

# GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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## SERVICES

### SUMMARY OF INFORMATION MADE AVAILABLE BY RELEVANT INTERNATIONAL ORGANIZATIONS

#### Note by the Secretariat Addendum

#### ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD)

The OECD has supplied the following information on the Codes of Liberalization of Capital Movements and of Liberalization of Current Invisible Operations.

1. The OECD countries agreed when the Organisation was established in 1960 that the free international movement of private capital flows and the removal of obstacles to the international exchange of services and current payments were desirable objectives because they would promote a more efficient use of economic resources and contribute to sound economic expansion in Member countries and non-member countries alike. Those principles were set forth in the OECD Convention and then embodied in two legal instruments adopted in December 1961 -- the Code of Liberalisation of Capital Movements and the Code of Liberalisation of Current Invisible Operations -- to which all OECD Members adhere.

#### A. The Code of Liberalisation of Capital Movements (CLCM)

2. The main objective of the Code of Liberalisation of Capital Movements (CLCM) is the progressive abolition of restrictions on capital movements between Member countries. It also requires that liberalisation measures (as well as any restrictions) be applied to all Member countries on a non-discriminatory basis. While the CLCM focuses on OECD Member countries, it recommends that those countries should endeavour to extend their liberalisation measures to all members of the International Monetary Fund.

3. The CLCM has four parts (I-IV) and four Annexes (A-D). Part I defines the undertakings of the Member countries with regard to international capital operations, including transactions and transfers, between residents and non-residents of the Member countries. Operations between residents are not covered. Part II deals primarily with procedures concerning the notification by Member countries of any measures of liberalisation or restriction that may affect their obligations under the CLCM, and the procedures for review and examination of measures requiring a dispensation from those obligations (i.e. a reservation or derogation). Part III lists the terms of reference of the Committee on Capital Movements and Invisible Transactions which is responsible for the surveillance of the application of the Code. Part IV provides the definition of certain terms such as "collective investment securities" and "recognised security market". Annex A lists the capital operations that are to be liberalised under the CLCM (see Annex I to this document).\* Annex B lists the reservations to the CLCM, i.e. the capital operations that have not yet been liberalised by each Member, and for which the Member concerned has been granted a dispensation from the obligations of the CLCM. Annex C refers to a decision under which the provisions of the CLCM do not apply to actions taken by states of the United States, but which also provides that if a Member country considers that its interests under the CLCM

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\* This document is available for consultation in the secretariat (Room 1062).

are being prejudiced by such actions, the United States Government will bring the provisions of the Code to the attention of the competent authorities of any state concerned and will inform the Organisation of the results of its efforts. Annex D contains a General List which is an attempt to establish a comprehensive catalogue of non-government operations which involve the transfer of capital from one country to another, as well as items concerning non-resident-owned blocked funds under which no such transfers take place. This list is more wide-ranging than the liberalisation obligations set out in Annex A. Both Annex A and the General List in Annex D are currently being re-examined with a view to bringing the General List up to date and strengthening the obligations of liberalisation in Annex A.

4. One of the most important capital movements covered by the CLCM is direct investment, which is defined as "investment for the purpose of establishing lasting economic relations with an undertaking such as, in particular, investments which give the possibility of exercising an effective influence on the management thereof." Moreover, the liberalisation obligations apply to "the creation, extension, acquisition of, or participation in, an enterprise, or a long-term loan (5 years or longer)". The authorities concerned must authorise automatically transactions and transfers involving international direct investment operations falling within this definition, whether to or from other OECD countries, and must allow the proceeds of investment liquidation to be re-transferred. Subject to certain limited provisions in the CLCM, this obligation is reduced only to the extent that some Member countries have a dispensation (i.e. a reservation or derogation) with respect to the relevant items of the Code (see paragraphs 9-11 below).

5. In 1984, as part of a general effort to strengthen its obligations regarding inward direct investment, the CLCM was amended to extend its coverage and explicitly to include measures or practices, including licensing or concession laws, that restrict what is generally known as the right of establishment for foreign investors. With this amendment, it has clearly been established that transactions for the purpose of inward direct investment are considered to be liberalised in a given country only if that country allows non-residents effective access to operate a corporation in any sector within the general framework for doing business in the country concerned. While not conferring on non-residents a claim to preferential treatment, the CLCM does require that Member countries avoid policies or practices that raise special barriers to non-resident as compared to resident investors.

6. The obligations of the Code do not extend to the activities of subsidiaries after establishment: these matters are covered by another OECD instrument known as the National Treatment Instrument. However, the CLCM does contain obligations on host countries to allow a non-resident parent enterprise to expand its affiliates, and to have its securities admitted to the capital markets of the country where its affiliates are located. Moreover, both the parent and its affiliates benefit from the liberalisation of other operations, such as trade credits (including those related to international service transactions), credits and loans by financial institutions, sureties and guarantees, and the physical movement of assets.

7. The obligation to liberalise direct investment, whether inward or outward, is subject to certain specific qualifications. First, Members are not required to permit investments of a purely financial character designed

only to give access to the money or financial market of another country. Second, Members are not required to allow a specific transaction if, in view of the amount involved or of other factors, it would have an exceptionally detrimental effect on the interests of the Members concerned. In the second case, however, the OECD must be notified if any transaction or transfer is restricted, and reasons for the restriction must be given; the OECD can then determine whether the Member concerned is complying with its obligations.

8. The liberalisation obligations concerning direct investment are also qualified by other provisions that apply to all the capital transactions covered by the Code. For example, the Code does not prevent Members from taking restrictive measures that are necessary for the maintenance of public order, or for the protection of essential security interests and the fulfillment of international obligations. The Code is not regarded as altering the obligations undertaken by a Member as a signatory to the Articles of Agreement of the International Monetary Fund or other, multilateral international agreements existing at the time of the Codes adoption. Nor does the Code limit the powers of Members to verify the authenticity of transactions or transfers, or to prevent the evasion of their laws and regulations in other spheres (e.g. taxation).

9. Many Member countries have not yet fully liberalised all of the operations covered by the Code. These countries have thus lodged reservations or invoked derogations in accordance with the procedures provided in the Code. The possibility of reservations or derogations provides a practical way of dealing with the situation of countries that are, for various reasons, considered to be unable to apply the liberalisation obligations in full or at all times. It should be noted in this regard that each Member remains obliged to extend its liberalisation measures to all other Members -- including those maintaining reservations or derogations -- on a non-discriminatory basis.

10. A Member is permitted to lodge a reservation to items of the Code only under specified conditions. This may be done at the time the Member adheres to the Code, or when a new item is added, or when the scope of an existing item is broadened. Reservations on some items cannot be otherwise extended or added to; they can only be withdrawn or their scope narrowed. This is true of the items dealing with inward and outward direct investment, including the liquidation of such investments. For some other items, for instance, real estate operations other than those associated with productive investment, a reservation can be entered at any time. All reservations are subject to periodic examination. The Member being examined is expected to give reasons for the reservations it wishes to maintain, and the examination is directed to making proposals designed to assist the Member to withdraw its reservations.

11. The derogation clauses may be invoked in well defined circumstances. First, a Member need not take the liberalisation measures called for under the Code if its economic and financial situation justifies such a course. At present, only two Members invoke this general derogation clause. Second, liberalisation measures may be withdrawn if they result in serious economic and financial disturbance in the Member concerned. Third, if the overall balance of payments and reserve position of a Member develops adversely in a way that the Member considers serious, that Member may temporarily suspend its liberalisation measures. In any of these circumstances, the Member invoking a derogation clause must notify the Organisation and give reasons for its action. If the Organisation considers that the invocation is justified, it

re-examines the measure at intervals until the Member terminates its derogation. If the invocation is not considered to be justified, the procedure laid down is for the Organisation to seek the Member's compliance with the Code through a process of consultation with the Member concerned. For a Member that invokes a derogation clause and that is considered to be in the process of economic development, the Organisation may grant a special dispensation from the liberalisation obligations of the Code.

12. The Committee on Capital Movements and Invisible Transactions, composed of independent experts designated by Member countries, is responsible for the surveillance of the application of the Code. This task includes, in particular, undertaking reviews of the reservations or derogations that Member countries maintain, examining in the light of changing economic and financial circumstances the justification for the maintenance of restrictive measures and, where appropriate, recommending that certain measures be relaxed or withdrawn. The Committee is responsible for the interpretation of the provisions of the Code, although final decisions on the Committee's recommendations are taken by the Council. In recent years, the Committee has also carried out several studies on the effectiveness of controls on capital movements (1).

13. The Code has facilitated a high degree of liberalisation of inward direct investment in the OECD area, and is regarded as an instrument which can be adapted to cover new issues in the area of capital movements as they emerge in relation to changing economic circumstances. Restrictions remain in several countries that represent obstacles and impediments to the ability of foreign investors to carry out business activities in certain areas. Comprehensive surveys of remaining obstacles and impediments were made in 1979 and in 1982 and the results of the most recent survey, including an expanded coverage of obstacles and impediments, should be available shortly. But, in accordance with the progressive liberalisation process that the Code promotes, these have been considerably reduced over the years. Furthermore, the Code and the liberalisation process associated with it are such that results in this direction, once achieved, tend to take root and become very difficult to dislodge.

#### B. The Code of Liberalisation of Current Invisible Operations (CLIO)

14. The Code of Liberalisation of Current Invisible Operations (CLIO) calls on Members to eliminate restrictions on a wide range of current invisible transactions and transfers. In parallel with the CLCM, the CLIO requires that all measures of liberalisation (or restriction) be applied to all Member countries on a non-discriminatory basis and, while the obligations apply strictly only between OECD Member countries, it recommends that those Members should endeavour to extend their liberalisation measures to all members of the International Monetary Fund. Similarly, the liberalisation obligations of the CLIO relate to international invisible transactions between residents and non-residents; transactions between residents (even if one of the residents is

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1. Experience with Controls on International Portfolio Operations in Shares and Bonds, OECD, 1980; and Experience with Controls on International Financial Credits, Loans and Deposits, OECD, 1982.

an affiliate of a foreign company) are not covered. The CLIO contains detailed provisions similar to those of the CLCM with respect to non-discrimination, public order and security, obligations in existing multilateral international agreements.

15. Like the CLCM, the CLIO is set out in four parts and four Annexes. The four parts of the CLIO -- which contain Members' obligations (Part I) procedures for notification, review and examination of measures of liberalisation, reservations and derogations (Part II), the terms of reference of the Committee on Capital Movements and Invisible Transactions (Part III) and, definitions (Part IV) -- are similar, though not identical to, the provisions of Parts I-IV of the CLCM. Annex A of the CLIO (see Annex II to the present document)\*sets out the list of current invisible operations that are to be liberalised under the following ten headings: business and industry, foreign trade, transport, insurance, films, income from capital, travel and tourism, personal income and expenditure, public income and expenditure, and general, i.e. advertising, professional services, registration of patents and trademarks, etc. The liberalisation obligations for some of these items are complemented by more detailed provisions set out in sub-annexes to Annex A. These additional provisions concern invisible operations in insurance, air transport, the international movement of bank-notes and traveller's cheques, exchange of means of payment by travellers, the use of cash cards and credit cards abroad, and films. Annex B lists the reservations to the CLIO. Annexes C and D refer to two decisions regarding the application of the provisions of the CLIO to actions taken respectively by states of the United States and provinces of Canada. Concerning the United States, the decision provides that, if a Member country considers that its interests under the CLIO are being prejudiced, the United States Government undertakes to bring the provisions of the Code to the attention of the competent authorities concerned. In the case of Canada, the decision takes note of the undertaking of the Canadian Government to carry out the provisions of the Code to the fullest extent compatible with the constitutional system of Canada.

16. The Committee on Capital Movements and Invisible Transactions (the CMIT Committee) periodically reviews the position of Member countries under the CLIO in general examinations of the remaining reservations and in examinations of any derogations invoked by Member countries. Moreover, in recent years, the Committee has undertaken an extensive review of the CLIO with a view to updating and strengthening its liberalisation obligations. In co-operation with other OECD Committees with expertise in the sectors concerned, the CMIT Committee has made considerable progress in the areas of insurance, tourism and travel, audiovisual works (formerly "films") and banking and related financial services, and preparatory work has been done on maritime transport. In regard to tourism and travel, for example, the decision was taken in 1985 to extend the CLIO provisions, in particular, to increase substantially the amounts of domestic and foreign bank-notes that travellers can carry abroad without need for justification, and to provide for the unlimited use of credit cards for tourism purposes. New provisions have been adopted also for insurance. In both of these sectors, the next step will be to examine Members' positions vis-à-vis the new obligations under the CLIO with a view to extending liberalisation measures by Member countries in the sectors concerned.

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