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Joint Meeting

THE EXPERIENCE OF THE OECD WITH THE CODE OF LIBERALISATION OF CAPITAL MOVEMENTS

This document reproduces a background paper by the OECD Secretariat circulated at an IMF Seminar on "Current Legal Issues Affecting Central Banks" which was held in Washington on 6 May 1998 and to which the OECD Secretariat was invited to make an oral presentation on the OECD experience with the OECD Capital Movements Code and lead the subsequent discussion on multilateral rules for capital movements liberalisation.

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The Experience of the OECD with the Code of Liberalisation of Capital Movements*

IMF Seminar on Current Legal Issues Affecting Central Banks Washington, 6 May 1998

I. Objective and approach of the OECD Capital Movements Code.

1. The OECD has the vocation of promoting sustainable economic growth and efficiency in Member countries, and the liberalisation of trade in goods and services and movement of capital between Member countries has been recognised as indispensable to the attainment of this goal. Accordingly, in the Convention which established the OECD in 1961, the Member countries agreed to "pursue their efforts to reduce or abolish obstacles to the exchange of goods and services and current payments and maintain and extend the liberalisation of capital movements".

2. With regard to capital movements, this solemn undertaking found concrete expression in the OECD Code of Liberalisation of Capital Movements adopted in December 1961[1]. In adhering to the Code, OECD Members have undertaken to remove restrictions on specified lists of capital movements between residents of different Member countries. OECD Members have thereby waived their right under the IMF's Articles of the Agreement to maintain capital controls (while the Code does not alter OECD Members' obligations as members of the IMF). The OECD Code is to date the only multilateral instrument promoting comprehensive capital movements liberalisation as its primary purpose.

3. The Code's approach to capital account liberalisation cannot be described as doctrinaire. Liberalisation need be neither immediate nor unconditional. Through an OECD Committee mechanism of peer pressure, the Code engages Member countries in a process of progressive liberalisation, allowing reasonable scope for Members in different circumstances to move towards the ultimate objective of complete freedom of capital movements in different ways and at varying speeds, according to the economic circumstances they face.

4. OECD Member countries' experience since the adoption of the Code has confirmed that the Organisation's objective of free movement of capital is well founded[2]. Where accompanying economic policies and supporting institutional frameworks are in place, international capital mobility has proved to bring essential macroeconomic benefits and efficiency gains: it offers a better allocation of world savings to productive uses; it ensures liquidity against domestic income fluctuations; it reduces investment risks by allowing portfolio diversification; and it provides signals from international markets that are salutary for the discipline of macroeconomic policies. Liberalisation of capital movements is also an integral part of regulatory reforms to improve corporate and public governance and transparency of rules.

5. Two new OECD Members, Mexico and Korea, were recently affected by major currency crises. Currency crises are not new phenomena, however. Other OECD countries -- in Europe and elsewhere -- experienced in the past severe currency crises, notably in the 1970s with the collapse of the Bretton Woods system and the first oil shock, and in the early 1980s and in 1992 within the European Monetary

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* This paper was prepared by Pierre Poret, Directorate for Financial, Fiscal and Enterprise Affairs, OECD. The views expressed in this paper are not necessarily those of the OECD and its Members. The author is grateful to Robert Ley and Rinaldo Pecchioli for their comments on this paper.

System. But despite the possibility of episodical serious financial instability, it has been recognised that the adoption of corrective policy measures which pass the test of free financial markets represented a long-run investment which offered a far better guarantee for economic stability in the future than recourse to capital controls.

II. Obligations and safeguards of the Code

6. In adhering to the Code, OECD Member countries undertake in particular the following obligations:

- -- To notify the Organisation of any existing measures affecting capital movements;
- -- To apply any measures without discrimination among OECD Members[3];
- -- To liberalise all the operations specified on the liberalisation lists of the Code, except with respect to items against which reservations are lodged;
- -- Not to introduce any new restrictions which would not be covered by reservations. This provision embodies the "standstill" principle. The adjustment of countries' reservations over time acts with a "ratchet" effect to capture higher degrees of liberalisation as they are achieved.

7. The Capital Movements Code covers all capital movements, ranging from direct investment to derivatives and currency trading[4]. The definition of a capital movement under the Code includes not only a capital transfer or a payment but also the underlying transaction since many capital operations, in particular capital inflows, are regulated at the level of the underlying transaction. Regarding inward direct investment, the Code's liberalisation obligation extends to regulations affecting the establishment of non-resident investments where FDI restrictions continue to apply.

8. Liberalisation means that residents should be allowed to transact freely with non-residents in any operations and instruments available abroad. This means for instance that residents should be free to buy on foreign markets commercial paper issued by non-residents, even if domestically no market for commercial paper exists or is permitted; or that residents should be free to issue securities abroad without prior approval from their national authorities even if an approval is required for issues on domestic markets[5].

9. Liberalisation also means that Members are required to apply National Treatment to non-residents wishing to engage in operations with residents on their territory. For instance, non-residents shall not be subject to more burdensome requirements for access to local capital markets than those applicable to residents. On the other hand, Members are not required to extend preferential treatment to non-residents on their territory. This implies for instance that non-residents may be prevented from issuing commercial paper on the domestic market if residents are not permitted to do so. In other words, the Code does not inhibit the normal exercise of regulatory powers of governments provided that they are carried out in a non-discriminatory manner.

10. The Capital Movements Code protects the liquidation of a foreign investment and the free cross-border transfer of profits and proceeds of liquidation in relation to a foreign investment, but it does not include provisions on expropriation, as host-country regimes on expropriation are not considered to interfere directly with the ability of non-residents to make an investment. More generally, the primary

purpose of the Capital Movements Code is to ensure the freedom of capital movements between residents of different Member countries and does not address the treatment by a host country of foreign-controlled enterprises once established on its territory[6]. The test of discrimination under the Capital Movements Code is therefore primarily based on residence criteria consistent with a balance-of-payments approach, rather than nationality criteria[7].

11. The Code contains a number of safeguards. In particular:

- -- When a new item is added on the liberalisation list of the Code or an obligation relating to an item is extended or begins to apply to a Member, a Member may lodge reservations.
- -- There may arise a case whereby a Member needs to re-impose restrictions on operations for which standstill applies. These cases are covered by the derogation procedure of Article 7 of the Code. A derogation, however, may apply only if a Member can demonstrate that its invocation of the derogation clause is justified by serious balance-of-payments difficulties or "a serious economic or financial disturbance". Derogations are expected to be maintained for a limited period only[8];
- -- The Code also contains a so-called "List B" of operations with respect to which a Member country can re-introduce restrictions, and lodge reservations accordingly, at any time. List B currently covers only short-term financial operations and non-resident acquisitions of real estate. The faculty for Member countries to re-introduce reservations under List B has proved to be in practice an effective way to facilitate liberalisation in sensitive areas and to avoid "precautionary" reservations (i.e. maintained for the sole reason of leaving open the opportunity to re-impose restrictions without breaching the standstill provisions of the Code);
- -- The net external position of financial institutions dealing in foreign exchange can be regulated for prudential purposes. However, the Code does not contain any general carveout for prudential measures. Invocation of prudential considerations for the justification of a particular measure is judged on a case-by-case basis through Committee review mechanisms;
- -- Article 5 on "controls and formalities" allows Members to impose measures to verify the authenticity of the operation concerned, such as anti-money laundering measures for instance, or to prevent evasion on laws and regulations, such as tax control measures for instance. These controls and formalities must be kept as simple as possible. Pursuant to Article 5, Members are thus permitted to require certain operations to be effected through an authorised intermediary, such as a resident broker for instance, acting on the account of its client, provided that this requirement is not used as a disguised means of restricting the making of the operation concerned. Capital transfers and payments may also be required to be executed through the banking system.

III. Enforcement procedures under the Code

12. The OECD Code has the status of an OECD Decision, which is legally binding. Accordingly, the Members are expected to take whatever steps are necessary to ensure that the obligations accepted are honoured. The strength of the Code lies also in the determination of the Member countries to make active use of it as an instrument of international co-operation.

13. While the Code does not explicitly refer to the possibility of countermeasures against a Member which would breach its obligations, it does not exclude that countermeasures may be taken under certain conditions, in accordance with international law. But in practice, there have never been such cases of countermeasures. Peer pressure, political persuasion and compromise solutions were felt by the drafters of the Code more suitable to resolve disputes in the field of capital controls which usually apply for general public policy purposes, in a non-discriminatory manner and on a cross-industry basis. This approach to dispute settlement has generally proven effective.

14. The Code provides a framework of notification, examination[9] and consultation within a specialised Committee[10] which culminates in Recommendations and Decisions by the OECD Council, through which observance of its prescriptions can be effectively monitored and achieved and disputes can be settled.

15. Experience shows that this framework exerts effective pressure on Member countries to accelerate capital control liberalisation and avoid backsliding. Often, national policymakers working to pursue liberalisation in their own country found that an internationally recognised forum as the OECD constituted a valuable source of support for their reforms. The role of the Code goes also beyond that of exerting a pressure on particular countries for unilateral liberalisation. Individual countries are better off if they act collectively to remove capital export barriers within the framework of multilaterally agreed rules and procedures that provide some assurance that others will follow the movement.

IV. Evolution of the Capital Movements Code.

16. The scope of the Code was progressively broadened as OECD economies developed and the stance of policies changed. In 1961, the liberalisation obligations of the Code were essentially limited to the free disposal of non-resident-owned blocked funds and free transfers in connection with the making and the liquidation of inward direct investments. The Code was revised in 1964 to include basic underlying transactions such as direct investment, certain long-term securities and credit operations and personal capital movements, and in 1984 to cover the right of establishment of direct investors. But it is only in 1989 that the Code was amended to cover all other capital movements, including short-term capital movements, such as money-market transactions, operations in forward markets, swaps, options, and other derivative instruments.

17. This evolution reflects the gradual process of liberalisation and its sequencing in most OECD countries[11].

18. During the 1960s and 1970s, the majority of OECD countries were prepared to liberalise only operations which were most closely related to business and trade activities and were perceived, for this reason, to be relatively stable. Only later, starting from the middle of the 1980s, other operations of a more financial character and of shorter maturities, which were considered more volatile, began to be liberalised. Along this process, investments in equities were usually liberalised before debt-creating capital flows[12], and operations in long-term bonds before those in short-term debt securities. (Interestingly, it seems that a number of emerging market economies affected by the recent crisis in Asia followed a pattern which in several respects was the opposite of the sequencing of liberalisation in OECD countries.)

19. In fact, the issue of "hot money", including the danger of excessive short-term and speculative capital inflows, which is widely debated today in the aftermath of recent currency crises, is not new to OECD Member countries. Already in 1964, they discussed the issue extensively in the context of the first reform of the Code. At that time, they took an explicit decision not to extend the scope of the Code to

short-term operations on the grounds that their liberalisation would make their balances of payments vulnerable to shifts in market participants' sentiments and compromise the independence of their economic policies, in particular undermine exchange rate objectives set out within the framework of the Bretton Woods system of fixed but adjustable exchange rates.

20. After a period of turbulence in the 1970s, the 1980s brought a new era in policy attitudes, heralded by the abolition of exchange controls by the United Kingdom in 1979 and by Japan in 1980. Other countries have since followed suit. By the early 1990s, no OECD Member countries maintained capital controls of any significance.

21. Many factors explain this new approach towards capital movements liberalisation in the OECD area. Factors common to most OECD Member countries, i.e. irrespective of differences in their level of economic and financial development, include the following:

- Over the last ten years, the priority objectives ascribed to monetary policies in OECD countries converged towards achieving long-term price stability, and, to this end, building up credibility-enhancing mechanisms. Capital controls, which had in the past aimed at preserving the ability of monetary policy to exploit a possible trade-off between inflation and unemployment, did not fit into this new policy paradigm and risked to distract the authorities from the essential task of maintaining sound and credible economic policies;

- It was also increasingly recognised that a "too" large share of short-term assets in total capital inflows often reflected a legitimate reluctance of traditionally risk-averse foreign institutional investors, such as pension funds, to take long-term, less liquid commitments, especially with respect to countries where property rights remained uncertain due to accounting and bankruptcy law deficiencies or where the stock market was not functioning properly. Attention was also paid to the fact that foreign investors' focus on short-term investment could simply reflect a lack of opportunities for longer-term, direct investment due to restrictions aimed at protecting national ownership. Rather than imposing restrictions on allegedly speculative short-term investments, Member countries sought therefore to remedy these underlying problems;

- Against a background of rapid domestic deregulation and internationalisation of markets, national authorities were increasingly concerned to strengthen the competitiveness of their enterprises and financial centres by allowing them to engage in the full range of cross-border capital operations;

- Evidence also mounted that, in increasingly market-based economies with growing financial innovation, capital controls were costly to administer and were rapidly losing effectiveness. The mixed experience of Germany and Switzerland in the 1970s with restrictions on capital inflows and episodes of large capital flight in a number of European countries in the 1980s despite tight controls already showed that restrictions can rapidly reach their limits[13].

22. It is against this background that the conviction grew among OECD Member countries that the time had come to consider a significant strengthening of the obligations and broadening of the scope of the Code to include all cross-border operations including those most sensitive to changes in interest rates and market sentiment, and that the 1989 amendment to the Code was adopted.

V. Adherence of new Members to the Capital Movements Code

23. While the accession processes of the five new Members (Mexico, Czech Republic, Hungary, Poland and Korea) that joined OECD in recent years involved OECD Committees reviews in a wide range of areas, an essential condition of their accession to OECD membership was their acceptance of the obligations of the OECD Codes[14]. Although each application to OECD Membership is judged on its own merits, all candidate countries are expected to meet *inter alia* the following standards under the Capital Movements Code:

- no restrictions on payments and transfers in connection with permitted international transactions;
- an open and transparent regime for foreign direct investment;
- liberalisation of other long-term capital transactions; and
- indication of a timetable for future further liberalisation.

24. The capacity of a candidate country to meet minimum OECD capital account liberalisation standards is considered to be in the interest of the country concerned itself. Liberalisation is seen as an integral part of regulatory reform, especially necessary in countries where capital controls could contribute to excessive government interference with normal corporate governance practices, opacity of rules or even corruption. In addition, access to direct corporate finance from abroad brings some of the disciplines of organised international stock markets over corporate governance. Liberalised capital outflows force domestic enterprises to compete more actively for scarce capital and financial institutions to improve the functioning of their local capital markets, and greater financial integration helps domestic financial institutions to familiarise themselves further with modern financial techniques and regulatory disciplines.

25. The willingness of a candidate country to deliver a timetable for future liberalisation in the area of capital movements is also viewed as a positive signal that the country concerned will strive to implement the necessary macroeconomic policies in support of liberalisation and maintain the momentum for further regulatory reform more generally.

26. The OECD membership conditions cannot be held responsible for the recent currency crises and banking instability experienced in some of the emerging market economies which recently joined the OECD. In particular, the OECD did not request the candidate countries to liberalise short-term cross-border capital operations, including interbank lending with respect to which excessive reliance has been identified as one cause of the problems faced in Asia. Moreover, tighter non-discriminatory banking regulations would have been fully consistent with the Code, the lack of which appears very much at the root of financial sector difficulties in some of them. As a matter of fact, the competent OECD Committees at the time of accession drew the new Members' attention to the need to modernise the banking system and, in particular, to upgrade and strengthen the prudential supervisory framework.

27. Half-way measures and delays in implementing in full the recommendations made by the OECD Member countries in the context of accession actually did not help the new Members concerned and may have contributed to retarding much needed improvements in corporate and public governance practices, and in the predictability and transparency of rules. As a matter of fact, following their recent currency crises, Mexico and Korea took further capital control liberalisation measures. None of them had recourse to new capital controls, though such measures would have been possible if the derogation clauses of the Code had been invoked.

28. So that the implementation of their accession commitments can be closely monitored and further recommendations can be made by the OECD Council as appropriate, the new Members agreed that full reviews of their positions under the Code should be held two years following their accession[15].

VI. Looking ahead

1. The MAI

29. The Multilateral Agreement on Investment (MAI) under negotiation at the OECD since 1995 is to be a comprehensive and high-standard multilateral framework for foreign investment, combining for the first time the three principles of foreign investment rule-making: protection; liberalisation; and dispute settlement. It is to be open to non-Member countries.

30. Its objective is to provide a "level playing field" for foreign investors, with non-discriminatory rules on both market access and legal security. It aims at reducing barriers and distortions to foreign investment, thereby promoting a more efficient allocation of economic resources, and achieving higher economic growth, more jobs and increased living standards.

31. The negotiations are taking place in the OECD for three principal reasons:

– OECD Member countries have a major stake in the outcome since they account for 60 per cent of global inflows of foreign direct investment and 85 per cent of outflows;

– Negotiators turned to the OECD because the option of negotiating a high standards investment agreement was simply not available in another multilateral forum;

– Negotiators have been able to build on existing OECD agreements relating to investment, including the Codes of Liberalisation (1961) and the Declaration on International Investment and Multinational Enterprises (1976), under which OECD Member countries have already accepted some basic principles in respect of foreign investment.

32. While further work is needed on key issues, including exceptions, extra-territoriality and labour and environment, the main elements of the MAI are ready including :

– The MAI will apply to a wide range of assets, including those arising from portfolio investments;

– The core National Treatment and Most-Favoured-Nation Treatment principles will apply to all phases of an investment, including the cross-border establishment of a new enterprise and the activities of already-established enterprises under foreign control. Specific disciplines will apply *inter alia* to performance requirements imposed on investors, privatisation, monopolies and concessions, and the movement of key personnel;

– Free cross-border transfer of funds, and prompt, adequate and effective compensation in the event of expropriation;

– Binding dispute settlement procedures between states, and between investors and states.

33. The MAI is designed to be compatible with other international agreements, including the Articles of Agreement of the IMF. In regard to the IMF, three features of the MAI should be noted :

- There is a consensus that the MAI should include an article similar to that in the OECD Codes, recognising the overriding nature of obligations of the IMF;

- There is broad support for a safeguard clause in the MAI which would allow temporary dispensation from the MAI obligations on free transfer of funds and National Treatment for cross-border capital transactions, where justified by serious difficulties for the balance of payments or macroeconomic management. The exception to National Treatment is in recognition of the fact that restrictions on capital inflows may be re-introduced in exceptional circumstances and that these restrictions, although imposed on non-residents, may disproportionately affect foreigners and thereby amount to *de facto* discrimination in the meaning of the MAI;

- The text developed so far defers to the IMF to assess the consistency of any new restrictions with the MAI safeguard clause. Measures invoked under the safeguard clause which are approved by the IMF in the exercise of its jurisdiction will be accepted as consistent with the MAI safeguard clause; for those measures falling outside the IMF's jurisdiction, IMF's assessments shall be requested; and would a dispute arise on the way measures taken under the MAI safeguard are actually applied, the IMF's assessment shall also be requested by the panel. Any IMF's assessments shall be accepted.

34. At the OECD Meeting at Ministerial Level held on 27-28 April 1998, Ministers took into account the positive results produced by the Negotiating Group, as well as the remaining difficulties and the concerns that have been expressed, and decided on a period of assessment and further consultation between the negotiating parties and with interested parts of their societies. They noted that the next meeting of the Negotiating Group will be held in October 1998 and directed the negotiators to continue their work with the aim of reaching a successful and timely conclusion of the MAI and seeking broad participation in it. In the same spirit, they supported the current work programme on investment in the WTO and once the work programme has been completed will seek the support of all their partners for next steps towards the creation of investment rules in the WTO. Finally Ministers welcomed the full participation as Observers of Argentina; Brazil; Chile; Estonia; Hong Kong, China; Latvia; Lithuania and the Slovak Republic with a view to their becoming founding members of the MAI, and expressed their commitment to pursue an active dialogue with non-Members, including on their development interests, particularly with those non-Members willing and able to meet the obligations of the agreement.

35. The <u>Capital Movements Code</u> does not contain many of the specific disciplines of the MAI on national treatment of established foreign-controlled enterprises, expropriation, performance requirement, movement of key personnel and so on; its approach for settlement of disputes is also different. On the other hand, unlike the MAI, the Capital Movements Code imposes on a Member country liberalisation disciplines with respect to <u>capital outflows</u> initiated by national residents and the liquidation of assets they may held abroad.

36. These distinct features of the two instruments reflect their differences in approach: the MAI is about discrimination by a Contracting Party against investors from another Contracting Party and its assets on <u>nationality</u> grounds; many of its provisions relevant to the post-establishment phase are mostly directed to the treatment of established foreign-controlled enterprises. On the other hand, the primary purpose of the Capital Movements Code is to remove controls on the free movement of capital between

residents of different Member countries, inward direct investment being only one category of a wide range of capital operations.

2. The future role of the Capital Movements Code

37. There is every reason to expect that the Capital Movements Code will continue to play an important role in the future life of the OECD, while adapting -- as in the past -- to the changing institutional and policy landscape affecting liberalisation. The respective roles of the OECD and the IMF (which regardless of the scope of its formal jurisdiction already shares the goal of liberalisation) will continue to be complementary and mutually reinforcing. The same may be said of the respective roles of the Codes of Liberalisation and the MAI.

38. First, the Code plays a unique operational role in promoting liberalisation in the OECD area, through peer monitoring, regular policy reviews and direct dialogue among OECD governments. Member countries will continue to make use of these procedures, which have proven well adapted in the OECD membership context of advanced economies and represent one of the comparative advantages of the OECD. Policy reviews can take a variety of forms. There is a broad support to continue horizontal reviews of the 29 Member countries under the Codes such as those recently conducted by the Committee on Capital Movements and Invisible Transactions (CMIT) in the fields of foreign investment in real estate and the admission of foreign securities on domestic capital markets.

39. Second, the Code provides a well-tested and objective yardstick for admission of new Members and have been instrumental to successful OECD accession negotiations. OECD Member countries consider it very important that the Code continues to play this role. In the context of OECD outreach activities, the Code is being used as a concrete basis for dialogue and assistance to non-Members; it has been studied by a number of non-Members as a reference tool for domestic reform of foreign exchange legislation.

40. Third, the Code constitutes the institutional expression of OECD leadership in the development of “best international practice” for cross-border capital movements. Already in the past, the Code played a precursor role -- when, through the adoption of the Code, OECD Member countries waived their right to maintain capital controls under Article VI of the IMF Agreement and, more recently in 1989, when the Code was enlarged to all capital transactions. Key to its continued policy relevance is that it is an evolving agreement which can be changed by OECD Council decisions to incorporate further innovative disciplines in the light of direct experience-sharing among Members[16].

NOTES

1. At the same date, the OECD also adopted the Code of Liberalisation of Current Invisible Operations. This Code covers current payments and transfers in connection with business, industry, foreign trade, personal income, and travel and tourism, as well as cross-border trade in transport services, financial services and films. The legal status and procedures of this Code are the same as those followed by the Capital Movements Code

2. For a detailed analysis of the experience of OECD Member countries with capital account liberalisation, see "Liberalisation of Capital Movements and Financial Services in the OECD Area", OECD (1990) and "Exchange Control Policy", OECD.CCEET (1993).

3. Unless the measures fall under the exception clause of Article 10 allowing for preferential treatment among Member countries which are part special customs or monetary systems. In practice, capital controls liberalisation in OECD countries has always been undertaken on an *erga omnes* basis. Where preferential treatment within special customs or monetary systems exists, it primarily apply to foreign direct investment in certain sectors, ownership of real estate and selective recognition arrangements in respect of certain securities market regulations, as far as capital movements are concerned.

4. The sole exception concerns consumer and mortgage credits extended by non-residents to resident individuals.

5. Surveillance over the admission of securities issued by residents of a Member country (home country) on the market of another Member country (host country) should be considered the primary responsibility of this other Member country. Not only a prior approval requirement on the part of the home country can interfere with the normal exercise of OECD Member countries' jurisdiction over the operation of their own capital markets but, more importantly, it can distort foreign investors' market assessment and encourage unchecked investments as it creates the perception that issues of domestic corporate securities, once approved by the home country authorities, are protected by some form of government guarantee. This being said, it is worth noting that nothing in the Code prevents the supervisory authorities of the country of residence of the issuer from taking the initiative to provide the host country's authorities with information, including a negative opinion, on the operation concerned. Also the Code would not prevent the supervisory authorities of the country where the securities are to be publicly offered from requiring to enter into co-operation arrangements with their counterparts in the country of the issuer as a condition to allow the public offer of the securities in question on its territory.

6. Deviations from National Treatment of foreign-controlled enterprises after they have established are covered by the OECD National Treatment instrument (which, unlike the Code, is not legally binding). However, there might be cases where preferential treatment for national investors would put established foreign investors at a significant competitive disadvantage and thereby *de facto* discourage the entry of non-resident investment. In these cases, Article 16 of the Code may be at the disposal of the country which considers itself prejudiced by such arrangements. Article 16 provides for the possibility that "internal arrangements", i.e. domestic measures not directed at non-residents as such, which are likely to restrict the possibility of effecting transactions or transfers, could frustrate the measures of liberalisation taken or maintained by a Member country. Under Article 16, a Member country which would consider itself prejudiced by domestic measures may refer to the Organisation to determine whether these measures can be assimilated to internal arrangements frustrating liberalisation and to make suitable suggestions for the removal or modifications of such arrangements.

7. Restrictions on inward direct investment and ownership of real estate are often imposed using nationality conditions. These restrictions fall, however, within the scope of the Capital Movements Code to the extent that restrictions on nationality grounds may disproportionately affect non-residents and thereby amount to *de facto* discrimination in the meaning of the Code.

8. Specifically for no more than 18 months in the case of an invocation of Article 7 for balance-of-payments reasons.

9. Along with the general notification obligations, Articles 12 and 13 require that the Organisation regularly examine reservations or derogations lodged by each Member country or reservations of all Member countries by operation areas. These examinations serve to heighten awareness of the need for liberalisation and provide a practical mechanism through which to promote it. In this process, the performance of each Member country is judged by its peers. Examinations do not involve negotiations in the sense of an exchange of concessions. Since liberalisation is considered to be in a country's own interest, it is not appropriate that it should agree to liberalise only if other Members do likewise. In the course of an examination, the nature and purpose of remaining restrictions are clarified and discussed, and the Member countries concerned are encouraged to modify their reservations to reflect current policies and practices. Efforts are also made to identify operations that could be freed from restrictions, particularly where this could be done without compromising the objectives of the authorities concerned. This process leads to formal recommendations to Members to withdraw or limit their reservations to the Code.

10. Responsibility for this process lies with the Committee on Capital Movements and Invisible Transactions, known as the "CMIT". Unique among the standing Committees of the Organisation, the CMIT is composed of "independent experts" appointed in their individual capacity by the OECD Council on the nomination of the Member countries. Representatives of the International Monetary Fund regularly attend. A representative of the Commission of the European Communities also attends meetings of the CMIT and participates in its work.

11. Exceptions include : the United States, Canada, Germany and Switzerland which traditionally maintained almost no forms of capital controls; the United Kingdom in 1979, Australia and New Zealand in the early 1980s, which opted for a "big bang" approach.

12. Equity investment, as opposed to debt creating instruments, imposes no obligations on the debtor to make fixed interest payments and to reimburse the principal at a determined date; a foreign investor may be unable or unwilling to liquidate his shares unless he can find a counterpart willing to buy them at the desired price. From a balance-of-payments perspective, these features make equity investment a more attractive candidate for an early liberalisation than other types of investment. Equity investment is also less directly sensitive to changes in monetary policies domestically and abroad than interest-bearing investment.

13. Over the past decade, the only OECD countries which tightened somewhat capital controls were Ireland, Portugal and Spain during the ERM turmoil of Autumn 1992. It is worth noting that these countries in fact subsequently removed all remaining controls in a matter of a few weeks.

14 For a detailed analysis of the terms and conditions of adherence to the OECD Codes of recent new Members, see Robert Ley and Pierre Poret, "The New OECD Members and Liberalisation", The OECD Observer, No. 205, April/May 1997.

15. The first of such reviews concerned Mexico and has resulted in further steps by Mexico in accordance with the Council's recommendations. The reviews of other new Members are underway.

16. New disciplines currently under consideration concern portfolio investment abroad by insurance companies and private pension funds. Future work envisaged include *de facto* restrictions on free capital movements through barriers to access to financial services; banking regulations for the purpose of non-prudential capital controls; prior approval formalities more burdensome than necessary; tax-based discriminatory measures.