



DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS

OECD INVESTMENT INSTRUMENTS

OECD Codes of Liberalisation

Forty years ago, faced with the challenge of promoting open markets everywhere whilst respecting each country's individual situation, OECD countries created a balanced framework for gradual progress towards liberalisation: the **OECD Code of Liberalisation of Capital Movements** which also covers direct investment and establishment, and the **OECD Code of Liberalisation of Invisible Operations** which covers financial and other services. While firmly committed to the central idea of open markets, the Codes build on a consultative process where understanding and persuasion have greater weight than pressure and negotiation.

In this way, the Codes have assisted OECD Member countries efficiently over many years in pursuing the aim of getting rid – for good – of unnecessary barriers to the free circulation of capital and services. Today, public interest worldwide focuses more than ever on globalisation and liberalisation issues, an interest often fraught with anxiety and distrust. The experience of progressive liberalisation under the Codes, assisted by peer reviews and discussions, serves as a useful example of reasonable and harmonious international co-operation.

Several recent publications address OECD work on the Codes of Liberalisation [www.oecd.org/daf/investment/instruments]:

- *OECD Codes of Liberalisation: User's Guide, OECD 2003*, an easily accessible summary of the Codes' principles, as well as technical commentary to the understandings and interpretations developed in their implementation.
- *Forty Years' Experience with the OECD Code of Liberalisation of Capital Movements, OECD 2002*, an account of the liberalisation process in respective OECD member countries over time.
- *OECD Code of Liberalisation of Capital Movements, OECD 2003*, this publication shows remaining restrictions in the OECD area and serves as a measure of the degree of liberalisation achieved by each member country in regard to capital movements.

The OECD Codes of Liberalisation are legal instruments which establish rules of conduct for the governments of OECD member countries. Technically, they are Decisions of the OECD Council, which are legally binding on member governments. They are, however, not a treaty or international agreement in the sense of international law, such as for instance the WTO agreements.

Today, the Capital Movements Code applies to all long- and short-term capital movements between residents of OECD countries. Coverage of cross-border trade in services by the Current Invisibles Code is

large, but not quite as comprehensive. Among the major sectors covered are banking and financial services, insurance, professional services, maritime and road transport and travel and tourism.

The main provisions of the Codes can be summarised as:

- the obligation to subscribe to the general undertaking of liberalisation. Specifically, member countries are committed to allow residents to transact freely with non-residents in any capital and financial services operations abroad. They also are committed to allow non-residents to deal with residents in any such operations when they are permitted between residents of the member concerned. The obligation to liberalise goes beyond the requirement that funds transfers to and from abroad should be free of exchange control restrictions. It also requires that the underlying transactions themselves should not be frustrated by laws, regulations or administrative approval processes;
- the right to proceed gradually towards liberalisation through a process of lodging and maintaining reservations where full liberalisation is not yet achieved. Members unable to liberalise immediately are permitted to lodge a reservation against specific operations, or items on the Codes' liberalisation lists. If a country has not lodged a reservation to a particular item, the transactions covered by this particular item are expected to be fully liberalised. This is referred to as the "top-down" approach to defining obligations as opposed to the bottom-up approach in the GATS). A full reservation means that the transaction to which it refers cannot be undertaken at all. A limited reservation means that the transaction may be permitted, subject to certain restrictions. Reservations are drafted so as to reflect as precisely as possible the restrictions still imposed. Reservations to the obligations of the Code can only be reduced or deleted but not added or extended.
- the obligation not to discriminate among OECD members. The only exception concerns provisions to ensure compatibility with special customs or monetary systems where faster internal liberalisation measures do not have to be extended to all OECD members automatically. The European Community has been recognised as such a special system. Reciprocity requirements affecting FDI and in place before 1986 can be maintained and are listed in Annex E of the Capital Movements Code.
- exceptions for reasons of public order and security;
- derogations from the standstill obligation for short-term capital operations¹ and, on a temporary basis, in case of serious balance of payments or financial system difficulties;
- a system of notification, examination and consultation administered by the Investment Committee. If and where a member country has decided to maintain restrictions to the free circulation of capital and services, the other member countries will be informed about the reasons why a restriction is considered necessary and may suggest alternative ways in which the country concerned can address its preoccupations.

¹ The Code 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 reintroduce 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 importance of adequate prudential regulation and supervision for orderly financial sector liberalisation is reflected in the Codes. There are references to the need for investor protection and preventing evasion of national regulation in separate remarks or supplementary explanations to certain individual sections and items. Limitations on financial institutions' net foreign exchange exposure are not viewed as restrictions, nor are reporting requirements to enable the authorities to for monitoring on an ongoing basis the risks inherent in their assets and liabilities. However, in line with the Codes' principles, it is understood that prudential regulations should not discriminate against non-resident market participants.

While the legal commitments under the Codes only apply to the OECD area, member governments have accepted to use their best efforts to extend the benefits of liberalisation to all members of the IMF.

OECD Declaration on International Investment and Multinational Enterprises

The 1976 Declaration by the Governments of OECD member countries on International Investment and Multinational Enterprises constitutes a policy commitment to improve the investment climate, encourage the positive contribution multinational enterprises can make to economic and social progress and minimise and resolve difficulties which may arise from their operations. The latest review by the OECD of Declaration and Decisions was held in 1991. All 30 OECD member countries, and eight non-member countries (Argentina, Brazil, Chile, Estonia, Israel, Latvia, Lithuania and Slovenia) have subscribed to the Declaration. Applications by several other countries are under consideration.

Several reports address OECD work on the Declaration:

- *National Treatment for Foreign Controlled Enterprises, OECD, 1993*, provides a comprehensive explanation and the nature of the National Treatment instrument of the Declaration;
- *Updating Country Exceptions under the National Treatment Instrument, 2004*, showing remaining post establishment restrictions in the OECD area and eight non-Member adherents as of June 2004 [www.oecd.org/daf/investment/instruments];
- *Annual Reports on the OECD Guidelines for Multinational Enterprises*, an account of progress and upcoming challenges in the promotion and implementation of the Guidelines [www.oecd.org/daf/investment/guidelines].

The Declaration consists of four elements, each of which has been underpinned by a Decision by the OECD Council on follow-up procedures:

- The *Guidelines for Multinational Enterprises* constitute a set of voluntary recommendations to multinational enterprises in all the major areas of business ethics, including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation. Adhering governments have committed to promote them among multinational enterprises operating in or from their territories. The instrument's distinctive implementation mechanisms include the operations of National Contact Points (NCP), which are government offices charged with promoting the Guidelines and handling enquiries in the national context. One of the NCPs' responsibilities is to contribute to the resolution of issues that arise relating to implementation of the Guidelines in specific instances. NCPs are available to assist the parties in resolving issues that may arise with respect to the activities of specific enterprises behaviour in specific business situations. NCPs also meet annually to share experiences and report to the Committee. The Committee's responsibilities include responding to requests from adhering countries on specific or general aspects of the

Guidelines, organising exchanges of views on matters relating to the Guidelines with social partners and non-Members, reviewing the Guidelines and/or the procedural Decisions so as to ensure their relevance and effectiveness, and reporting to the OECD Council on the Guidelines. The Committee is also responsible for issuing, as necessary, clarifications of the Guidelines.

- *National Treatment*: countries commit themselves to treating foreign-controlled enterprises operating on their territories no less favourably than domestic enterprises in like situations. Exceptions to National Treatment fall into five categories: (i) investments by established foreign-controlled companies, (ii) official aids and subsidies, (iii) tax obligations, (iv) access to local bank credit and the capital market, and (v) government procurement. Transparency measures include (i) measures based on public order and national security interests, (ii) restrictions on activities in areas covered by monopolies, (iii) public aids and subsidies granted to government-owned enterprises by the state as a shareholder. The National Treatment Instrument is concerned with discriminatory measures that apply to foreign-controlled enterprises after they are established, i.e. not with their right of establishment. If restrictions prohibit or impede in any way the activities of foreign-controlled enterprises, compared to domestic ones, these restrictions are to be reported as exceptions to National Treatment. If and when an official monopoly is abolished, the stipulations of the National Treatment Instruments will begin to apply to the sector formerly covered by the monopoly;
- *Conflicting requirements*: Members shall co-operate so as to avoid or minimise the imposition of conflicting requirements on multinational enterprises. This co-operative approach includes consultations on potential problems and giving due consideration to other countries' interests in regulating their own economic affairs;
- *International investment incentives and disincentives*: Members recognise the need to give due weight to the interest of Members affected by laws and practices in this field; they will endeavour to make measures as transparent as possible. . The instrument also provides for consultations and review procedures to make co-operation between adhering countries more effective. Adhering countries may be called upon to participate in studies on trends and effects of incentives and disincentives on FDI, and to provide information on their policies.

All parts of the Declaration are subject to periodical reviews. A major Review of the Guidelines was completed in June 2000.