GAIDAR FORUM

THE OECD CODE OF LIBERALISATION OF CAPITAL MOVEMENTS

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BETTER POLICIES FOR BETTER LIVES

The Context

Communiqué by the G20 Finance Ministers and Central Bank Governors in Baden Baden, 18 March 2017:

- "A number of non-OECD G20 members have declared their intention to join the OECD Code of Liberalisation of Capital Movements starting already the process of adherence this year."
- "Those G20 countries that have not yet adhered to the Code are encouraged to participate voluntarily in the current review and to consider adhering to the Code, taking into consideration country-specific circumstances."

The Code as an instrument for progressive liberalisation

- Adopted in 1961 as an OECD Council Decision to:

Article 1. "... progressively abolish ....

.... restrictions on movements of capital"

Code of Liberalisation of Capital Movements (CLCM)

The Code is the only binding multilateral agreement (among 35 countries, including twelve G20 members) covering international capital movements, short-term and long-term, inflows and outflows.

The liberalisation list of the Code

- I & II: Foreign Direct Investment
- III: Real Estate
- IV: Capital Markets (shares and bonds)
- V: Operations on Money Markets
- VI: Negotiable Instruments and Non—Securitised Claims
- VII: Collective Investment Securities
- VIII: Commercial loans
- IX: Financial loans
- X: Sureties, Guarantees and Financial Back-up Facilities
- XI: Operation of Deposit Accounts
- XII: Operations in Foreign Exchange
- XIII: Life assurance (transfers only)
- XIV: Personal Capital Movements
- XV: Physical Movement of Capital Assets
- XVI: Disposal of Non-Resident owned Blocked Funds

The Code as an instrument for international cooperation

- **Liberalisation in a multilateral setting**

Overall an open multilateral regime for international capital flows serves the global economy better than closed capital accounts.

- **and at a pace that takes into account individual country circumstances**

But there is no presumption that full liberalisation is an appropriate goal for all countries at all times. An adhering country should benefit from the liberalisation measures of other adhering countries regardless of its own degree of openness (i.e. making reciprocity a condition for liberalisation is contrary to the Code).

- **Role for dialogue and cooperation on capital flow measures**

While capital controls can play a role in specific circumstances, international co-operation is important. An unilateral approach to controls can have negative spill-overs and invite countermeasures.

Benefits for an individual country

You get support and recognition of the peers for your actions

The peers owe you transparency in their measures

You send reassuring signals to the market at times of turbulence

You enjoy others' liberalisation measures regardless of your own degree of openness

You can seek redress in case of unfair treatment

You shape the jurisprudence and evolving rules under the Code

Scope of obligations

Freedom to complete listed operations

Operation = transaction + associated transfers and payments

Only operations between residents and non-residents

- In **domestic markets**, key criteria is non-discrimination vis-a-vis non-residents compared with residents operating in domestic market in like circumstances.
- In **markets abroad**, key criteria: freedom for residents when abroad to carry out operations covered by the Code under rules of foreign jurisdiction
- **Freedom of choice of currency** for denomination and settlement for operations between residents and non- residents

Flexibility through the reservation system

Article 2:

"…   *A Member may lodge* ***reservations*** *relating to the obligations … when: …*

iii) obligations relating to any such item begin to apply to that Member; or

iv) ***at any time, in respect of an item in List B***"

Over the last 5 years two countries have availed themselves of "List B" right

Flexibility through derogation

Article 7: **Derogation clauses**

"b. If any measures of liberalisation…result in serious economic and financial disturbance in the Member State concerned, that Member may withdraw those measures.

c. If the overall balance of payments of a Member develops adversely at a rate and in circumstances …which it considers serious, that Member may temporarily suspend the application of measures of liberalisation taken or maintained …"

Over the last 5 years, two countries have invoked these clauses

Exemptions through understandings

Adherents have agreed to exclude certain types of measures from the scope of their Code obligations, including:

Government operations for its own account

- Privatisation
- Primary placement of government securities
- Rules regarding operations/transactions reserved to the State

Rules on the net foreign exchange exposure of banks are exempt

Other safeguards

- **National security** *[Art. 3]*

“The provisions of this Code shall not prevent a Member from taking action which it considers necessary for:

i) the maintenance of public order or the protection of public health, morals and safety;

ii) the protection of its essential security interests;

iii) the fulfilment of its obligations relating to international peace and security.”

- **Controls and formalities** *[Art. 5]*

“a. The measures of liberalisation provided for in this Code shall not limit the powers of Members to verify the authenticity of transactions or transfers nor to take any measures required to prevent evasion of their laws or regulations.”

- **Authorised agent rules**

Members may require that transactions and transfers be effected through **“authorised agents”**

Due process

Articles 11 – 17: **Procedural rules**

- **Mutual transparency**:

  → notification of liberalisation steps and of new measures

- **Mechanism for dialogue and peer review**:

  → examination of derogations and reservations

  → thematic peer reviews

  → common understandings on conforming practices

Agreed "protocol" in case of re-introduction of capital flows restrictions (1)

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.

Agreed “protocol” in case of re-introduction of capital flows restrictions (2)

- 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.

Macro-prudential measures typically fall outside the scope of the Code

- **Basle minimum requirements** for banks are not covered
- 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 special disincentives for their conclusion **fall outside of the scope of the agreement.**
- Non-resident financial lending to non-corporate residents has been excluded from the Code’s liberalisation list of operations

However, some capital flow measures with a declared macro-prudential intent, typically targeting only one side of banks' balance sheets, may fall in the category of restrictive measures

- 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

IMF-OECD examples of Capital Flow Management Measures that are also Macro-prudential Measures (1/3)

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment[2]	IV. OECD Assessment[3]
1	Limit	Limit on banks' foreign exchange derivative contracts set as a percentage of bank capital. The measure increases the cost of derivative transactions, thereby limiting banks' reliance on short-term external funding. 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.	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. 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 macroprudential policy instruments.	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. Adherents may limit the scope of their Code obligations under List B at any time by lodging a reservation. See OECD's Background Note, section 5: "Illustrative examples", for further details on this measure.
2	Limit	Limit on the daily balance of banks' short- term (up to one year) liabilities to nonresidents set as a percentage of bank capital. The measure increases the cost of banks' use of short-term funding from non- residents beyond a set limit. 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.	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. 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 macroprudential policy instruments.	The measure has a bearing on Code obligations under: • Liberalisation List A - item XI. Operation of deposit accounts. A. Operation by non-residents of accounts with resident institutions. 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). • Liberalisation List B - 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. Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.

IMF-OECD examples of Capital Flow Management Measures that are also Macro-prudential Measures (2/3)

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment2	IV. OECD Assessment3
3	Tax	Additional buyer's stamp duty on purchases of certain categories of residential property levied at a higher rate for nonresidents than residents. 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.	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. 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 macroprudential policy instruments.	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. Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.
4	Tax	Bank levy on non-deposit FX liabilities with maturities shorter than one year. The measure increases the cost of short- term non-core FX funding. 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.	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. 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 macroprudential policy instruments.	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: ● Liberalisation List B - 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. Adherents may introduce such measures, covered by List B, at any time by lodging a reservation. 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.

IMF-OECD examples of Capital Flow Management Measures that are also Macro-prudential Measures (3/3)

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment2	IV. OECD Assessment3
5	Reserve requirement	A reserve requirement on domestic banks' foreign currency swap and forward transactions with nonresidents. The measure increases the cost to domestic banks of foreign currency swap and forward transactions with nonresidents. The reserve requirement mitigates systemic liquidity risk related to increasing currency and maturity mismatches on banks' balance sheets driven by short-term capital inflows.	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. 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 macroprudential policy instruments.	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. 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. Adherents may limit the scope of their Code obligations under List B at any time by lodging a reservation.
6	Reserve requirement	A reserve requirement on banks' credit lines and other external obligations with nonresidents of three years or less in maturities. The measure increases the cost of banks' reliance on external funding. 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.	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. 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 macroprudential policy instruments.	The measure has a bearing on Code obligations under: Liberalisation List A 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. 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). Liberalisation List B item V. Operations on money markets. D. Operations abroad by residents.

Relation with G20 and IMF Institutional View

The Code approach is **consistent with and a contribution to implementing the G20 Coherent Conclusions** for the Management of Capital Flows, which recognise the overlap between CFMs and macro- prudential policies.

Indeed, the G20 Coherent Conclusions call for CFMs to be "*transparent, properly communicated, and be targeted to specific risks identified. In order to respond properly to the specific risks identified, capital flow management measures should be regularly reviewed by national or regional authorities as appropriate*"

and include CFMs among the category of policies that *"should be the object of regular, credible and even-handed multilateral surveillance to assess both their individual and aggregate spillover effects."*

- and **complementary with the IMF Institutional View**

IMF-OECD update to G20 IFA WG, Feb. 2016

- ***“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.”***.**

IMF-OECD update to G20 IFA WG, Feb. 2016

- *"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".***

Adherent countries are expected to fulfil the following three core principles:

NON-DISCRIMINATION: Grant the benefit of their liberalisation measures to all other adherents and apply remaining restrictions in a non-discriminatory (MFN) fashion.

TRANSPARENCY: Report up-to-date information on barriers to capital movements which might affect the Code's obligations and the interests of other adherents.

STANDSTILL: Avoid taking new restrictive measures or introducing more restrictive measures except in accordance with the Code's derogation provisions and other safeguards or with established understandings regarding their application.

Prospective adherents are expected to

- avoid the lodging of ‘precautionary’ reservations under the Code (reservations reflect existing operative restrictions);
- maintain an open and transparent regime for FDI (restrictions are best understood when they concern sectors where restrictions are not uncommon in other countries);
- liberalise other long-term capital movements, including equity investment and debt instruments of a maturity of one year or more;
- indicate a non-binding timetable or expected conditions for relaxing remaining controls on short-term capital movements;
- avoid restrictions on payments or transfers in connection with international current account transactions; comply with IMF Article VIII requirements.

Examples: the cases of Mexico (April 1994) and Korea (December 1996)

Mexico: List of Reservations to the Code of Liberalisation of Capital Movements (C(94)49-FINAL)

Korea: List of Reservations to the Code of Liberalisation of Capital Movements (pages 42-56 of document C(96)256)

Governance of the Code

The Code is governed by the OECD Investment Committee which considers all matters concerning the operation of the Code. The Committee acts as a forum for discussion and exchange of information, considers questions of interpretation of its legal provisions, reviews country measures and assesses their conformity with the Code's obligations.

The OECD Council has decided to enlarge the Investment Committee to include participation of countries adherents to the Code that are not OECD members, with equal rights and responsibilities. The enlarged Investment Committee has been given the authority to take all final decisions concerning the Code of Liberalisation.

Inclusive governance of the Code (1)

Article 20, as amended in 2012

"In this Code:

"Member" shall mean a country which adheres to this Code…"

Non-OECD countries can adhere to the Code with equal rights and responsibilities as OECD countries.

Inclusive governance of the Code (2)

Should the existing text of the Code need to be amended, the amendment decision would need to be agreed both in the enlarged Investment Committee and in Council. This "double consensus rule" also applies to the decision to invite an additional country to adhere to the Code.

Accordingly, no decision regarding the Code can be made without the consent of adherents that are not members of the OECD.

The Code is going through a review (1) - Why now?

- *Non-OECD emerging economies moving toward full capital account liberalisation as a long-term goal. Time to share national experiences*

- *Renewed interest in CFMs in the aftermath of the GFC and at this current turbulent juncture. International dialogue and "conflict avoidance device" such as the Code needed*

- *Code now open to adherence by non-OECD countries*

The Code is going through a review (2) - areas of special attention

I. Reaffirm the broad scope of the Code

- *currency-based restrictions extended to operations with non-residents*

II. Clarify the treatment of measures taken in the name of "macro-prudential" objectives

- *no presumption that Basel III-type liquidity standards differentiated by currency and regulations applicable to domestic banks' lending operations such as Loan-to-Value ratios, which extend to non-resident borrowers in the same manner as to residents, are capital flow restrictions*

Review of the Code (2) - areas of special attention

III. Consider the merits of rebalancing standstill and no-standstill lists of operations

- *non-residents' deposit accounts with domestic financial institutions as a possible candidate to be moved to the no-standstill list*

IV. Improve governance and strengthen implementation

- *support for formalising the possibility to elicit inputs from relevant international organisations to assist in informing Adherents' deliberations and decisions*

Review of the Code (3) – opportunity to strengthen the collective vision of the transparent, open and resilient economy we want

- The expert discussions on the review take place at meetings of a task force on the Code (ATFC) in Paris
- ATFC meetings are open to non-adhering G20 countries
- Next ATFC meeting: April 2018

Reports and information

Text of the Code: http://www.oecd.org/daf/inv/investment-policy/codes

Reports to the G20 FMCBG and its International Financial Architecture Working Group (on the G20 and above OECD websites):

- ✓ Cooperation on approaches to macro-prudential and capital flow management measures: Update by the IMF and the OECD, February 2016
- ✓ The OECD Code of Liberalisation of Capital Movements: Update on New developments, June 2017