/reports/index_en.htm.

2.1. The global picture

Worldwide, the drastic decline of flows of international financial resources (being the total of current account surpluses, inward FDI, portfolio investments and other investments) since 2007 reversed into a very modest recovery in 2010. The small recovery amounted to a 5% increase in flows from € 1.37 trillion (in 2009) to €1.44 trillion in 2010 (see figure 1).

This modest increase primarily concerned regions outside Europe: the USA, Asia and Latin America. Foreign Direct Investment (FDI) also increased globally, by 10%. It was notable that Brazil, Russia, India and China (commonly referred to together as the "BRIC" countries) saw their level of inward FDI significantly increase. Moreover, developing economies continued to receive an increasing share of global FDI inflows.

Figure 1: Trends in worldwide inflows of financial resources (€bn)



Note: "Inflows of financial resources" = "Current Account, Net*" + "Direct Investment In Reporting Economy, Liabilities" + "Portfolio Investment (Excluding Financial Derivatives), Liabilities" + "Other Investment, Liabilities". Original data in US$ converted to € using annual €/US$ exchange rate published by the ECB. (*"current account, net" does not necessarily sum to zero in practice because, for example, of transportation lags and asymmetric valuations between exports and corresponding imports).

Source: London Economics (IMF Balance of Payments Statistics and ECB)

2.2. The performance of the EU

2.2.1. FDI

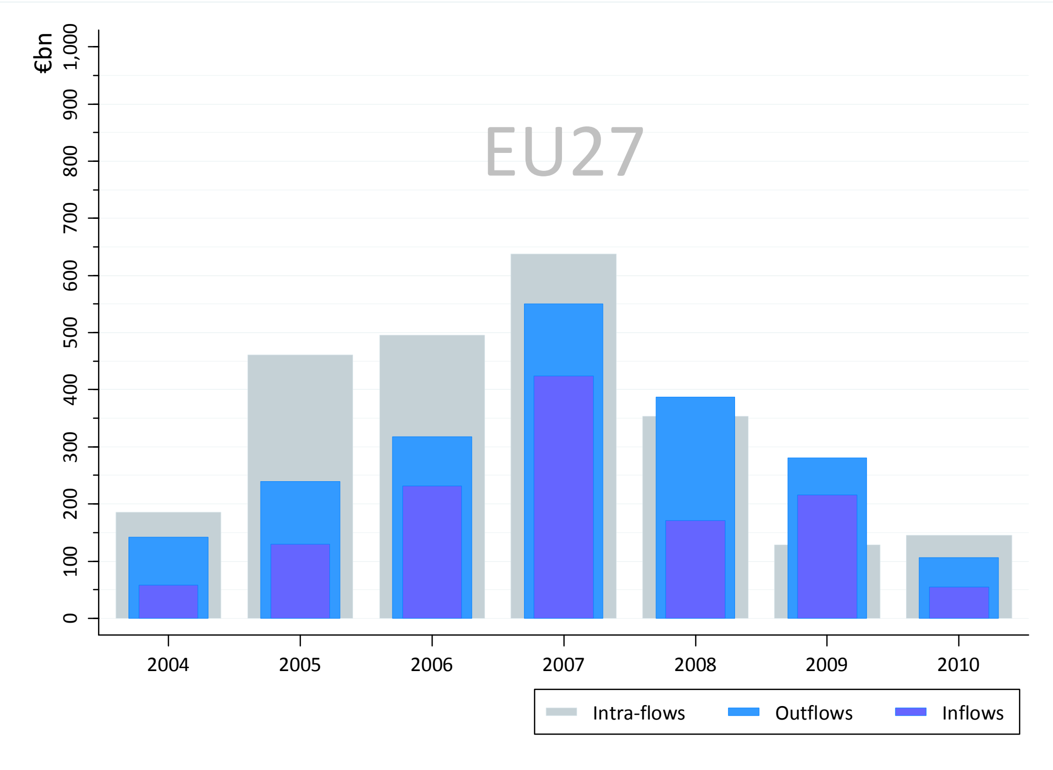
In the EU both inward and outward FDI flows (from and to third countries) continued to fall and were far below the 2007 peak (see figure 2). FDI inflows had recovered slightly in 2009, but they contracted again substantially in 2010. The value of inflows dropped from €215.7bn to €54.2bn between 2009 and 2010 – a substantial reduction of 75%. Generally, inward investment into the EU27 from third countries was significantly affected by the economic crisis. The contraction of inflows over the financial crisis affected in particular new Member States.

FDI outflows showed a similar trend to inflows. Outflows declined sizeably from €280.6bn to €106.7bn between 2009 and 2010 – a reduction of 62%. Moreover, outflows have fallen below their 2004 level, fully eliminating the trend increase in outflows that had taken place over 2004-2007. The economic crisis and subsequent sluggish recovery continued to depress EU27 outward FDI flows as EU27 businesses remained hesitant to invest both at home and abroad, and access to funding (and its cost) continued to be an issue in the ongoing difficult economic climate.

Intra-EU27 flows compensated only marginally for the reduction in extra-EU flows over 2009-2010 by growing from €128.7bn to €145.6bn. Indeed, intra-EU27 flows slightly increased whereas both outflows from the EU27 and extra-EU inflows into the EU27 both fell over that period. Although intra-EU flows had fallen more sharply from their peak in 2007 than outflows, such intra-EU flows have shown earlier signs of recovery than outflows. In short during the crisis EU direct investment flows appear to have been reoriented from outside the EU to inside the EU. Nevertheless, in absolute terms, the level of intra-flows remains also rather depressed.

FDI flows channeled through special-purpose entities (SPEs) played a significant role in the results for 2010.

Figure 2: EU27 inward and outward FDI flows, 2004-2010, €bn



Source: London Economics (Eurostat - EU direct investments - Main indicators (bop_fdi_main))

The current debt crisis casts a long shadow on the economic climate. Market confidence and thus investment may not recover until the debt crisis has been properly resolved. The reasons for the differences between changes in FDI inflows as experienced by the EU and those experienced by certain other parts of the world might only partially be explained by the uncertainty caused by the debt issue in the EU. This is because the level of sovereign debt is not exceptionally high within the EU and high debt levels are also a matter of concern in certain large countries and regions outside the EU. Other factors, therefore, such as market perceptions, have had a role to play as well.

2.2.2. Mergers and acquisitions

In line with the continuing weak economic environment of 2010, total EU cross-border Mergers and Acquisitions (M&A) in value terms (from third countries and other Member States combined) recovered by 30% in 2010 over the previous year, but then seem to have dropped again in 2011[3]. However, even in 2010 they were still 64% below the recent high point in 2007. On the other hand the number of deals continued to recover (see Table 1 below). This difference in trends between deal value and deal number indicates an orientation towards smaller deals in a continuing uncertain business climate.

[3] On the basis of the data available for the first seven months of 2011.

Table 1: M&A activity into the EU, 2000-2011						
	Within EU cross-border deal		Cross-border deals from outside the EU into the EU		All cross-border deals in the EU	
	Number of deals	Value (EUR mn)	Number of deals	Value (EUR mn)	Number of deals	Value (EUR mn)
2011(1)	1599	49092	773	38220	2372	87312
2010	1054	44026	732	67 817	1786	111843
2009	986	56838	641	29 353	1627	86191
2008	1322	90819	931	34 162	2253	124981
2007	1482	229253	926	76 143	2408	305396
2006	1401	175983	963	84 233	2364	260216
2005	1500	244319	929	60 647	2429	304966
2004	1193	71954	809	53 589	2002	125543
2003	1121	33543	625	47 598	1746	81141
2002	1163	74762	667	64 115	1830	138877
2001	1353	125181	695	63 265	2048	188446
2000	1584	456703	830	75 439	2414	532142

Note: (1) 2011 data for the first 7 months at an annual rate.

***Source:** London Economics (Zephyr database, London Economics search using the following criteria: 1) deal type: merger and acquisition; 2) current deal status: completed; 3) time period: 2000 until July 2011; 4) geography acquirer: Austria, Belgium, Bulgaria, Cyprus, Czech Republic... for intra-EU27 cross border deal and all other countries for M&A from outside the EU27; 5) geography target: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovenia, Slovakia, Spain, Sweden and United Kingdom. The geography target criterion reflects the location of the acquired company while the geography acquirer criterion reflects the location of the acquiring company).*

3. POLICY DEVELOPMENTS, MONITORING AND ENFORCEMENT OF SINGLE MARKET LAW

3.1. Monitoring, enforcement and infringement proceedings within the EU

The EU has one of the world's most open capital movement regimes, noticeably above the OECD average[4]. The free movement of capital has been an essential objective of the EU since its early existence and has been enshrined in subsequent Treaties. Having the principal of free capital flows enshrined in the highest legal instrument of a country or region, is a legal situation that is not resembled in all countries or regions of the world. It shows the utmost commitment the EU and its Member States have to the free movement of capital, both inside and outside the EU.

Commission services have continued to monitor developments in Member States with a view to ensuring that relevant laws and practices (e.g. in the context of privatisations) are in compliance with Article 63 of the TFEU (the former Article 56 of the EC Treaty) on the free movement of capital between Member States and between Member States and third countries. The Commission does not hesitate to act should infringements be suspected. Over the years, the Commission has initiated many infringement procedures with a view to enforcing the freedom of capital movements as an important element of the Internal Market.

In a considerable number of cases, the Court of Justice of the EU (CJEU) has interpreted the scope of this freedom, so that solid case law is available on Articles 63 to 66 of the TFEU[5]. In 2010, in two separate cases, the CJEU ruled that Portugal's holdings of special rights in Portugal Telecom and Energias de Portugal (EDP) were contrary to European Union law[6]. More recently, on 10 November 2011, the Court ruled in the case of GALP Energia[7]. The Court found that by maintaining special rights in favour of the Portuguese State and other public bodies, Portugal had failed to fulfil its obligations under Article 63 of the TFEU. These rulings confirm earlier jurisprudence on special rights and provide further clarity and discipline in this complex area[8].

In informal contacts, the Commission services go to great efforts on finding amicable solutions with Member States on cases. Apart from these informal contacts, the Commission services also make use of a tool called EU Pilot[9]. EU Pilot is an on-line pre-infringement system in which Commission services and the Member States, in line with a partnership approach, exchange factual and legal information to provide quicker solutions to problems regarding the interpretation, application and implementation of EU law. EU Pilot thus offers enhanced information exchange and problem-solving possibilities before the stage of a formal infringement procedure and has allowed certain cases to be closed without the need of going through the steps of a formal infringement

4 OECD's FDI restrictiveness index: 2010 update (OECD working paper on international investment N° 2010/03).

5 An overview of the freedom of capital movements policy and the related jurisprudence is provided on the respective website of DG Internal Market and Services: http://ec.europa.eu/internal_market/capital/infringements/index_en.htm

6 Case C-171/08, Commission v Portugal of 8.7.2010 and Case C-543/08, Commission v Portugal, of 11.11.2010.

7 Case C-212/09, Commission v Portugal, of 10.11.2011.

8 See: http://ec.europa.eu/internal_market/capital/infringements/index_en.htm

9 See: http://ec.europa.eu/eu_law/infringements/application_monitoring_en.htm. The EU Pilot project was introduced by the Commission with 15 volunteer Member States in April 2008 (currently 25 member States are participating) with the aim to improve the cooperation and problem-solving between Member State authorities and the Commission on issues concerning the correct application of EU law or the conformity of the law in a Member State with EU law at an early stage before a formal infringement procedure is launched under Article 258 TFEU. Wherever there might be recourse to the infringement proceeding, EU Pilot is used as a general rule before the first step of a formal infringement procedure under Article 258 TFEU is taken by the Commission.

procedure. In addition, the application of a pre-infringement process ("CHAP") by Commission services continues to facilitate the handling of complaints[10].

There were fourteen ongoing formal infringement cases at the end of November 2011. One infringement case was opened and five closed during the reporting period. The most common types of cases are those relating to privatisation and special rights of the state in privatised companies and amount to over a third of the total number. The other types of (ongoing) cases concerned bilateral investment matters, strategic foreign investment control, real estate law, collective investment, and regulatory restrictions. At the same date (November 2011), there were thirteen other cases where the Commission services were requesting and assessing information through EU Pilot.

Particularly, in the current economic climate, it is important to remain vigilant against the rise of protectionist policies. This has notably been a call from the G 20.

3.2. Extension of transitional periods for the acquisition of agricultural land

Despite its clear commitment to free capital movements, on the basis of the Accession Treaties, seven Member States of the EU still have transitional derogations insofar as they relate to the acquisition of agricultural land by non resident persons from other EU Member States. The following Member States have such derogations in place: Poland (until 30 April 2016), Hungary, Latvia, Lithuania and Slovakia (all four initially until 30 April 2011), Romania and Bulgaria (both until 2014). Following the requests of four Member States (Hungary, Latvia, Lithuania and Slovakia), the Commission adopted Decisions to allow for maintaining restrictions existing in their legislation at the date of their accession for a further three years (i.e. until 30 April 2014). Two other Member States (Czech Republic and Estonia) had transitional derogations which ended on 30 April 2011.

The main reason for each of these requests was the claimed need to safeguard the socio-economic conditions for agricultural activities following the introduction of the single market and the transition to the common agricultural policy. In particular, concerns had been raised about the possible impact on the agricultural sector of liberalising the acquisition of agricultural land due to initial large differences in land prices and income when compared to the fifteen Member States which were members of the EU before 2004.

Whilst granting these extensions to the transitional periods[11], the Commission also called on these four Member States (Hungary, Latvia, Lithuania and Slovakia) to speed up their efforts to progressively reform their agricultural sectors in order to prepare for full liberalisation. Progress needs to be made on issues such as the privatisation process and property rights. The Commission recalled that it had already emphasised the importance of completing these reforms in its "Review of the transitional measures for the acquisition of agricultural real estate set out in the 2003 Accession Treaty"[12] (Mid-Term Review). In the Mid-Term Review, the Commission had also emphasised that the progressive loosening of restrictions on foreign ownership during the transitional period was strongly advised as it would also contribute to better prepare agricultural land markets for full liberalisation.

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10 See: http://ec.europa.eu/eu_law/your_rights/your_rights_en.htm

11 Decision of 20/12/2010 on Hungary: 2010/792/EU OJ L 336, 21/12/2010.
Decision of 07/04/2011 on Latvia: 2011/226/EU OJ L 094, 08/04/2011.
Decision of 14/04/2011 on Lithuania: 2011/240/EU OJ L 101, 15/04/2011.
Decision of 14/04/2011 on Slovakia: 2011/241/EU OJ L 101, 15/04/2011.

12 COM(2008) 461 final, 16 July 2008.

During the reporting period the Commission also carried out a Mid-Term Review of the transitional periods in the agricultural sectors of Bulgaria and Romania[13]. The Commission proposed in the Mid-Term Review that Bulgaria and Romania should be allowed to maintain their restrictions until that date. The reasons underpinning the Commission's opinion were that in both Member States there is no total ban on farmland acquisitions and the socio-economic grounds that provided the basis for the transitional period are claimed to remain valid. At the same time, the Commission also recommended that Bulgaria and Romania should consider taking concrete measures to better prepare for the future liberalisation of their respective agricultural markets.

On the other hand, no derogation is provided, either in the Accession Treaties or elsewhere, for the continuing application of the Bilateral Investment Treaties between EU Member States, which cover a number of internal market issues (see below).

3.3. Financial transaction tax

Another issue of relevance in the context of free capital movement was the Commission proposal for a financial transaction tax as submitted on 28 September 2011[14]. If adopted by the EU, the tax would be levied on all transactions on financial instruments between financial institutions where at least one of the parties is based in the EU. The exchange of shares and bonds would be taxed at 0.1% and derivative contracts at the rate of 0.01% of the notional value. The tax would be paid respectively by each party to a transaction. The tax is expected to raise €57 billion annually. The proposal also substantially contributes to the ongoing international debate on financial sector taxation and in particular to the development of a financial transactions tax on a global level. In order to best minimise risks, a coordinated approach at international level is the best option.

[13] COM(2010) 734 final, 14 December 2010.
[14] COM(2011) 594 final, 28 September 2011.

4. SELECTED ISSUES CONCERNING THE INTERNATIONAL DIMENSION OF EU FREE CAPITAL MOVEMENT POLICY (UNDER ARTICLE 63 TFEU)

4.1. Intra-EU Bilateral Investment Treaties

In the context of international investment protection Bilateral Investment Treaties (BITs) are a prominent feature. BITs are agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each other's territories by investors based in either country. Member States have concluded many BITs with third countries. In 2010, the Commission proposed a Regulation[15] to enable Member States to re-negotiate provisions in existing BITs that may be in conflict with the EU law[16], to deal with existing BITs in the light of the new exclusive EU competence, and/or to enable Member States to conclude new investment agreements. Discussions between the Commission, the Council and Parliament on this proposed Regulation are ongoing.

With the accession of new Member States in 2004 and 2007, a number of former third country BITs became BITs between EU Member States ("Intra-EU BITs"). In February 2011 there were 176 such agreements in total within the EU.

BITs between Member States concern fields also covered by EU law. As repeatedly underlined by the Commission services, they contain serious incompatibilities with EU law. In particular, they imply discrimination among EU investors and, furthermore, as they provide for investor-to-state arbitration of a binding character which is not subject to review by the CJEU on issues of the interpretation of EU law.

Based on these and other legal arguments, Member States have been requested to terminate Intra-EU BITs. Commission services have organised various meetings with all Member States and bilateral discussions, where it urged the Member States to phase out Intra-EU BITs and offered its assistance to finding a solution built upon consensus with and amongst all Member States to possible transitional issues.

Commission services are especially concerned about ongoing investor-to-state arbitration proceedings which could possibly affect EU law. In the arbitration procedure Eureko N.V. vs. Slovak Republic, which was initiated in 2009 under the BIT between the Netherlands and Slovakia, the arbitration tribunal requested the Commission to submit its observations on the compatibility of the BIT in question with EU law. In this context the Commission confirmed its general position regarding Intra-EU BITs.

The problems posed by Intra-EU BITs with EU law have to be addressed. Commission services are ready to work with Member States and industry to resolve the matter whilst safeguarding investments as effectively as possible. However, Commission is ready to take action to ensure compatibility with EU law whenever the issues cannot be remedied by mutual agreement.

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15 Draft Regulation aimed to establish transitional arrangements regarding bilateral investment agreements concluded by Member States with third countries (COM(2010)344 final): http://trade.ec.europa.eu/doclib/docs/2010/july/tradoc_146308.pdf

16 The CJEU, in its judgments of 2009 against Sweden, Austria and Finland, held that the BITs provision on free transfers related to investment to the third country (commonly referred to as a "transfer clause") is incompatible with EU law if it does not allow the application of potential EU measures restricting capital movements (as is the case in most third country BITs). The CJEU has called for Commission *facilitation* to resolve this issue, which potentially affects many third country BITs. Many Member States are likely to be in a similar situation as the three mentioned above; see case C-205/06 of 3/3/2009, Commission v Austria, case C-249/06 of 3/3/2009, Commission v Sweden and case C-118/07 of 19/11/2009, Commission v Finland.

4.2. Sovereign Wealth Funds

The EU has continued, alongside the US and OECD, to play an important role in monitoring of the implementation of the Santiago Principles[17] by Sovereign Wealth Funds (SWFs). These Principles are a set of twenty four guidelines designed to promote features such as good governance and transparency. The Commission also took part in the third meeting of the International Forum on Sovereign Wealth Funds ("IFSWF") in Beijing in May 2011This is a group composed of SWFs which meets to discuss issues of common interest including the Santiago Principles. At the May 2011 meeting the Commission raised a number of questions related to the implementation of the Santiago Principles by SWFs. Recent public positions from the IFSWF show that most SWFs now see themselves as established investment partners and are ready to cooperate with the authorities oin recipient countries in an open spirit. As an example of this positioning, the IFSWF recently published on its website a statement in which it addressed questions asked by the EU about the implementation of the Santiago Principles.

In its 2008 Communication on SWFs the Commission called for engaging SWFs in a cooperative effort to enhance their governance standards and the quality of information they provide to markets. In this context, Commission services have continued to have regular bilateral contacts with SWFs collectively and individually. It intends to continue to play this constructive role, act as a facilitator, monitor the situation actively, and, in this way, the motivation of SWFs to contribute to sustainable investment in the EU should be ensured.

The work in this area continues to be of importance also in view of recent developments in certain third countries which have SWFs that have made significant investments in individual EU Member States.

4.3. Multilateral relations

The Commission continues to work within international forums such as the OECD, WTO, UNCTAD, G8 and G20 on investment and capital flows and use bilateral dialogues, e.g. with China, Russia or the US, to ensure that countries resist any temptations to introduce new restrictions on investment.

Some notable exceptions to the free movement of capital still remain in some countries. According to the OECD[18], certain countries, such as China, Indonesia, Japan, Korea, New Zealand and Russia, already more restrictive towards FDI than the OECD average, have become even more restrictive in recent years. Over the same period, the vast majority of individual EU Member States have moved towards being less restrictive towards FDI. The most restrictive Member States were around the OECD average.

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17 See: http://www.ifswf.org/pst/ifswfstatmt.pdf. In September 2008, The International Working Group of Sovereign Wealth Funds (SWFs) of 26 SWFs from 23 countries published a code of voluntary principles, "The Generally Accepted Principles and Practices (GAPP"), also known as the "Santiago Principles"; see also the Commission Communication on "A common approach to Sovereign Wealth Funds", COM(2008) 115 final, 27.February 2008.

18 OECD's FDI restrictiveness index: 2010 update (OECD working paper on international investment N° 2010/03).

5. CONCLUSION

Over the reporting period levels of capital flows have shown a very modest recovery on a global standpoint. However, EU levels have substantially fallen again and are now considerably below the pre-crisis levels. The current debt crisis casts a long shadow on the economic climate. Market confidence and thus investment decisions may not recover until the debt crisis has been properly resolved.

The Commission continues to monitor developments in Member States with a view to ensuring that relevant laws and practices (e.g. in the context of privatisations) are in compliance with Article 63 of the TFEU on the free movement of capital. While trying to pre-emptively address situations which could develop into infringements, the Commission will bring cases before the CJEU when necessary.

EU Member States which currently have transitional periods for maintaining restrictions on the acquisition of agricultural land should speed up their efforts to complete their reforms in this area in time for full liberalisation.

The problems posed by Intra-EU BITs with EU law have to be addressed. Commission services stand ready to work with Member States and industry to resolve the matter whilst safeguarding investments as effectively as possible. However, the Commission is ready to take action to ensure compatibility with EU law whenever the situation cannot be remedied by mutual agreement.