

THE OECD CODE OF LIBERALISATION OF CAPITAL MOVEMENTS: RECENT DEVELOPMENTS

OECD REPORT TO THE G20

April 2016



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The OECD Investment Committee is mandated by the OECD Council to consider all questions concerning the interpretation and implementation of the provisions of the OECD Code of Liberalisation of Capital Movements or other Acts of the Council relating to the liberalisation of capital movements. This report has been developed by the Secretariat on the basis of the text of the Code and other Investment Committee official documents. It is intended to foster a better understanding of the OECD Code and its review process as agreed by Code's Adherents; it does not in any way alter or modify rights and obligations of Adherents, the interpretation and implementation of which remain the sole responsibility of the Investment Committee.

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Mandate. At their meeting on 26-27 February 2016 in Shanghai, G20 Finance Ministers and Central Bank Governors stated that they “look forward to further work on capital flows by the IMF, the BIS, the OECD, and other IOs” and “to their studies and reports”. At the meeting of the G20 International Financial Architecture Working Group on 24 February 2016, the OECD was asked for an update on the review of the OECD Code of Liberalisation of Capital Movements during its next meeting in April 2016. This report provides information on recent developments in work at the OECD on capital flows, in particular the launch of the review of the OECD Code.

About the OECD Code of Liberalisation of Capital Movements. Adhered to by thirty-four OECD countries, including twelve G20 countries, the OECD Code is the sole binding multilateral agreement among State parties dedicated to openness, transparency and international co-operation on cross-border capital flows. While distinct in nature, this agreement supports the implementation of the G20 Coherent Conclusions and is consistent with the IMF’s Institutional View on capital flow management and liberalisation.

Work on the Code can help to inform G20 discussions on capital flows. Indeed, since its inception in 1961, the Code has served as a platform to get peer recognition for reform efforts, compare progress and exchange good practices among Adherents in a path toward progressive capital account liberalisation that is very similar to the one which China and other non-adhering G20 members are currently embarking upon as a long-term goal. Furthermore, the Code has served as an anchor for countries’ policies in times of financial stress such as in the current juncture, by providing a due process --- transparency and accountability – to observe when countries reintroduce capital flow restrictions while wishing to signal their continued commitment to openness. For these reasons, it is in the individual and collective interest to widen adherence to the Code and in 2012 the Code was open for adherence by non-OECD G20 countries with equal rights and responsibilities as OECD countries.

The review of the Code. On 17 March 2016 Adherents adopted terms of reference for the review of the Code. The purpose of the review is to strengthen the Code and to ensure its continued relevance. The review of the Code will also improve clarity and predictability in the implementation of the instrument, as well as the transparency of specific measures introduced by Adherents. Ultimately the work on the review will be a contribution to shaping the desirable features of the open, transparent and resilient economy which we want.

The terms of reference of the review. Key areas of work are:

- a. Reaffirming the broad scope of the Code by clarifying the treatment of measures equivalent to restrictions and reviewing the treatment of financial innovations.
- b. Developing understandings on the treatment of measures with stated prudential objectives. This includes currency-based capital flow management measures. The vast majority of macro-prudential measures fall outside the scope of the Code; national adaptations of liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) requirements differentiating by currency will be considered.
- c. Considering the merits of rebalancing the list of operations subject to standstill (i.e. derogation is needed to introduce new restrictions) and the list of operations that is not subject to standstill (i.e. new reservations can be lodged to reflect new restrictions).
- d. Considering ways of strengthening in practice the governance and improving the decision-making process.

Participation of non-adhering G20 members in the review is welcome. Bringing the perspectives of all G20 members will enrich the discussions and facilitate non-Adherents' consideration of the merits of adhering to the Code. While final decisions lie with the parties to the agreement, the discussions will be conducted by the Advisory Task Force on the Code in which non-OECD G20 members already participate. The next meeting will be held at the OECD in Paris on 27 April 2016.

The Background Note annexed to this report provides detailed information on the Code and its review.

BACKGROUND NOTE¹

THIS BACKGROUND NOTE PROVIDES
INFORMATION SUPPORTING THE REPORT

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¹ This document is an updated and expanded version of the Background Note provided to the G20 International Financial Architecture Working Group meeting in Shanghai in February 2016.

1. AN OVERVIEW OF THE CODE'S FRAMEWORK

1. The OECD Code is one of the key elements in the international framework for economic co-operation since the post-war period. While the GATT was adopted to oversee open trade and international current payments and transfers were brought under the jurisdiction of the IMF's Articles of Agreement, the OECD Code has since its inception in 1961 promoted a collective view and common disciplines on capital flow management and liberalisation policies among adhering countries.

2. The Code is binding for the 34 OECD members, including twelve G20 countries, that have adhered to it. Since 2012, the Code is also open to non-OECD countries. All Adherents have an equal say in the governance of the agreement.

3. The establishment of the Code in 1961 was based on several premises validated by evidence and experience:

- An open multilateral regime for international capital flows serves the global economy better than closed capital accounts. This is all the more true today as financial markets need to play their full role in allocating cross-border saving and investment efficiently in support of a sustainable global recovery.
- Reintroducing capital flow restrictions can play a role in specific circumstances. On these circumstances, transparency and international co-operation are important. While restrictions can be justified from an individual country's viewpoint, a "beggar-thy-neighbour" approach to restrictions can lead to negative collective outcomes.

Box 1. The Code is a living instrument which has been adapted to different settings since 1961

The Code is a living instrument which has undergone a process of review and adaptation over time. The review process has brought about a gradual but continual expansion of the scope of obligations and a lifting of liberalisation standards.

- Collective investment securities were introduced as part of the Code's obligations under List A since 1973.
- The right of establishment under item I/A of the Code was introduced in 1984.
- Short-term capital movements are covered since 1992, the time of the last major review.
- The understanding regarding "measures equivalent to restrictions" also dates back to 1992.
- Restrictions applying to portfolio investment abroad by certain institutional investors, namely insurance companies and pension funds, were brought within the purview of the Code in 2002.
- The Code was opened to non-OECD countries in 2011.
- New governance arrangements were established in 2012, which grant non-OECD adherents the same rights and obligations as OECD countries.

4. The Code was established at a time when many OECD countries were in the process of economic recovery and development and when the international movement of capital faced many barriers. When the Code was first established, its coverage was rather limited. Since then, national economies have become more integrated, financial market regulation more harmonised and financing techniques more sophisticated. Over time the Code has been revised to reflect both these changing economic realities and new aspirations of adhering countries (Box 1).

1.1 A forum for international dialogue and co-operation

5. The Code has provided an established and tested process of international dialogue and co-operation. The process is managed and controlled by Adherents through a dedicated forum at the OECD in which each country can explain its policies and raise questions about the policies of others. The IMF and other relevant international organisations are invited to this forum.

6. The process is peer driven. Over time, Adherents have developed a well-established jurisprudence regarding implementation of the Code's rights and obligations and the conformity of individual country measures. Notification and examination of country measures enhance transparency and mutual understanding.

7. The OECD Investment Committee has formal responsibility to look after all Codes matters. It has established an Advisory Task Force on the OECD Codes (ATFC) open to all G20 and FSB members to examine financial issues under the Code, including its review (Box 2).

Box 2. The Advisory Task Force on the OECD Codes (ATFC)

The ATFC is composed of governmental experts from Adhering countries, non-adhering G20 and FSB members, other non-OECD countries, as well as experts from relevant international organisations such as the IMF and the BIS.

As a way of illustration, agenda items considered recently by the ATFC include:

- Adherents' invocation of the Code's derogation clauses for new restrictions (e.g. Greece, Iceland).
- Implications of certain measures such as limitations on banks' foreign exchange derivatives positions for Adherents' reservations under the Code of Liberalisation of Capital Movements.
- National applications by currency of Basel III Liquidity Coverage and Net Stable Funding Ratios as alternatives to CFMs falling under the Code (e.g. Iceland).
- Presentations by G20 members that have not adhered to the Code on their plans with capital flows liberalisation and management (e.g. China and Indonesia).
- Discussions on recent changes in regulatory requirements for establishment of foreign banks (e.g. US new Federal Reserve Rule and UK's new requirements for branches of foreign banks).
- Terms of reference for the review of the Code of Liberalisation of Capital Movements.
- New work on the trends in the use of currency-based measures, including CFMs.

1.2 An agreement adapted to different levels of development

8. A country wishing to adhere to the Code is reviewed and its measures assessed on their merits in addressing legitimate policy goals and in light of the specific circumstances of the country, including its level of economic and financial development and taking into account the provisions of the Code (Box 3).

9. Countries can pursue liberalisation progressively over time, in line with their level of economic development. Emerging economies such as Chile, Korea and Mexico have adhered to the Code. Other countries, specifically Spain until 1962, Greece until 1977, and Turkey until 1986, availed themselves of a special dispensation from their obligations under the Code for countries in the process of development while still enjoying the same rights as other adhering countries.

Box 3. Experience with sequencing liberalisation

Many but not all Adherents have followed a gradual approach to lifting capital controls. The process typically begins with less volatile transactions and those more directly necessary to normal business activities. Hence, direct investment is usually authorised earlier than portfolio investment and commercial credits are liberalised before financial loans. Equity operations are liberalised before those in debt securities—and when these have been liberalised, Adherents begin with long-term bonds, thus keeping control over money-market instruments for a longer period.

As financial market integration accelerated in the 1980s, countries found limits to the merits of further fine-tuning sequencing of liberalisation.

- In Turkey, outward direct investment and portfolio investment were liberalised at the same time.
- Sweden liberalised operations in Treasury bills and longer-term government bonds together, in 1989; Italy and Ireland liberalised operations in equities and bonds in tandem rather than in sequence.
- Several countries, such as France and Norway, maintained restrictions on lending to non-residents in local currency until the latest stage of liberalisation, for fear of facilitating speculation against the currency.
- In general, the last operations to be liberalised were those concerning deposit accounts with non-resident institutions abroad; and this mainly for tax evasion concerns that are met today in adhering countries by means other than capital controls.

Overall, today OECD countries have reached high-levels of financial openness, compared with non-OECD economies including large G20 countries such as China and India. These countries are embarked in gradual capital movement liberalisation very much for the same reasons that prompted OECD countries adhering to the Code to start opening their capital accounts many years ago and can benefit from country experiences under the Code.

1.3 The contribution made by the Code over time

10. Article 2(d) of the OECD Convention of December 1960 enjoined members to “pursue their efforts to reduce or abolish obstacles to the exchange of goods and services and current payments and to maintain and extend the liberalisation of capital movements”. In this spirit, the Code was designed to reflect members’ search for a balanced and orderly process where liberalisation could be pursued in a safe manner, taking into account individual countries’ specific needs and preferred pace of liberalisation.

11. Over time the Code has contributed to:

- entrenching the capital account opening process as undertakings by Adherents;
- pushing the opening process forward and consolidate it on a broad multilateral and non-discriminatory basis;
- guiding sequencing of liberalisation, thanks to the structure and tenets of the Code's obligations;
- providing a benchmark for regulation in this area, which has then served a reference for other treaties such as the Treaty on the Functioning of the European Union, whose provisions on capital movements have been inspired by the Code;
- providing a forum for discussion and exchange of information on country measures;
- establishing a peer-review mechanism in the context of a multilateral agreement, which has provided incentives for policy makers to undertake reforms and policy adjustments.

12. In addition to these collective benefits of the Code, the Code brings additional significant benefits to individual Adherents (Box 4).

Box 4: The Code brings significant benefits to Adherents

A country receives international support and recognition for its openness.

A country has the right to transparency regarding the measures of the other adhering countries.

A country reassures market participants that it does not intend to maintain restrictions broader or longer than necessary.

A country communicates that, as a co-operative member of the international community, it refrains from a "beggar-thy-neighbour" approach.

A country is protected against unfair and discriminatory treatment of its investors established in other adhering countries or of its enterprises seeking to raise capital abroad, and will be entitled to bring problems to the Code's dialogue and seek remedy.

As an adherent with equal rights and responsibilities, a country fully participates in reviewing and influencing other adherents' policies, shaping jurisprudence and improving rules under the Code.

A country enjoys the liberalisation measures of other adherents, regardless of its own degree of openness.

1.4 The time is ripe for review

13. Important momentum has built up for a review of the Code. The current policy environment around capital flows has moved multilateral co-operation, openness and transparency to the top of the policy agenda. The global financial and economic crisis of 2008 left the international monetary system with vulnerabilities caused by volatile

capital flows and the spill-over effects from diverging national policies. Three European Economic Area (EEA) countries have returned to traditional capital controls that restrict operations on the basis of residency. In parallel, OECD data suggest that CFMs that take the new form of Currency-Based Measures (CBMs)¹ applied to banks' operations with non-residents have become more prevalent, including among OECD countries. Signs of a reversal in the trend towards greater financial openness following the 2008 crisis are visible from an increase in saving-investment correlations in OECD and BRICS countries²; while this reversal may reflect cyclical factors and subsequent retrenchment of banks' international operations, the increased recourse of these measures also plays a role.

14. At the same time, the bulwark against restrictive tendencies for the most part held up during the crisis in the vast majority of OECD countries. What is more, major non-OECD emerging economies, in particular the world's second largest economy China, are opening up their capital accounts as a long term objective in order to fully participate in the global economy. India is looking at allowing fuller current account convertibility in years to come, while other countries such as South Africa have been pursuing efforts to modernise their foreign exchange regimes. In Latin America, Colombia, Costa Rica and Peru are following the path of their OECD neighbours - Chile and Mexico, and made credible commitments to progressive liberalisation and have applied for adherence to the Code.

15. Resisting financial protectionism and persevering with the process of opening up capital movements in the long run will contribute to addressing some of the structural imbalances that created frictions in the global economy prior to the 2008 crisis. Restrictions on the capital account often go hand in hand with foreign exchange interventions to perpetuate misaligned exchange rates and unsustainable growth models. And currency convertibility, among other factors, is an important contributor to efficient allocation of global resources and growth. A deepening of global foreign exchange liquidity engineered by a broad openness agenda will reduce the perceived need for CFMs as macro-prudential policies that guard against key currency mismatches in crisis situations. Permanent capital flow restrictions work in the opposite direction to improved global liquidity.

16. Recent experience with use of CFMs has prompted renewed debate on their effectiveness to address financial sector vulnerabilities and their implications for longer-term prosperity. Econometric evidence on the growth benefits of capital flow restrictions or the impact of currency-based CFMs on decoupling the economy from global credit cycles is mixed or remains subject to different interpretations, with results being sensitive to updates in data, expansion in country samples or model specifications³. Financial protectionism should not be the collective outcome of individual countries' efforts to shore up their financial systems. Progressive, sequenced liberalisation, mindful of vulnerabilities stemming from large and high financial flow volatility is called for, underpinned by a clear benchmark. The Code review process will provide a timely and important opportunity to advance consensus on the desirable features of a multilateral regime for cross-border capital movements.

¹ CBMs directed at banks are defined as regulations on banks' operations discriminating on the basis of the currency of an operation—in other words, measures that apply a less favourable treatment to operations by banks in a particular currency, typically foreign currencies. CBMs encompass a broad category of measures: regulations imposing a different treatment between domestic and FX-denominated operations by banks. CBMs may be addressed at operations amongst residents, or at operations also with non-residents. Within this latter broad category, CBMs may have the character of CFMs as they extend to operations abroad with non-residents. Also, among currency-based CFMs, those measures that apply to operations with non-residents only are traditionally defined as capital controls.

² See www.oecd.org/daf/inv/investment-policy/CapMovCodeBrochure.pdf

³ See OECD staff research papers at: www.oecd.org/investment/codes

2. A ROBUST STANDARD OF LIBERALISATION

17. Under Article 1, members (Adherents to the Code) “shall progressively abolish between one another, in accordance with the provisions of Article 2, restrictions on movements of capital to the extent necessary for effective economic co-operation. Measures designed to eliminate such restrictions are hereinafter called measures of liberalisation”.

18. Article 2 establishes that: “Members shall grant any authorisation required for the conclusion or execution of transactions and for transfers specified in an item set out in List A or List B of Annex A to this Code” (Box 6).

2.1 Measures equivalent to restrictions

19. In the context of the 1992 review of the Code which expanded the scope of the obligations substantially, members agreed that “*equivalent measures*” were to be covered. Thus, measures which create disincentives for operations covered by liberalisation lists A and B are considered as restrictions. Members also agreed that the Committee would be responsible for making the determination of whether a specific measure is to be considered an “*equivalent measures*” and thus deemed to be a restriction.

2.2 Internal arrangements

20. The liberalisation obligations under the Code apply to operations between residents and non-residents, internal arrangements do not normally have a bearing on Code’s obligations. Such internal arrangements include for example domestic regulations concerning only residents or local licensing requirements applying to residents and non-residents in a non-discriminatory manner.

21. However, under Article 16 “If a Member considers that the measures of liberalisation taken or maintained by another Member, in accordance with Article 2(a), are frustrated by internal arrangements likely to restrict the possibility of effecting transactions or transfers, and if it considers itself prejudiced by such arrangements, for instance because of their discriminatory effect, it may refer to the Organisation”.

3. A FLEXIBLE FRAMEWORK FOR COPING WITH CAPITAL FLOW VOLATILITY

3.1 Safeguards and policy space

22. Capital flows are an integral component of international finance. They allow for savings to be channelled from surplus countries to deficit countries, where returns to investment are typically higher. However, these flows can also pose important challenges to open economies. The Code contains flexibility mechanisms to cope with situations of economic and financial instability:

- Reservations and derogation allow countries to limit the scope of their liberalisation obligations and so maintain restrictions on operations which they are not in a position to liberalise at the time of adherence to the Code or they need to reintroduce after adherence.
- Certain operations are not covered in the liberalisation lists A and B of the Code: operations among residents are not covered, nor are financial credits and loans by non-residents to residents other than enterprises.

- Furthermore, Adherents have agreed to exclude certain types of measures from the scope of their Code obligations. Such understandings are formalised as decisions of the Investment Committee. For example, Adherents have agreed that rules on the net foreign exchange positions of banks are exempted from Code obligations.
- Other ways in which the Code's provisions protect countries' policy space are discussed in Box 5.

Box 5. The protection of countries' policy space

In addition to the Code's provisions allowing for the reintroduction of restrictions on capital flows, the protection of countries' policy space in a range of other aspects is granted, for example, by:

- Article 3: contains safeguard provisions relating in particular to public order and essential security interests deemed to address exceptional situations.
- Article 5: affirms Adherents' rights to prevent fraud connected to transactions and transfers, to act against evasion of their laws and regulations.
- Liberalisation obligations under the liberalisation lists provide scope for prudential measures, for example for operations in securities (items IV, V, VI and VII of the Code). Adherents *"may require that transactions and transfers be carried out through authorised resident agents;"* and that *"residents may hold funds only through the intermediary of such agents;"* and that members may *"take measures for the protection of investors, including the regulation of promotional activities"*.
- Regarding financial credits and loans, *"Members may regulate the net external positions of domestic financial institutions dealing in foreign exchange"*.
- According to understandings reached among Adherents, Adherents *"would be free to regulate for prudential purposes the foreign exchange exposure of certain key institutions, such as banks, pension funds and life assurance companies"*.

23. At present, putting aside reservations to reflect restrictions on FDI and portfolio investment abroad by pension funds and insurance companies which many Adherents have, four Adherents maintain reservations for some forms of CFMs, another is in the process of lodging a reservation, and two Adherents are under the derogation regime.

24. In the event of recourse to new restrictions on capital movements, countries have agreed under the Code to well-tested guiding principles such as transparency, non-discrimination, proportionality and accountability:

- Capital flow restrictions are measures that could best be considered when alternative policy responses are insufficient to effectively achieve the objective pursued.
- Their implementation needs to be transparent. Measures should be subject to accountability, including open for international discussion.
- Measures should not discriminate among investors from different countries, and avoid unnecessary damage, especially when they have a bearing on the interests of another country.
- The severity of restrictions should be proportional to the problem at hand, with measures disrupting business as little as possible and in particular minimising adverse impacts on operations such as FDI and commercial credits.

- Restrictions and corresponding reservations may be maintained for as long as needed, but should be removed once non-restrictive means become available to address legitimate policy concerns.
- Countries should be mindful of their rights and obligations under international agreements, including IMF's Articles of Agreement.

3.2 The Code's reservation system

25. Article 2 of the Code protects the right of Adherents to reintroduce and maintain measures which limit liberalisation obligations. The way to do so is to lodge reservations with respect to operations which they are not in the position to liberalise, at the time of adherence, when obligations are added or expanded, and at any time when needed for List B operations.

26. When the Code were amended in 1992 and during past adherences, countries lodged reservations for restrictions on capital movements which today would likely to be considered as CFMs taken with a macro-prudential intent.

27. By lodging reservations, adherents can maintain measures in force while still placing them under the disciplines of the Code's provisions, both procedural (transparency and peer review) and substantive (granting of equal treatment to all adherent countries and commitment to standstill).

28. Reservations are to be reviewed with an aim of "*making suitable proposal designed to assist Members to withdraw their reservations*". Restrictions and corresponding reservations may be maintained for as long as needed, but are expected to be removed once non-restrictive means become available to address legitimate policy concerns.

29. Restrictions on most short-term capital operations fall under Liberalisation List B (Box 6) and can be introduced at any time, even if no reservation had been initially lodged (the usual "standstill" rule does not apply). Over the last 5 years, two Adherents have availed themselves of the List B right. Restrictions can be re-imposed on other operations (List A) by invoking the Code's "derogation" clauses.

Box 6. Operations covered by liberalisation lists A and B of the Code

LIST A “Standstill” applies to these operations (i.e. derogation needed to reintroduce restrictions)	LIST B No “standstill” applies to these operations
I. Direct investment	
II. Liquidation of direct investment	
III. Real estate – Sale	III. Real estate – Purchase
IV. Operations in securities on capital markets	V. Operations on money markets
VII. Collective investment securities	VI. Negotiable instruments and non-securitised claims
VIII. Credits directly linked with international commercial transactions or rendering of international services In cases where a resident participates in the underlying commercial or service transaction	VIII. Credits directly linked with international commercial transactions or rendering of international services In cases where no resident participates in the underlying commercial or service transaction
	IX. Financial credits and loans
X. Sureties, guarantees and financial back-up facilities (see List B)	X. Financial back-up facilities in cases not directly related to international trade, international current invisible operations or international capital movement operations, or where no resident participates in the underlying international operation concerned
XI. Operation of deposit accounts by non-residents of accounts with resident institutions	XI. Operation of deposit accounts by residents of accounts with non-resident institutions
XIII. Life assurance	XII. Operations in foreign exchange
XIV. Personal capital movements Except Gaming	XIV. Personal capital movements Gaming
XV. Physical movement of capital assets	
XVI. Disposal of non-resident-owned blocked funds	

3.3 The derogation of Code's obligations

30. For measures with a bearing on List A operations, for which standstill applies, restrictions can be imposed by invoking the Code's derogation clause under Article 7, which is allowed:

- if an Adherent's *"economic and financial situation justifies such a course"*, as per Article 7(a); or
- in case of *"serious economic and financial disturbance"*, as per Article 7(b); or
- if the *"overall balance of payments of a Member develops adversely at a rate and in circumstances, including the state of its monetary reserves, which it considers serious"*, as per Article 7(c).

31. Derogations for balance-of-payments reasons (Article 7(c)) have time limits, but not for *"serious economic and financial disturbance"* (Article 7(b)), nor if an Adherents' *"economic and financial situation justifies"* (Article 7(a)). Over the last 5 years, two Adherents have invoked Article 7 (b).

32. The resort to derogation for balance of payments (Article 7(c)) and for economic and financial disturbance (Article 7(b)) is well tested for cases of temporary departures from standstill obligations⁵, and there is precedent for long-lasting derogations justified under the *"economic and financial situation"* clause (Article 7(a)) for countries in process of development. However, the use of Article 7 to introduce preventive measures to deal with capital inflow surges that may threaten stability or to cover a measure introduced for an indeterminate time period and intended as a permanent feature of the financial regulatory regime, are not tested practices that are supported by precedent.

3.4 Macro-prudential measures generally fall outside the scope of the Code

33. The vast majority of macro-prudential measures (MPMs) simply fall outside the scope of the Code, even those that may have an incidence on capital flows. For a measure to have a bearing on the Code's obligations, it does not suffice that it have an impact on capital flows or capital mobility; measures which do not target the specific operations covered by the Code –by either prohibiting such operations or creating disincentives for their conclusion– fall outside of the scope of the agreement. MPMs such as Basle minimum capital requirements for internationally active banks impinge on all bank operations, do not create impediments or specific disincentives for operations listed under the Code, are typically not capital flow measures and have no bearing on Code obligations of Adherents. They are rather set regulatory requirements to manage the risk of operations for the bank's capital.

34. Operations among residents also fall outside the scope of the Code, as they are not covered by liberalisation obligations under lists A and B. Thus a measure targeting such operations, e.g. a prohibition for established banks to lend in foreign currency to residents, falls outside the scope of the Code. Such internal measures can have an impact on capital flows but have no bearing on Code obligations.⁶ In contrast, the IMF's approach may cover such measures, as they may be tools used to manage capital flows. This is an example of the distinct and complementary approaches of the IMF and OECD, pursuant to their respective mandates.

35. Some MPMs, including in particular some which are CFMs, would be considered conforming measures from the viewpoint of the Code. These are measures which limit, create impediments or disincentives for the conclusion of a listed operation but that are not covered by liberalisation obligations under lists A and B. These measures are

⁵ These clauses have been used 30 times since 1961.

⁶ Except to the extent that such internal measures can be shown to frustrate liberalisation commitments, see section 2.2.

conforming due to carve-outs in text of the Code, or as a result of explicit understandings reached among Adherents, notably measures commonly used by Adherents to address prudential issues. An example of such a carve-out in the text of the Code is the exclusion of financial credits and loans provided by non-residents to residents other than enterprises from the list of operations covered by the Code's liberalisation obligations. Rules for the net foreign exchange position of banks are carved-out by an understanding among Adherents.

36. Finally, some CFMs do fall in the category of restrictive measures which impede or create disincentives for the conclusion of operations covered by liberalisation lists A or B. Such measures may be maintained by members which have limited the scope of their commitments under the agreement by lodging of reservations or by invocation of derogation. An Adherent may still be in conformity with the Code, provided that the Adherent in question respects the procedural requirements.

37. In sum, the vast majority of MPMs fall outside the scope of obligations, while many CFMs that are MPMs are conforming measures. Even for those which are not, Adherents which maintain measures constituting restrictions can always avail themselves of the reservation and derogation facilities. While reservations and derogations cannot be made with respect to the basic principles of the Code, as set out in its Articles, this is unlikely to impose any constraint on the introduction of prudential regulations.⁷

38. Furthermore, there is scope for narrowing the scope of the Code to accommodate the need to regulate: this has been done by explicit specific carve-outs in the text of the Code, or by limiting the scope of further understandings reached among Adherents that are formalised in decisions of the Investment Committee. This practice has been used for internationally agreed regulatory standards and provides a mechanism to avoid creating conflicting requirements for countries that have obligations under the Code and are also committed to internationally agreed minimum standards for financial regulation.

39. Table 1 provides an illustrative list of possible CFMs which the IMF and the OECD consider to also be MPMs together with explanations on how these measures are currently assessed under the Code.

4. OBLIGATIONS FOR OPERATIONS IN FOREIGN CURRENCY AND USE OF FOREIGN CURRENCY

40. The Code does not cover operations among residents. A key test is non-discrimination in the treatment of non-residents relative to the treatment afforded to residents, but the Code also includes other specific liberalisation commitments.

41. Under Article 2 “[W]henver existing regulation or international agreements permit loans between different Members [...] the repayment obligation may be expressed or guaranteed in the currency of either of the two Members concerned”.

⁷ For example, a measure is not conforming under the Code if it violates the MFN principle under Article 9 of the Code; this discipline of the Code is unlikely to be an impediment to the implementation of needed financial regulations. The obligation under Art 2(d) to allow loans between residents of two adhering countries to be “*expressed or guaranteed*” in the currency of either country, where such loans are allowed, can be seen to be in the nature of a commitment to avoid conflicting requirements that would frustrate a liberalisation measures, rather than a commitment to liberalisation in itself.

42. Furthermore, under item XII of Liberalisation List B, members –subject to reservation (see section 3.1) which they may have lodged– commit to permit their residents to freely buy and sell domestic currency for foreign currency and to exchange currencies, by means of spot or derivative transaction, when the operation takes place abroad.

43. The 1992 review of the Code’s obligations led to enlarged obligations on use of foreign currency in denomination and settlement. At that time, members agreed on the following, as reported in Council document C(92)4:

“{3. Use of foreign currency in denomination and settlement}

35. One of the innovations of the Revised Code is to provide that all the operations are to be liberalised regardless of the currency in which they are denominated or settled. This includes currency composite units of account such as the ECU and the SDR.

36. In the sense of the Codes, the Committee took this to imply that non-residents in dealing with residents on the territory of residents should have access to the same facilities and can use the same foreign currencies that residents are permitted to use for domestic operations.

37. Similarly, residents should be permitted to use, in respect of operations abroad in another OECD Member country, any currency that may be used in the Member country concerned for the transactions in question.

38. Where operations have no natural domestic counterpart (e.g. Sections VIII to XII of the Revised Code), Members should be able to use any foreign currency for the denomination or settlement of those operations”.

5. THE CODE IN RELATION TO OTHER INTERNATIONAL OBLIGATIONS AND G20 AND IMF APPROACHES

44. The EU Treaty provisions have much in common with the Code but the membership is regional. They require free capital movements among EU countries and between EU countries and third countries. Many investment chapters of regional free trade agreements (FTAs) and bilateral investment treaties (BITs) use a broad definition of inward international investment. However, unlike the Code, they do not cover capital outflows by residents. In addition, while the Code provides for liberalisation of entry of new investments, most BITs protect only existing investments. The GATS includes some elements of capital movement liberalisation, but only insofar as a capital movement is needed for the effective delivery of a service. If, for instance, a foreign services provider wants to deliver a service by means of a commercial presence in a country, it should have the ability to move capital to establish a subsidiary or a branch in this country. But, unlike the OECD Code, the GATS is not a code of conduct for capital movements.

45. The Code has been designed to ensure consistency with other international obligations of adhering countries, including the IMF’s Articles of Agreement. The IMF’s Articles do not impose an obligation on member countries to liberalize their capital account policies, while recognizing that members have the right (albeit not unlimited) to “exercise such controls as are necessary to regulate international capital movements.” The IMF’s institutional view on the liberalisation and management of capital flows does not alter members’ rights and obligations under the Articles or under other international agreements. The IMF has explained that rather, the IMF would take into account the institutional view in its policy advice and where relevant, in assessing members’ capital account policies, particularly in its surveillance and that the institutional view also serves to facilitate consistency and evenhandedness in IMF staff advice on the appropriateness of such policies, taking into account country circumstances and macroeconomic and financial stability considerations.

46. The Code and the IMF's Institutional View do not create conflicting requirements. Rather, as stated in the joint note of February 2016 by the IMF and the OECD to the G20 International Financial Architecture Working Group⁸, both [IMF and OECD] approaches assist countries in ensuring that measures are not more restrictive or maintained longer than necessary. The economic usefulness of maintaining CFMs over the longer term for managing systemic financial risks needs to be evaluated against their costs on an ongoing basis, and due consideration given to alternative ways that may be available to address the prudential concern that are not designed to limit capital flows. While the appropriateness of CFMs including those used with a macro-prudential intent depends on specific country circumstances that vary over time, features of CFMs recommended by the two institutions include: no substitute for warranted macroeconomic adjustment, transparency and temporary use of the measure, its proportionality relative to the objective pursued, and no discrimination between residents and non-residents to the extent possible and among countries in its application, being mindful of the rights and obligations of the country under international agreements it may have entered into, including the IMF's Articles of Agreement and the OECD Code.

47. The Code echoes and supports implementation of the G20 Coherent Conclusions for the Management of Capital Flows Drawing on Country Experiences (2011) that calls for CFMs to be "transparent, properly communicated, and be targeted to specific risks identified" and includes CFMs among the category of policies that "should be the object of regular, credible and even-handed multilateral surveillance to assess both their individual impact and aggregate spillover effects."⁹

⁸ See also [Co-operation on approaches to macro-prudential and capital flow management measures](#), *IMF/OECD update to G20*, September 2015

⁹ See also [OECD's approach to capital flow management measures used with a macro-prudential intent](#), *Report to G20 Finance Ministers*, April 2015

TABLE 1. SELECTION OF CAPITAL FLOW MANAGEMENT MEASURES (CFMS) THAT ARE ALSO MACRO-PRUDENTIAL MEASURES (MPMS)¹

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment ²	IV. OECD Assessment ³
1	Limit	<p>Limit on banks' foreign exchange derivative contracts set as a percentage of bank capital.</p> <p>The measure increases the cost of derivative transactions, thereby limiting banks' reliance on short-term external funding.</p> <p>Measure introduced in the context of capital flow volatility and limits the systemic impact of large movements in capital flows. The measure mitigates systemic liquidity risks associated with banks' reliance on FX funding and volatile capital inflows.</p>	<p>The measure is an MPM because it limits banks' reliance on short-term external funding and the exposure of the financial sector to systemic liquidity risks associated with a sudden stop in capital flows. Although the measure does not discriminate on the basis of residency, given the circumstances, including the announced objective, it is nonetheless designed to limit capital flows. Therefore, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the section on liquidity tools, para 135 of the detailed staff guidance note on macro-prudential policy instruments.</p>	<p>The measure has a bearing on Code obligations only to the extent that it extends to operations carried-out abroad by resident banks, in which case it has a bearing on obligations established under Liberalisation List B, item XII. Operations in foreign exchange. B. Abroad by residents.</p> <p>Adherents may limit the scope of their Code obligations under List B at any time by lodging a reservation.</p> <p>See OECD's Background Note, section 5: "Illustrative examples", for further details on this measure.</p>

Notes

1. This table is an illustrative list of possible measures that can be considered as both CFMs and MPMS, and is not a recommended or exhaustive list. The description and purpose of the measures provided under column II focuses on their use as CFMs/MPMS.
2. The IMF approach for assessing whether a particular measure is a CFM and an MPM is based on "[The Liberalization and Management of Capital Flows: An Institutional View](#)" and "[Key Aspects of Macro-prudential Policy](#)" and the associated staff guidance notes, including the "[Staff Guidance Note on Macro-prudential Policy—Detailed Guidance on Instruments.](#)" A measure is considered as both a CFM and an MPM when it is designed to limit capital flows in order to reduce systemic financial risk stemming from such flows. In practice, the IMF assessment of such measures has been guided by the provisions noted in the table, and also depends on country-specific circumstances, including the overall context in which the measure was implemented. Such measures can have a role in supporting macroeconomic policy adjustment and safeguarding financial system stability in certain circumstances, such as in response to capital inflows: (i) when the room for adjusting macroeconomic policies is limited; (ii) when the needed policy steps require time, or when the macroeconomic adjustments require time to take effect; (iii) when an inflow surge raises risk of financial system instability; or (iv) when there is heightened uncertainty about the underlying economic stance due to the surge.
3. The assessment of a specific country measure is guided by its bearing on the operations covered by the Code. Specifically, measures are to be assessed in a meeting of the Investment Committee on the basis of adherents' obligations under the Code, notably under Article 2 of the [Code of Liberalisation of Capital Movements](#) to grant any authorisation required for the conclusion and execution of transactions and for transfers set out in liberalisation lists A and B. The further understanding among members on measures equivalent to restrictions extends liberalisation commitments to include measures which constitute disincentives for the conclusion of operations covered by the Code (see [Users' Guide](#): Measures constituting restrictions).

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment ²	IV. OECD Assessment ³
2	Limit	<p>Limit on the daily balance of banks' short-term (up to one year) liabilities to nonresidents set as a percentage of bank capital.</p> <p>The measure increases the cost of banks' use of short-term funding from non-residents beyond a set limit.</p> <p>The measure contains systemic liquidity risk by reducing banks' reliance on short-term external funding and indirectly dampens excessive credit growth funded by capital inflows.</p>	<p>The measure is an MPM because it increases the cost of banks' reliance on short-term external funding, thereby limiting excessive credit growth and the exposure of the financial sector to systemic liquidity risks associated with a sudden stop in capital flows. Since the measure discriminates between resident and nonresident lenders, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the section on liquidity tools, para 135 of the detailed staff guidance note on macro-prudential policy instruments.</p>	<p>The measure has a bearing on Code obligations under:</p> <ul style="list-style-type: none"> • Liberalisation List A <ul style="list-style-type: none"> - item XI. Operation of deposit accounts. A. Operation by non-residents of accounts with resident institutions. <p>Adherents may limit the scope of their Code obligations under List A by lodging a reservation only when obligations are added, extended or begin to apply. Adherents may invoke a derogation to suspend their obligations, subject to additional review and reporting requirements (see OECD's Background Note).</p> <ul style="list-style-type: none"> • Liberalisation List B <ul style="list-style-type: none"> - item V. Operations on money markets. D. Operations abroad by residents. - item VI. Other operations in negotiable instruments and non-securitised claims. D. Operations abroad by residents. - item IX. Financial credits and loans. A. Credits and loans granted by non-residents to residents. <p>Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.</p>
3	Tax	<p>Additional buyer's stamp duty on purchases of certain categories of residential property levied at a higher rate for nonresidents than residents.</p> <p>The measure mitigates the build-up of systemic risk stemming from capital flows to an overheating property market. By increasing the costs of purchase of residential property particularly for nonresidents, the measure reduces non-residents' housing demand.</p>	<p>The measure is an MPM because by limiting the inflow of foreign capital into the domestic property market, it reduces the systemic risk associated with property price corrections when these inflows recede. Since the measure discriminates between residents and nonresidents, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the sections on household sector tools (para 71) and corporate sector tools (para 90) of the detailed staff guidance note on macro-prudential policy instruments.</p>	<p>The measure affects non-residents' purchase of real estate in the country introducing the measure and as such has a bearing on Code obligations under List B, item III. Operations in real estate. A. Operations in the country concerned by non-residents. 1. Building of purchase.</p> <p>Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.</p>

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment ²	IV. OECD Assessment ³
4	Tax	<p>Bank levy on non-deposit FX liabilities with maturities shorter than one year.</p> <p>The measure increases the cost of short-term non-core FX funding.</p> <p>Measure was introduced in the context of capital flow volatility and limits the systemic impact of large movements in capital flows. The measure mitigates systemic liquidity risk associated with banks' excessive reliance on short-term non-core FX funding and volatile capital flows.</p>	<p>The measure is an MPM because it limits banks' reliance on short-term external funding and the exposure of the financial sector to systemic liquidity risk associated with a sudden stop in capital flows. Although the measure does not discriminate on the basis of residency, given the circumstances, including the announced objective, it is nonetheless designed to limit capital flows. Therefore, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the section on liquidity tools, para 135 of the detailed staff guidance note on macro-prudential policy instruments.</p>	<p>To the extent that the measure limits the freedom for residents to freely decide on the use of currency for denomination and settlement of operations with non-residents, the measure has a bearing on Code obligations under:</p> <ul style="list-style-type: none"> • Liberalisation List B <ul style="list-style-type: none"> - item V. Operations on money markets. D. Operations abroad by residents. - item VI. Other operations in negotiable instruments and non-securitised claims. D. Operations abroad by residents. - item IX. Financial credits and loans. A. Credits and loans granted by non-residents to residents. <p>Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.</p> <p>Specific measures may also have a bearing on operations covered by Item X, Sureties, guarantees and financial back-up facilities of the General List, with items falling under both liberalisation lists.</p>
5	Reserve requirement	<p>A reserve requirement on domestic banks' foreign currency swap and forward transactions with nonresidents.</p> <p>The measure increases the cost to domestic banks of foreign currency swap and forward transactions with nonresidents.</p> <p>The reserve requirement mitigates systemic liquidity risk related to increasing currency and maturity mismatches on banks' balance sheets driven by short-term capital inflows.</p>	<p>The measure is an MPM because it limits systemic liquidity risks related to increasing currency and maturity mismatches on banks' balance sheets caused by short term capital inflows. Since the measure discriminates between residents and nonresidents, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the section on liquidity tools, para 135 of the detailed staff guidance note on macro-prudential policy instruments.</p>	<p>The measure has a bearing on Code obligations only to the extent that it extends to operations carried-out abroad by resident banks, in which case it has a bearing on obligations established under:</p> <ul style="list-style-type: none"> • Liberalisation List B <ul style="list-style-type: none"> - item XII. Operations in foreign exchange. B. Abroad by residents. - item VI. Other operations in negotiable instruments and non-securitised claims D. Operations abroad by residents. To the extent that swaps contain also an interest rate element. - item VI. Other operations in negotiable instruments and non-securitised claims C. Operations in the country concerned by non-residents. To the extent that swaps contain also an interest rate element and that residents are allowed to carry-out such operations. <p>Adherents may limit the scope of their Code obligations under List B at any time by lodging a reservation.</p>

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment ²	IV. OECD Assessment ³
6	Reserve requirement	<p>A reserve requirement on banks' credit lines and other external obligations with nonresidents of three years or less in maturities.</p> <p>The measure increases the cost of banks' reliance on external funding.</p> <p>The reserve requirement prevents the build-up of systemic risk associated with FX lending in the context of a highly dollarized economy and strong capital inflows.</p>	<p>The measure is an MPM because it increases the cost of banks' reliance on external funding and the exposure of the financial sector to systemic risks associated with currency mismatches on banks' balance sheets and a sudden stop in capital flows. Since the measure discriminates between resident and nonresident lenders, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the sections on tools that target foreign exchange loans (para 109) and liquidity tools (para 135) of the detailed staff guidance note on macro-prudential policy instruments.</p>	<p>The measure has a bearing on Code obligations under:</p> <ul style="list-style-type: none"> • Liberalisation List A <ul style="list-style-type: none"> - item IV. Operations in securities on capital markets. D. Operations abroad by residents. - item XI. Operation of deposit accounts. A. Operation by non-residents of accounts with resident institutions. <p>Adherents may limit the scope of their Code obligations under List A by lodging a reservation only when obligations are added, extended or begin to apply. Adherents may invoke a derogation to suspend their obligations, subject to additional review and reporting requirements (see OECD's Background Note).</p> <ul style="list-style-type: none"> • Liberalisation List B <ul style="list-style-type: none"> - item V. Operations on money markets. D. Operations abroad by residents. - item VI. Other operations in negotiable instruments and non-securitised claims. D. Operations abroad by residents. - item IX. Financial credits and loans. A. Credits and loans granted by non-residents to residents. <p>Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.</p> <p>Specific measures may also have a bearing on operations covered by Item X, Sureties, guarantees and financial back-up facilities of the General List, with items falling under both liberalisation lists.</p>