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THE OECD EXPERIENCE WITH CAPITAL ACCOUNT LIBERALIZATION

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I. INTRODUCTION

Since the late 1980s a number of developing countries have pursued rapid capital account liberalization. Some of them have done so in a broader context of economic reforms. In most cases the "big-bang" approach of simultaneous reforms was adopted, thus departing from the conventional wisdom which recommended that reforms should be sequenced, with capital account liberalization occurring last (McKinnon, 1991; Williamson and Mahar, 1998).

The financial crises of the 1990s, resulting in severe developmental costs, have demonstrated the inconvenience of fast and deep capital account liberalization, particularly among emerging economies. Concerns have become widespread about the appropriateness of full capital account convertibility. There is a growing view that not only should capital account

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liberalization come last – as the conventional wisdom advocates – but that it should be gradual and sequenced. Furthermore, for certain developing countries full capital account liberalization may not be desirable for a very long time.[1]

Mexico and the Republic of Korea and, to a lesser extent, the Czech Republic figured among those emerging economies that undertook rapid capital account liberalization and experienced financial crises in the 1990s. Their liberalization pattern was largely associated with their recent accession to the OECD. This was in sharp contrast with the original members of that organization, which undertook gradual liberalization of their capital accounts – over 25 years in most cases – a process that was supported by the OECD Code of Liberalization of Capital Movements. The Code provided the framework that initially gave member countries the necessary mechanism for an orderly process of liberalization. This important fact, however, is neither sufficiently known nor acknowledged.

The objective of this study is to better inform the debate on capital account convertibility. To this end, the study examines the evolution of the OECD Code of Liberalization of Capital Movements since its inception. It shows that this initially allowed for a long-term, sequenced process that took due account of the heterogeneity of OECD member countries, but that it has changed over the past two decades, with a shift in emphasis towards rapid liberalization, irrespective of countries' conditions and circumstances.

The analysis of capital account liberalization in the OECD is presented in six sections. Following this introduction, section II provides a historical background and a short description of the OECD Code of Liberalization of Capital Movements. Section III describes how the Code has evolved over time, and identifies different liberalization patterns among the OECD member countries. Section IV examines the use of instruments provided by the Code that have enabled countries to pursue different liberalization paths. Section V compares the liberalization experiences of selected countries, highlighting the dissimilarities in their liberalization approaches and the results. Section VI concludes with a discussion of the relevant lessons.

II. THE CODE OF LIBERALIZATION OF CAPITAL MOVEMENTS: HISTORICAL BACKGROUND AND INSTRUMENTS

The first years of the post-war period were marked by extensive restrictions on all sorts of balance-of-payments operations, from trade and services to capital movements.[2] Although they were part of countries' efforts to reconstruct their economies (OECD, 1993), these restrictions reflected, above all, an economic approach that asserted, as a basic value, the need to preserve autonomy in the conduct of national policies.

Initiatives towards reducing such restrictions began in the late 1940s, with European countries forming the Organisation for European Economic Co-operation (OEEC) in 1948.[3] In the subsequent two years, the OEEC member countries agreed to gradually remove restrictions on trade and current "invisible" operations, as well as to avoid new restrictions on the current account. In 1950, a Code of Trade Liberalization was established, and in 1951 it was extended to include invisible current account operations, especially those related to economic activities and international trade. Later in the 1950s, restrictions on current payments were dropped in most of the OECD countries (OECD, 1987). Recommendations to liberalize capital movements had started slowly and tentatively in the mid-1950s, leading eventually to the creation of the OEEC Code of Liberalization of Capital Movements in 1959. Its structure was similar to that of the Code for Current Invisible Operations, but with a narrower scope regarding the sorts of operations to be liberalized.

In December 1961, the year when the OECD was created,[4] the existing Codes were adapted to form the OECD Code of Liberalization of Current Invisible Operations and the OECD Code of Liberalization of Capital Movements. According to the OECD, the latter Code was created as an agreed multilateral framework to promote capital account liberalization among the OECD member countries.[5] From its originally narrow scope, it expanded gradually over time. This implied an embedded flexibility, which permitted the OECD member countries initially to pursue a gradual liberalization of their capital account in conformity with their specific needs and circumstances. This flexibility was made possible by the existence of legal procedures – reservations and derogation – which countries used extensively in order to dictate their own liberalization path.

Countries aiming to pursue a gradual liberalization process could – and still can – lodge *reservations* (i.e. restrictions under specified rules) on items covered by the Code. A reservation can be applied when the country adheres to the Code, when a new item is included in the Code or when a specific item begins to apply to the country concerned.[6] The OECD created two lists (A and B) in order to prevent countries from keeping reservations in place even when they do not use them. For the items in list A, once such reservations are withdrawn, they cannot be imposed again. For items on list B, countries can reimpose reservations at any time. With list B, the OECD hoped that countries would be more inclined to remove reservations, as these can be reimposed in the future if need arises.

Countries can also apply *derogation*, which can be general (Article 7a) or specific (Articles 7a and 7b). General derogation is a dispensation from all operations specified in the Code, and can be applied if the country finds that its economic and financial situation justifies such a course of action, with no time specified for its removal. In the past, countries that have adopted general derogation are Greece, Iceland, Spain, Turkey and Portugal. This has permitted them to liberalize very slowly and over a long period of time, in most cases over 20 years. More recently, although formally the right to impose a general derogation still exists, countries have not used it on joining the OECD. Specific derogation can be applied in two cases: first, when a country faces economic and financial problems caused by liberalization (Article 7b), and second, when it faces serious balance-of-payments difficulties (Article 7c). The latter kind of derogation is temporary and is expected to be lifted as soon as the problems justifying its application are overcome. In principle, it is not permitted to last longer than 18 months.[7]

III. EVOLUTION OF THE OECD CODE AND PATTERNS OF LIBERALIZATION AMONG THE OECD MEMBER COUNTRIES

From its inception in the early 1960s until the late 1980s, the OECD Code of Liberalization of Capital Movements was gradually expanded (see box 1 for a detailed description of the main items of the Code and major changes over time).

In the early 1960s, the main items covered by the Code included inward foreign direct investment (FDI), long-term portfolio flows, and transactions related to business and trade. Member countries decided not to liberalize short-term operations in order to avoid balance-of-payments problems caused by speculative activities of investors, and to preserve autonomy in the conduct of their economic policy, particularly with regard to the exchange rate (Poret, 1998).

In the 1970s, an important step towards liberalization was the inclusion of collective securities in the Code. In the 1980s, inward FDI was further encouraged, with the adoption of the right of establishment and the inclusion of conditions of reciprocity. Finally, in 1989 a major step towards further liberalization was taken with the inclusion in the Code of short-term transactions in securities and inter-bank markets, short-term financial credits and loans, and foreign exchange operations (including spot and forward transactions, swaps, futures, options and other innovative instruments). The year 1989 can thus be considered a turning point; since then virtually all types of capital movements have been covered by the Code.[8] Meanwhile, most operations involving portfolio flows have been moved to list A, which, as noted earlier, implies that, once withdrawn, reservations on these operations cannot be reimposed.

Thus, gradualism was an important feature of the initial OECD approach to capital account liberalization. A second important feature was sequencing: the OECD member countries first liberalized long-term capital flows, particularly FDI,[9] followed by short-term flows, particularly short-term portfolio flows. The latter category of flows was clearly specified in the Code only in the late 1980s. Gradualism and sequencing were part of a

Box 1

ITEMS INITIALLY COVERED BY THE CODE AND MAJOR CHANGES OVER TIME

- Initially, the Code covered the following items: inward and outward long-term FDI, liquidation of non-resident-owned FDI,[1] personal capital movements (e.g. exchange authorizations to nationals and foreigners, inheritances, dowries, gifts), use and transfer of non-resident-owned funds, physical movements of securities and buying and selling of securities.[2]

- Major changes in the Code occurred in the following years: 1964, 1973, 1984 and 1989.

1964: The list was considerably expanded, to include new items: operations in real estate, credits directly linked to international commercial transactions and services, financial credits and loans, admission of securities to capital markets, sureties and guarantees, and physical movements of capital assets other than securities (see table A.1).

In addition, the existing items were better specified. For example, on direct investment, the Code permitted long-term loans (of five years or more) for the purpose of establishing lasting FDI and removed the possibility of countries restricting operations if they believed such operations to be detrimental to their interests. On physical movements of capital, the Code introduced a distinction between bonds and securities.

Furthermore, a number of items were placed in list B, such as: the trading of securities in unrecognized security markets, and credits directly linked to international transactions which are short- and medium-term (up to five years) and provided by (non-financial institutions) residents to foreigners, in addition to other outward credit flows not specified in list A.

The changes apparently reflected a desire to better discriminate between operations within each category listed in the Code so as to

Box 1 (continued)

provide countries with the flexibility to impose restrictions on certain operations, particularly those involving securities and certain kinds of credits and loans. Indeed, most of the member countries have lodged reservations on items of securities placed in list B. As for credits and loans, a number of restrictions have been imposed on those not related to international trade. As argued in OECD (1990: 43), countries have targeted such types of credits and loans because they are seen as being "of less importance to the 'real' side of the economy, potentially destabilising, and an easy conduit for circumventing other controls".

1973: The Code was amended to include operations in collective investment securities in List A. Specifically, buying and selling of collective investment securities by residents operating abroad and non-residents operating in the country concerned were permitted. These operations, however, had to be carried out through authorized resident agents. Moreover, residents were expected to hold funds and securities only through such agents, and the contracting of buying and selling was permitted only in the spot market.

1984: The definition of inward FDI was expanded to include the main features of the right of establishment, such as licences, concessions, requirements for running an enterprise and the type of operating - subsidiary, branch or agency (OECD, 1995: 22). In 1986, the principle of non-discrimination[3] was relaxed, with the inclusion in the Code of conditions of reciprocity for inward FDI. This amendment allows a country to restrict the conditions under which it permits access to its markets for a direct investor to those applying in the investor's country of origin.

1989: The Code explicitly discriminates between short- and long-term securities and bonds, and covers the new and innovative forms of financing, such as swaps, futures and options. As regards operations in securities on capital markets, those of more than one year previously placed in list B (see above) are now in list A, while those of less than one year remain in list B under the new item, "operations on money markets". The Code is also updated to include in list B other operations in negotiable instruments and non-securitized claims, as well as operations of deposit accounts and those in foreign exchange, not

Box 1 (concluded)

specified in list A. Finally, the Code adds financial back-up facilities to the item on sureties and guarantees, while those facilities that are not related to international trade are placed in list B (see table A.2 for changes).

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[1] More specifically, the area of FDI covered the creation or extension of a wholly-owned enterprise, subsidiary or branch, acquisition of full ownership of an existing enterprise, participation in new existing enterprises and long-term loans of five years or more.

[2] Physical movements of securities are far more restricted than other operations involving securities. For example, in certain cases only movements for administrative purposes are permitted and only on a temporary basis. A summary of the 1960 Code list and the amendments made thereafter can be found in table A.1.

[3] According to the principle of non-discrimination originally established in the Code, a country should not discriminate between member countries when applying liberalization measures or restrictions. This however can be relaxed when a country, as a member of a special customs or monetary union, applies liberalization measures to other member countries of the union without extending such measures to non-members.

widely accepted view in the 1960s and early 1970s on how capital account liberalization should be pursued. At that time, growth and full employment were major policy objectives, and autonomous national policies, which could be badly affected by premature liberalization, were seen as a basic condition to achieve them.

In the 1970s, although further liberalization was carried out through an expansion of the provisions of the Code, with the inclusion of collective securities, countries remained cautious, reinforcing rather than relaxing their restrictions. Evidence of their cautious approach was that they continued to maintain fairly numerous regulations (which directly and indirectly affected the balance-of-payments operations) and exchange controls not captured by the Code, partly in response to the collapse of the Bretton Woods system and the first oil crisis.

However, gradualism soon began to wane as a result of a major ideological shift towards greater liberalization in the late 1970s; OECD member countries no longer followed changes in the Code but rather anticipated them. Many of them speeded up liberalization by removing their reservations and derogation and by dropping restrictions not captured by the Code. By the late 1980s, when the Code included short-term financial operations, many countries had almost fully liberalized their capital accounts.

Another important influence on capital account liberalization in the OECD area was the process of deregulation in the domestic financial sector. This process, which had begun in OECD countries in the early 1960s, intensified in the late 1970s and early 1980s in search of a higher degree of efficiency and competition for the sector (OECD, 1989). In addition, membership of the then European Economic Community (EEC, the precursor to the EU) also influenced the path of liberalization of many OECD countries at the time; the EEC regime for capital movements, particularly its 1988 directive, represented a significant step towards full capital account convertibility. (For a detailed account of the EEC/EU regime for capital movements, see Akyuz and Cornford, 1994.)

In the 1990s, OECD member countries continued to liberalize further, especially the new members, which faced pressure to catch up quickly with the original members. Some of these new members probably accepted tough conditions to join the OECD because of various incentives to do so. For example, becoming an OECD member country gave them a lower risk weight, according to the 1988 Basel Accord, which meant that banks would probably lend more and/or with lower spreads. Paradoxically, though, Mexico, whose risk weight was lowered as a result of its accession to the OECD in 1994, faced a currency crisis that same year.

Thus, another important feature of OECD membership was that countries followed different liberalization paths. Three main categories of countries can be identified, according to the timing and speed of their liberalization (see figure 1). The first wave comprised the developed countries of the OECD area.[10] These countries undertook a fairly gradual liberalization path, with a speeding up only from the early 1980s onwards. The second wave constituted those members that were middle-income countries at the time of accession to the OECD: Greece, Iceland,[11] Portugal, Spain and Turkey. They liberalized very slowly for more than 20 years (due to the prolonged use of the general derogation, as noted above), with some opening being observed only towards the late 1980s and a speeding up of the process from the early 1990s onwards. Finally, the third wave comprised the emerging economies that acceded to the OECD more recently: the Czech Republic, Hungary, Mexico, Poland and the Republic of Korea. These newcomers, though not ready for full liberalization, had to face tougher liberalization conditions to enter the organization, including no restrictions on payment transfers, an open and transparent regime for FDI, liberalization of long-term transactions, and a short time frame for further liberalization (Poret, 1998).[12]

Even within each of these categories the speed of liberalization differed, especially among the first-wave countries. In this group the United States, Switzerland and Canada adopted a more liberal approach in the

Figure 1

SPEED OF LIBERALIZATION, BY GROUPS OF COUNTRIES

Countries/years	*1960s*	*1970s*	*1980s*	*1990s*
First wave				
Second wave				
Third wave				

Source: Authors' compilation.
Note: White = no liberalization; light shade = slow liberalization; dark shade = fast liberalization.

early 1950s, and Germany abolished most of its controls by 1958 (OECD, 1993). Therefore these countries began liberalizing even before their adoption of the OECD Code, though, as discussed below, most of them later resorted to controls (and benefited from the safeguards of the Code), either in response to balance-of-payments difficulties or to avoid excessive capital inflows.

Among the remaining countries of the first-wave group, which constitute the large majority of members, liberalization was initially very gradual, with restrictions of different sorts being kept during the first 15 to 20 years, for the purpose of retaining autonomy to conduct economic and monetary policies and avoiding macroeconomic instability. After this initial period marked by caution, these countries started to liberalize more quickly, but in different ways. For example, Australia, Japan, New Zealand and the United Kingdom lifted the remaining extensive restrictions virtually in one sweep. The United Kingdom abolished nearly all its capital controls in 1979, and Japan did the same in 1980. Australia almost completely liberalized its capital movements in 1983, and New Zealand in 1984 (OECD, 1990: 40–41). Rapid liberalization in that group of countries was motivated mainly for ideological reasons, except in Japan. In the latter case, the quick move towards a liberal capital account reflected a structural change in the country's external sector, which started to witness a growing surplus in the balance of payments.[13] The remaining first-wave countries speeded up liberalization but retained a measure of gradualism: the Netherlands completed liberalization by 1986, and Denmark and France in 1988 and 1989 respectively. Finally, only between 1988 and 1990 did Austria, Ireland, Italy, Norway and Sweden drop a substantial number of restrictions.

Among the second-wave category of countries, liberalization was more homogeneous than among the first-wave countries, as all of them (except Spain) made use of a general derogation until the 1980s. Once they removed the use of that instrument, they pursued a gradual liberalization path, though at different speeds. Turkey, for example, dropped the general derogation in 1985, and kept just a few reservations while moving towards a very open capital account by the end of the 1980s. This pattern seemed to be associated with the country's political developments, marked by an ideological shift in the direction of a market-based economic approach. Other countries such as Portugal and Spain, which faced pressures in the 1980s to liberalize due to their accession to the EEC, were, nevertheless, more cautious. Portugal dropped its general derogation in 1981, but kept a specific derogation until 1987 – one year after its entry into the EEC – and invoked it again between mid-1991 and late 1992 (see below). It also kept in place a large number of reservations throughout the 1980s and until 1992, when it undertook broad liberalization. The liberalization path pursued from then onwards was closely associated with the EEC requirements for capital account liberalization. As for Spain, it had dropped the general derogation in the early 1960s, but slowed down the liberalization process by relying on a wide variety of reservations and other restrictions until the early 1990s. In the next section, we describe in greater detail Spain's experience with capital account liberalization.

Finally, as regards the third-wave countries, owing to the requirements for obtaining OECD membership, none of them made use of the general derogation. Therefore, unlike the first- and second-wave countries, the third-wave countries liberalized their capital accounts very rapidly, either before or at the time of their entry into the organization. This seems particularly surprising in the case of the transition economies, which were only just starting to develop the necessary market institutions.

Below we attempt to describe how countries proceeded with liberalization of their capital accounts through their use of the reservation and derogation instruments. However, a number of caveats are in order when adopting this approach. On the one hand, resort to derogation and reservations over time might merely reflect a precautionary approach, thus not showing the precise degree of the countries' capital account liberalization. On the other hand, many countries kept indirect controls over capital movements that were not captured by the Code. As argued in OECD (1990: 41), this was particularly true until the mid-1970s, when countries such as Belgium, France, Ireland, Italy, Japan, the Netherlands and the United Kingdom "allowed certain capital movements to take place only through particular closed-circuit payments channels or alternative exchange markets". Among other kinds of controls also extensively used were restrictions on the overall positions of financial institutions, reserve requirements and restrictions on interest payments. Germany, for example, imposed reserve requirements on banks' and non-banks' external liabilities between 1971 and 1974, whereas Switzerland prohibited interest payments on non-residents' deposits in 1972 (OECD, 1990: 41).

IV. USE OF DEROGATION AND RESERVATIONS

This section provides a more detailed analysis of the pattern of liberalization among OECD member countries by examining their use of reservations and derogation. These are the two main instruments they have used to adjust the Code to their specific policy objectives and needs.

A. Analysis of derogation in the Code

(i) The use of general derogation (Article 7a)

As explained above, derogation can be specific (Articles 7b and 7c), but most importantly it can take the form of a general dispensation from the Code (Article 7a). It is thus a powerful measure for determining the true pattern of capital account liberalization.

In the past, the OECD member countries that made use of general derogation at the time of adherence to the Code – the second-wave countries – kept this instrument in force for more than 10 years (excluded Spain), the average being 24.5 years (in sharp contrast with the third-wave countries which did not apply the general derogation at all). Greece and Portugal removed the general derogation in the early 1980s, Turkey in 1985 and Iceland in 1990 (see table A.3). This means that in fact this group of countries only started to liberalize their capital accounts in the 1980s.

(ii) The use of specific derogation (Articles 7b and 7c)

Since then, some of the second-wave countries have applied Articles 7b and 7c on a number of occasions (table A.3). As explained above, Article 7b allows for the use of a specific derogation when the country faces economic and financial problems caused by liberalization, and Article 7c when the country faces serious balance-of-payments difficulties.

Portugal, which removed the general derogation in 1981, already had specific derogation in place since 1977. This lasted until 1987 and was invoked again between mid-1991 and late 1992. Although specific, the derogation clause covered quite a large number of items relating to both capital inflows and outflows (OECD, 1990: 42). Iceland, which removed the general derogation in December 1990, applied a specific derogation in January 1993. Spain, unlike the other countries, made use of a general derogation only in the early period of adherence to the Code – from 1959 to 1962 – and it applied a specific derogation for three years during the 1980s (from mid-1982 to mid-1985).

Most of the first-wave countries have made considerable use of specific derogation over the years. Between the creation of the Code and 1993, their average use of the articles 7b and 7c was 4.5 years. Countries that sought such a recourse for relatively long periods (five years or more) were Australia, Austria, Finland, Germany, Italy, Norway, Sweden and the United States. On the other hand, Belgium, Canada, France, Ireland, Luxembourg, the Netherlands and New Zealand did not apply the derogation clauses (table A.3).

As reported in OECD (1990), in the 1960s and early 1970s countries such as the United Kingdom, the United States, Italy and Sweden used the derogation procedure to avoid capital outflows, while in the early 1970s another group of countries – Australia, Austria, Germany and Japan – applied the derogation clause to prevent excessive capital inflows. In the 1980s and 1990s, the use of derogation became far less frequent and was restricted to the Scandinavian countries.

B. Analysis of reservations in the Code

A first step in the analysis of the use of reservations by the OECD member countries is to look at the number of items that have been subject to reservations in each country over time.[14] As explained above, these items are distributed between lists A and B. In the former list, once withdrawn reservations cannot be reimposed, whereas in the latter they can be.

(i) The first-wave countries

The first-wave countries have exhibited a fairly homogeneous pattern in the use of reservations. As can be seen from table 1, initially the number of reservations each country lodged under the Code increased gradually, reaching a peak in 1978, with an average number of 7.1 against 2.9 in 1960. This increase reflected not only the expansion of the Code to include more items of the capital account, but also a real attempt to impose restrictions on balance-of-payments movements. The need for such restrictions was associated with the problems relating to the Bretton Woods system in the late 1960s and early 1970s and with the effects of the 1973 oil shock.

From 1978 a gradual decline in the number of reservations can be observed (table 1). This decline stopped (and was in some cases reversed) at the turn of the 1870s to the 1980s. Two major exceptions to that deserve mentioning: the United Kingdom and Japan; the former removed all of its reservations between 1979 and 1982, and the latter reduced reservations from five to two over the same period. This is consistent with the fact noted above, that these two countries almost completely liberalized their capital accounts at the time, from a previously fairly restrictive regime.

From 1982 onwards, the decline in the number of reservations resumed and accelerated during the decade. It is noteworthy that the number of restrictions on list B was larger among the first-wave countries than among the second-wave countries, which suggests that for the former (the developed countries) such a recourse was temporary and associated with balance-of-payments problems.

Table 1

RESERVATIONS LODGED BY FIRST-WAVE COUNTRIES, 1960–1997

		1960	*1969*	*1978*	*1982*	*1990*	*1992*	*1997*
Austria	List A	2	3	4	3	1	3	1
	List B	0	3	4	4	2	4	1
	Total	2	6	8	7	3	7	2
Australia	List A			5	5	4	2	2
	List B			5	5	5	5	3
	Total			10	10	9	7	5
Belgium	List A		1	2	2	3	3	4
	List B		1	1	1	1	2	1
	Total		2	3	3	4	5	5
Canada	List A					2	2	2
	List B					2	1	1
	Total					4	3	3
Denmark	List A	2	3	4	3	1	1	1
	List B	0	4	4	4	3	1	1
	Total	2	7	8	7	4	2	2
Finland	List A			7	6	5	3	2
	List B			5	5	5	3	1
	Total			12	10	9	6	3
France	List A		1	2	2	2	3	3
	List B		2	5	4	1	1	1
	Total		3	7	6	3	4	4
Germany	List A					1	2	2
	List B					0	1	1
	Total					1	3	3
Ireland	List A	2	4	5	5	4	8	1
	List B	0	5	5	5	4	8	1
	Total	2	9	10	10	8	16	2
Italy	List A	4	5	6	5	4	3	2
	List B	0	5	5	5	4	0	0
	Total	4	10	11	10	8	3	2
Japan	List A		4	1	1	1	2	2
	List B		5	4	1	0	1	1
	Total		9	5	2	1	3	3

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Table 1 (concluded)

RESERVATIONS LODGED BY FIRST-WAVE COUNTRIES, 1960–1997

		1960	*1969*	*1978*	*1982*	*1990*	*1992*	*1997*
Luxembourg	List A		1	0	0	0	0	0
	List B		1	0	0	0	0	0
	Total		2	0	0	0	0	0
Netherlands	List A		2	2	2	1	1	1
	List B		4	4	4	0	0	0
	Total		6	6	6	1	1	1
New Zealand	List A			4	4	2	3	2
	List B			4	4	1	1	1
	Total			8	8	3	4	3
Norway	List A	3	5	5	5	4	2	2
	List B	0	5	5	5	5	1	1
	Total	3	10	10	10	9	3	3
Sweden	List A	4	3	4	4	2	2	2
	List B	0	5	5	5	3	2	1
	Total	4	8	9	9	5	4	3
Switzerland	List A		1	1	1	1	3	2
	List B		3	3	3	2	3	1
	Total		4	4	4	3	6	3
United Kingdom	List A	3	3	4	0	1	1	1
	List B	0	5	5	0	0	0	0
	Total	3	8	9	0	1	1	1
United States	List A		1	1	1	1	3	2
	List B		0	0	0	0	1	0
	Total		1	1	1	1	4	2
Total	List A	**20**	**37**	**57**	**49**	**40**	**47**	**34**
	List B	**0**	**48**	**64**	**55**	**38**	**35**	**16**
	Total	**20**	**85**	**121**	**104**	**78**	**82**	**50**
Average	List A	**2.86**	**2.64**	**3.35**	**2.88**	**2.11**	**2.47**	**1.79**
	List B	**0.00**	**3.43**	**3.76**	**3.24**	**2.00**	**1.84**	**0.84**
	Total	**2.85**	**6.07**	**7.12**	**6.12**	**4.11**	**4.32**	**2.63**

Source: Authors' compilation, based on the OECD Code of Liberalization of Capital Movements (various issues).

Note: Totals do not add up due to rounding.

(ii) The second-wave countries

Table 2 shows the number of reservations the second-wave countries applied between 1960 and 1997. It is clear that they kept quite a large number of reservations – more than 10 on average – for most of the period between 1960 and 1992. This means that, on average, each country imposed

Table 2

RESERVATIONS LODGED BY THE SECOND-WAVE COUNTRIES, 1960–1997

		1960	*1969*	*1978*	*1982*	*1990*	*1992*	*1997*
Greece	List A				11	10	11	2
	List B				6	5	8	1
	Total				17	15	19	3
Iceland	List A							2
	List B							1
	Total							3
Portugal	List A	2	7	8	8	6	6	2
	List B	0	6	6	6	6	9	0
	Total	2	13	14	14	12	15	2
Spain	List A		6	6	6	4	5	2
	List B		6	6	6	6	8	1
	Total		12	12	12	10	13	3
Turkey	List A					5	4	4
	List B					5	4	3
	Total					10	8	7
Total	List A	**2**	**13**	**14**	**25**	**25**	**26**	**12**
	List B	**0**	**12**	**12**	**18**	**22**	**29**	**6**
	Total	**2**	**25**	**26**	**43**	**47**	**55**	**18**
Average	List A	**2.00**	**6.50**	**7.00**	**8.30**	**6.25**	**6.50**	**2.40**
	List B	**0.00**	**6.00**	**6.00**	**6.00**	**5.50**	**7.25**	**1.20**
	Total	**2.00**	**12.50**	**13.00**	**14.30**	**11.75**	**13.75**	**3.60**

Source: Authors' compilation, based on the OECD Code of Liberalization of Capital Movements (various issues).
Note: Totals do not add up due to rounding.

restrictions (total or partial) on at least 10 items of the Code. Until the early 1980s such reservations coexisted with the use of general derogation in all cases, except for Spain. The reason for this was that reservations had to be adopted at the time of adherence to the Code and when a new item was included. This precautionary approach enabled the countries to have reservations in place during the 1980s, when derogations were dropped. As can be seen from table 2, the number of reservations kept during the 1980s was very high, averaging 12 to 14, with a marginal increase from 1990 to 1992.

From 1992 onwards an important change occurred: the number of reservations declined very rapidly, reaching an average of 3.6 in 1997, which is very low, especially if we take into account the fact that derogation had been removed. For Greece, Portugal and Spain, the speeding up of the liberalization process was probably associated with their accession to the EEC. Turkey, a non-EEC member, however, dropped the general derogation in 1985, and from then until 1997 kept a lower-than-average number of reservations for most of the time.

Three phases in the liberalization process can thus be identified for the second-wave countries through the analysis of the use of derogation and reservations. Initially, between the early 1960s and 1980s, due to the use of general derogation, liberalization was extremely slow, except in Spain. Then, for most of the 1980s, with the removal of the general derogation but with a significant number of reservations in place, a gradual liberalization process took place. Finally, during the 1990s, with the rapid decline in the number of reservations, reaching an average of 3.6 per country, liberalization speeded up considerably for the first time.

(iii) The third-wave countries (or newcomers)

For the emerging-market, third-wave countries, the analysis is restricted to the year 1997, given that all of them adhered to the Code only by about the mid-1990s. According to table 3, at first view the newcomers in 1997 were in a situation similar to that of the second-wave countries in the 1980s; their number of reservations averaged 11.4. However, in relative

Table 3

RESERVATIONS LODGED BY THE THIRD-WAVE COUNTRIES, 1997

	Czech Republic	*Hungary*	*Mexico*	*Poland*	*Rep. of Korea*	*Total*	*Average*
List A	4	5	6	7	7	29	5.8
List B	2	8	4	7	7	28	5.6
Total	6	13	10	14	14	57	11.4

Source: Authors' compilation based on the OECD Code of Liberalization of Capital Movements (various issues).

terms this number is actually lower, given that in the 1990s the Code had been considerably expanded, with the inclusion of items related to short-term portfolio flows.

Thus the third-wave group differs markedly from the second-wave group at least in two ways. First the countries in the former group made less use of reservations at the time of adherence to the Code,[15] and second, but more importantly, they did not apply any general derogation. Since this recourse was still available, it suggests that they indeed faced considerable pressure to accept stringent requirements concerning liberalization of their capital account as a condition for OECD membership. Also, at least in some cases, their new governments were committed to rapid capital account liberalization and/or had made such commitments in other contexts (e.g. Mexico with the North American Free Trade Agreement).

V. EXPERIENCES OF SELECTED COUNTRIES WITH CAPITAL ACCOUNT LIBERALIZATION: A COMPARATIVE ANALYSIS

This section sheds additional light on the dissimilar liberalization paths between the second- and third-wave countries, by describing the experiences of Spain (representative of the second-wave category) and of the Czech Republic, Mexico and the Republic of Korea (representative of the third-wave countries). It shows the appropriateness of the gradual approach adopted by the second-wave countries and the risks and costs of the "big-bang" approach adopted by the third-wave countries.

A. Spain[16]

To compensate for the removal of the general derogation in 1962, Spain made extensive use of reservations to restrict capital movements in the 1960s and 1970s. The country then began a number of structural reforms, including, initially, trade liberalization, and then labour market deregulation and domestic financial liberalization, as part of its preparation for accession to the EEC in 1986.

Between 1982 and 1985, Spain made use of specific derogation while keeping a number of reservations in place. Between 1987 and 1989, the country witnessed increasing capital inflows, linked mainly to its EEC accession. It responded to these inflows by permitting free entry to most forms of FDI (believed to be sustainable), and imposing a number of restrictions on portfolio and short-term capital inflows, seen as speculative and therefore easily reversible.[17]

Such restrictions took various forms and were adopted in steps. In March and April 1987, the reserve requirements on domestic bank accounts were extended to include deposits in convertible currency held by non-residents, with non-bearing interest rates for such account balances exceeding 10 billion pesetas. In July 1987, non-residents were forbidden to purchase short-term domestic public assets in the forward market or those with buy-back clauses. In June 1988, resident borrowers had to obtain authorization for external financial loans of over 1.5 billion pesetas that had a maturity of less than three years. And in February 1989, the Government adopted non-remunerated reserve requirements. The requirement levels were 30 per cent on foreign loans to physical residents and the corporate sector, and 20 per cent on the increase in the short-term currency position of the banking sector. (Note that the latter measures were the forerunner of the now widely-known Chilean reserve requirements!)

By helping to moderate the volume of capital flowing to the country, especially the more volatile kind, these restrictions facilitated the conduct of domestic macroeconomic policies, particularly in the monetary and exchange rate areas, and they contributed to the sustainability of the external sector. However, by February 1992, the restrictions were phased out in order to comply with the EEC directives on capital account movements. As these controls were removed, the country started to witness increasing net inflows of portfolio and short-term capital, which led to the overvaluation of the peseta and, later, made the economy prone to currency attacks. These attacks materialized in full force during the crisis with the European Monetary System (EMS) in September 1992.

The Spanish response to such speculative attacks was to keep the peseta within the exchange rate mechanism (ERM) of the EMS after devaluing it by 5 per cent. To sustain this new exchange rate, it imposed punitive restrictions on short-term swap operations involving non-residents. These restrictions took the form of requiring the domestic financial system to make one-year, non-remunerated deposits in the Bank of Spain equivalent to its total new lending to non-residents. In addition, ceilings were imposed on the foreign currency transactions of foreign banks operating in Spain and of domestic banks having branches abroad. The restriction in the form of deposit requirements on outflows showed a reasonable degree of effectiveness, but lasted only a short while, until the 23 November 1992, when the peseta was again devalued, this time by 6 per cent. Since then, Spain has maintained a very liberal regime with regard to capital movements.

B. The Czech Republic, Mexico and the Republic of Korea

In stark contrast with Spain, all new OECD members liberalized their capital accounts very rapidly, partly because of the liberalization requirements imposed as a condition for accession to the OECD, and partly because of their own drive towards a market-based economy. The case of the Czech Republic is a good illustration of the pattern of liberalization adopted by the economies in transition. The move towards a market-based economy included, from the outset, rapid liberalization of the capital account, even though it was initially designed to be a gradual process (Klacek, 1999). Liberalization included allowing inflows of direct and portfolio investment and external credit borrowed by residents.[18] By the mid-1990s, the country became a recipient of massive capital flows that reached over 16 per cent of its GDP in 1995, much of them short-term. This was despite an initial regulatory attempt to influence their maturity structure. The response to such developments was to reform the legislation in order to adapt it to the reality, and to further liberalize capital movements, leaving just a few restrictions in place. The Czech authorities discussed the possibility of introducing safeguards such as giving discretionary powers to the central bank to impose interest-free reserve requirements on certain types of credit inflows; however, these were never implemented.[19] Furthermore, although the country experienced a "mini" currency crisis in 1997, it did not resort to capital controls; instead, it responded to the crisis with a liquidity squeeze and let the exchange rate float (Dedek, 2002).

Both Mexico and the Republic of Korea joined the OECD in the 1990s, together with the transitional economies, and followed a path of capital account liberalization similar to that of the Czech Republic.

Mexico undertook major liberalization measures in 1989 and 1990. At that time the Government allowed non-residents to buy money market instruments, invest in the stock market and hold domestic bonds, including public ones (Griffith-Jones, 1996). As a result, Mexico experienced massive inflows, averaging nearly 7 per cent of GDP between 1992 and 1994; most of these were of short-term maturity and were invested in government and equity securities, as well as in private sector instruments (Edwards, 1997).

Government papers and bonds held by non-residents were a key factor in the Mexican peso crisis of 1994–1995. Edwards (1997) suggests that the desire to join the OECD was one reason for Mexico's liberalization. However, equally, if not more important, may have been the Government's interest in joining NAFTA as well as its own free-market preferences.

In the Republic of Korea, broad liberalization started in 1991 and 1992, when residents were granted permission to issue securities abroad and foreigners were allowed to invest directly in the Korean stock markets (Park and Song, 1998).[20] In 1993, the new government of Kim Young Sam accelerated the pace of capital account liberalization (Chang et al., 1998). Non-residents could hold domestic bank accounts, and later, in 1994, they were permitted to invest in public bonds. Between then and 1997, additional deregulation measures were undertaken in the area of capital movements. These included allowing small and medium-sized firms to issue equity-linked bonds and non-guaranteed bonds, and large firms to issue non-guaranteed, long-term bonds, and, most importantly, short-term foreign loans were permitted for different sorts of domestic activities (commercial, infrastructure and FDI-related) that previously had been restricted.

As Wang (2000) notes, the Government maintained some restrictions on the capital account, particularly on some forms of capital inflows, due to concerns about a surge of capital inflows caused by interest rate differentials. The restrictions were mainly in the form of ceilings on foreign portfolio investments in domestic securities and borrowings from abroad by non-banks. However, there were exceptions where liberalization occurred far more rapidly, some of which we now know proved harmful. This included trade-related short-term financing for domestic firms. Another and particularly problematic area was the short-term foreign currency borrowings of domestic banks. Finally, control over FDI by domestic firms was also relaxed (Shin and Wang, 1999).

According to Chang (1998) and Chang et al. (1998) both domestic and foreign pressures played a role in speeding up liberalization in the Republic of Korea. It is worth pointing out that on the external front both the United States Government and the OECD are believed to have put strong pressure on the Korean Government to open up the economy.

However, as Wang (2000: 11) reports, in the negotiations over the country's accession to the OECD in 1996, the Korean Government tried to resist full capital account liberalization (although short-term credit had already been liberalized) for the reasons already mentioned; it intended to delay full liberalization "until the interest rates would significantly converge". But its resistance was weaker than its desire to "show the world" the achievements of the Korean economy, and to prove it by "joining the OECD club". Thus more rapid capital account liberalization was seen as a price worth paying for this prize.[21]

Some of the changes in Korean capital account liberalization were rather subtle, although important. For example, from the early 1990s banks and financial institutions were legally free to borrow short-term capital from abroad; however, till 1994 such borrowings required the Government's discretionary authorization. Similarly, limits on ratios of long-term foreign currency loans to short-term currency loans for individual finance were lowered in 1996, which Korean economists now view as having been a serious mistake. The scale of the increase of the short-term debt was apparently not fully captured in the statistics, as about half of banks' foreign currency operations were handled by overseas branches, whose transactions were not recorded in the overall Korean data on debt exposure. The Korean authorities were reportedly warned by United States regulators in early 1997 of this problem and of a maturity mismatch in foreign branches; however, they did not react.

Among the reasons given by the authorities for not controlling short-term loans or taking other measures, was that they had "just joined the OECD and had agreed to liberalize; imposing controls or taxes on short-term flows would imply losing credibility in relation to the OECD". Furthermore, the fact that the country had joined the OECD was seen by the authorities to imply that it did not need to worry about the high level of short-term debt. However, there were other reasons (not related to OECD accession) given as to why the Korean authorities did not move to curb excessive growth; these included, the far lower cost of short-term loans, the fact that banks were inundated with lenders willing to lend, with rollover ratios of 100 per cent – and the perception that the Republic of Korea held large reserves.[22]

The liberalization path thus resulted in a large foreign debt, although not so large when measured as a proportion of the country's GDP (25 per cent in early 1997). Also, it was mostly short-term (58 per cent by the end of 1996). This implied a large maturity mismatch, particularly among merchant banks, whose borrowings were 64 per cent short-term, and lending was 85 per cent long-term (Chang et al., 1998). Short-term foreign debt and maturity (and currency) mismatch were the main causes of the major currency and financial crises in 1997 (Park, 2001; Park and Park, 2002).

C. Lessons

The Spanish experience shows that gradual and sequenced liberalization gave the country time to build regulatory institutions in the financial sector that helped it to maintain macroeconomic stability. When the economy witnessed surges of capital inflows, it managed to reduce their potentially destabilizing effects with a variety of both quantitative and price-based restrictions on short-term, speculative flows. Removing such restrictions left the country vulnerable to currency attacks. Yet when the currency crisis erupted, it had the flexibility to reintroduce restrictions, doing so fairly successfully in terms of taming speculative attacks against its currency. Restrictions on the balance of payments were imposed in the late 1980s and early 1990s, when the first-wave countries were undertaking their final major steps towards full capital account convertibility. This clearly shows that different timing of liberalization was still permitted among the OECD member countries.

However, the experiences of the Czech Republic, Mexico and the Republic of Korea with capital account liberalization were quite different from those of Spain as they faced radically different conditions within the OECD. The new members experienced rapid liberalization, a predominance of short-term over long-term capital flows (in the Mexican and Korean cases) and currency crises. The contrasting experiences and outcomes of Spain on the one hand, and the Czech Republic, Mexico and the Republic of Korea on the other, strongly point to the need for a new approach towards capital account liberalization for the emerging economies. This approach should take account of the positive aspects of the liberalization experience of Spain (and, more generally, of second-wave countries), as well as the earlier experiences of the first-wave industrialized countries. These include gradual liberalization, a cautious approach to short-term capital flows, and the provision of safeguard mechanisms that can be used effectively in times of difficulties.

VI. CONCLUSION

A number of important conclusions can be drawn from this study. First, the original OECD member countries initially adopted a gradual approach to capital account liberalization. Second, the process was sequenced, with long-term capital flows being liberalized first, and short-term capital flows only later when the economies had the strength and institutional capacity to absorb such flows. Third, the process initially allowed for heterogeneity, with countries being able to shape their own liberalization pattern in accordance with their structural characteristics and policy objectives.

From the adoption of the OECD Code of Liberalization of Capital Movements in the early 1960s until the 1980s, the developed member countries of the OECD had, on average, 25 years to pursue orderly capital account liberalization. If we take the end of the Second World War as the starting point to gauge the time frame of liberalization, then the whole process lasted even longer, 40 years on average. Among the original OECD members, that were middle-income countries at the time the OECD was created, liberalization started only in the 1980s, as it was recognized that these countries needed even more time in order for the process to be sustainable. This has changed in the recent past, however. New OECD members – emerging economies – have been, if not pushed, at least greatly encouraged to liberalize more rapidly. As a consequence, they have undergone premature liberalization, and half of them have experienced deep and costly financial crises.

In the light of these experiences, it would seem preferable if the OECD returned to its original mission, which was to support orderly capital account liberalization. Accordingly, it should support member countries that prefer to relax controls on capital movements gradually, and discourage countries that are tempted to open up quickly from doing so. This should apply particularly to those countries that have weak and badly regulated domestic financial systems. A cautious approach should, however, be broad based to include even those developing countries that are believed to have solid market institutions and supervisory frameworks in place, as these can at best reduce the likelihood, but not entirely prevent, a crisis episode. Particularly short-term and other easily reversible inflows should not be fully liberalized.

Given the potentially destabilizing international financial markets, the ultimate aim should be both orderly and sustainable liberalization, an approach through which financial crises and reversibility of the process could perhaps be avoided. Nonetheless, capital account liberalization should be sufficiently deep to allow countries to benefit from the positive effects of capital flows.

Another important lesson that emerges from the study is that no matter how well designed a multilateral agreed framework may be for the purpose of supporting orderly liberalization, it can become ineffective, and even turn against the weaker members of the accord, if divergence of interests exists among member countries. This fact should be seen as a warning about the risks of an internationally agreed framework on capital account liberalization. Rather than guaranteeing orderly liberalization, such a framework, even if implemented with carefully designed safeguards, may result in one group of countries imposing, through an international body, full capital account convertibility on a wide range of countries, most of which are still unprepared for such a step. This latter problem could possibly be overcome to the extent that developing countries are properly represented in the international organization implementing capital account liberalization.

More broadly, as long as there is no significant progress on an international financial architecture (including mainly international measures) that would make the occurrence of currency crises far less likely and less costly, it seems appropriate that decisions on pace and timing of capital account liberalization (as well as reintroduction of measures to discourage inflows or outflows) should be left to individual countries. As it is the country that has mainly to bear the costs of a crisis, should one occur, it is best, in present circumstances, for the national authorities to be left to weigh the benefits and costs of different paths of capital account liberalization. International experience or advice can be useful, but autonomous national decision-making seems clearly more appropriate.

ANNEX TABLES

Table A.1

MAIN ITEMS COVERED BY THE CODE

Code		*List A*		*List B*
1960	I.	Direct investment.	I.	Direct investment (not specified).
	II.	Liquidation of direct investment.	II.	Liquidation of direct investment (cases not covered in List A).
	III.	Personal capital movements.	III.	Personal capital movements (not specified).
	IV.	Use and transfer of non-resident-owned funds.	IV.	Use and transfer of non-resident-owned funds (cases not covered in list A).
	V.	Physical movement of securities.	V.	Physical movement of securities (not specified).
	VI.	Security dealing.	VI.	Security dealing (not specified).
1969	*I.*	*Direct Investment.*		
	II.	Liquidation of direct investment.		
	III.	Admission of securities to capital markets.	III.	Admission of securities to capital markets (cases not covered in List A).
	IV.	Buying and selling of securities.	IV.	Buying and selling of securities (cases not covered in List A).
	V.	**Operations in real estate.**	**V.**	**Operations in real estate (cases not covered in List A).**
	VII.	**Credits directly linked with international commercial transactions or with the rendering of international services.**	**VII.**	**Credits directly linked with international commercial transactions or with the rendering of international services.**
			VIII.	**Financial credits and loans.**
	X.	Personal capital movements.	X.	Personal capital movements (cases not covered in List A).
	XI.	Life assurance.		
	XII.	**Sureties and guarantees.**		
	XIII.	**Physical movement of capital assets.**		
	XIV.	Disposal of non-resident-owned funds.		
1978	I.	Direct investment.		
	II.	Liquidation of direct investment.		
	III.	Admission of securities to capital markets.	III.	Admission of securities to capital markets (cases not covered in List A).
	IV.	Buying and selling of securities.	IV.	Buying and selling of securities (cases not covered in List A).
	V.	**Buying and selling of collective investment securities.**		

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Table A.1 (concluded)

MAIN ITEMS COVERED BY THE CODE

Code	*List A*	*List B*
	VI. Operations in real estate.	VI. Operations in real estate (cases not covered in List A).
	VIII. Credits directly linked with international commercial transactions or with the rendering of international services.	VIII. Credits directly linked with international commercial transactions or with the rendering of international services (cases not covered in List A).
		IX. Financial credits and loans.
	XI. Personal capital movements.	XI. Personal capital movements (cases not covered in List A).
	XII. Life assurance.	
	XIII. Sureties and guarantees.	
	XIV. Physical movement of capital assets.	
	XV. Disposal of non-resident-owned funds.	
1990[a]	I. Direct investment.	
	II. Liquidation of direct investment.	
	III. Operations in real estate.	III. Operations in real estate (cases not covered in List A).
	IV. Operations in securities on capital markets.	
		V. Operations on money markets.
		VI. Other operations in negotiable instruments and non-securitized claims.
	VII. Operations in collective investment securities.	
	VIII. Credits directly linked with international commercial transactions or with the rendering of international services.	VIII. Credits directly linked with international commercial transactions or with the rendering of international services.
		IX. Financial credits and loans.
	X. Sureties, guarantees and **financial back-up facilities.**	X. Sureties, guarantees and **financial back-up facilities.**
	XI. Operation of deposit accounts.	**XI. Operation of deposit accounts.**
		XII. Operations in foreign exchange.
	XIII. Life assurance.	
	XIV. Personal capital movements.	XIV. Personal capital movements.
	XV. Physical movement of capital assets.	
	XVI. Disposal of non-resident-owned funds.	

Source: Authors' elaboration based on information obtained from the Code of Liberalization of Capital Movements 1960, 1969, 1978 and 1990 (revised version). The 1982, 1992 and 1997 editions of the Code did not show any change from their preceding ones.

Note: Bold: new items, not included before under another item.
Italic: items that have partially or totally changed from one list to the other.

a Revised.

Table A.2

THE 1990 CODE LIST AND REVISED VERSION[a]

			Revised Code	*1990 Code*
IV.	**Operations in securities on capital markets**			
	A,B.	Admission of domestic securities on a foreign capital market		
		Issue through placing or public sale	List A	List B
		Introduction on a recognized foreign security market	List A	List A
	C,D.	Buying and selling of securities		
		Quoted on a recognized security market	List A	List B
		Not quoted on a recognized security market	List A	List A
V.	**Operations on money markets**			
	A,B.	Admission of securities and other instruments	List B	-
	C,D.	Purchase and sale of securities, and borrowing and lending through other money market instruments	List B	-
VI.	**Other operations in negotiable instruments and non-securitized claims**			
	A,B.	Admission of negotiable instruments and claims	List B	-
	C,D.	Purchase, sale and exchange of other assets	List B	-
VII.	**Operations in collective investment securities**			
	A,B.	Admission of collective investment securities	List A	List B
	C,D.	Purchase and sale of collective investment securities	List A	List A
VIII.	**Credits directly linked with international commercial transactions or with the rendering of international services**			
i)	*In cases where a resident participates in the underlying commercial or service transaction*			
	A,B.	Short- and medium-term credits (up to 5 years)	List A	List A
		Long-term credits (more than 5 years)	List A	-
ii)	*In cases where no resident participates in the underlying commercial or service transaction*			
	A.	-		
	B.	Short- and medium-term credits (up to 5 years)	List B	List B
		Long-term credits (more than 5 years)	List B	-
IX.	**Financial credits and loans**			
	A.	Credits and loans granted by non-residents to residents		
		Short-term (less than one year)	List B	-
		Medium- and long-term (one year and more):		
		a) The debtor being a financial institution	List B	List B
		b) The debtor not being a financial institution	List B	-

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Table A.2 (concluded)

THE 1990 CODE LIST AND REVISED VERSION[a]

			Revised Code	*1990 Code*
	B.	Credits and loans granted by residents to non-residents		
		Short-term (less than one year)	List B	-
		Medium- and long-term (one year and more)	List B	List B
X.	**Sureties, guarantees and financial back-up facilities**			
i)	*In cases directly related to international trade or international current invisible operations, or in cases related to international capital movement operations in which a resident participates*			
	A.	Sureties and guarantees	List A	List A
	B.	Financial back-up facilities	List A	-
ii)	*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*			
	A.	Sureties and guarantees	List A	-
	B.	Financial back-up facilities	List B	-
XI.	**Operation of deposit accounts**			
	A.	Operation by non-residents of accounts with resident institutions	List A	-
	B.	Operation by residents of accounts with non-resident institutions	List B	-
XII.	**Operations in foreign exchange**			
	A,B.	Purchase and sale	List B	-
XIV.	**Personal capital movements**			
	A.	Securities and other documents of title to capital assets	List A	List A
	B,C.	Means of payment	List A	-

Source: OECD (1990).
a Revised items are displayed in bold.

Table A.3

DEROGATION INVOKED UNTIL 1993

	Invocation of derogation	*Cessation of invocation*	*Duration (Years)*
Australia	09/1972	06/1978	5.75
Austria	11/1972	08/1980	7.75
Belgium	-	-	0
Canada	-	-	0
Denmark	02/1979	03/1983	4.08
Finland	06/1985	01/1991	5.58
France	-	-	0
Germany	06/1972	01/1974	1.58
Germany	02/1973	11/1980	7.75
Germany (total)			9.33
Greece	09/1967[a]	06/1980	22.75
Iceland	1961[a]	12/1990	29.92
Iceland	01/1993	-	-
Ireland	-	-	0
Italy	04/1969	01/1978	8.66
Japan	01/1972	11/1973	1.83
Japan	03/1978	02/1979	0.91
Japan (total)			2.74
Luxembourg	-	-	0
Netherlands	-	-	0
New Zealand	-	-	0
Norway	11/1984	12/1989	5.08
Norway	08/1986	12/1989	3.33
Norway (total)			8.41
Portugal	1968[a]	1981	13
Portugal	1977	1981	4
Portugal	1983	1987	4
Portugal	07/1991	11/1992	1.33
Portugal (total)			22.33
Spain	1959[a]	1962	3
Spain	07/1982	06/1985	2.92
Spain (total)			5.92
Sweden	09/1969	06/1986	16.75
Switzerland	03/1964	10/1966	2.58
Switzerland	07/1972	02/1974	1.58
Switzerland	02/1978	01/1979	0.92
Switzerland (total)			5.08
Turkey	1962[a]	1985	23
United Kingdom	05/1966	03/1971	4.83
United States	01/1968	04/1974	6.25
Average years of derogation for countries with general derogation (Greece, Iceland, Portugal, Spain and Turkey)[b]			20.78
Average years of derogation for countries without general derogation			4.48
Average years of derogation for OECD countries until 1993[b]			7.56

Source: OECD (1993).

a General dispensation from the liberalization provisions of the Code.

b Without considering second derogation in Iceland.

NOTES

1 For a more elaborate discussion on this point, see for example, Akyuz (2000).

2 See OECD (1995) for a detailed account of the historical background of the OECD Code of Liberalization of Capital Movements.

3 The OEEC was founded by Austria, Belgium, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Sweden, Switzerland, Turkey and the United Kingdom. Spain and the former Yugoslavia were included as countries with "special status", and outside Europe, Canada and the United States were made "associate members".

4 The original OECD members were Canada, Spain and the United States, in addition to the 17 founders of the OEEC listed in the previous footnote. Those that joined next were Japan (1964), Finland (1969), Australia (1971) and New Zealand (1973). In the 1990s a new wave of accession took place: first with Mexico (1994), then the Czech Republic (1995), and, finally, the Republic of Korea, Hungary and Poland in 1996.

5 Liberalization here means the abolition of government restrictions on both transactions and transfers of those operations specified in the Code.

6 For example, there are instances in which certain items of the Code have not been developed in the country's domestic financial market; hence reservations on these can be applied only when such items finally come into existence.

7 Reservations and derogation are periodically examined by the Committee on Capital Movements and Invisible Transactions (CMIT). In the case of reservations, the purpose is to review existing provisions and amendments, as well as to propose their removal when they are no longer deemed necessary. This task is conducted on a country-by-country basis. In the case of derogation, the purpose is to restore liberalization as quickly as possible.

8 The major exceptions are credits and loans from non-residents to residents other than enterprises. According to OECD (1995: 22), this springs from the desire to protect consumers.

9 However, it should be noted that since the early 1960s operations involving easily reversible flows were permitted, such as physical movements of securities (see box 1).

10 These were: Austria, Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Sweden, Switzerland, and the United Kingdom, followed by Canada, the United States, Japan, Finland, Australia and New Zealand.

11 Iceland may be an exception, given its relatively high income per capita at the time of its adherence to the Code.

12 Under such requirements, the newcomers did not apply a general derogation at the time of accession, even though, in theory, this is still possible, since Article 7a has not been removed from the Code. This suggests that there seems to have been a tendency towards a growing gap between the formality of the Code and the unwritten rules for capital account liberalization in the OECD area.

13 For a discussion of the Japanese experience with capital account liberalization, see, *inter alia*, Mathieson and Rojas-Suarez (1992).

14 Reservations on items of the Code can be total (i.e. cover the whole item) or partial (i.e. cover just one or a few sub-items).

15 As stressed above, this is true in relative terms. Moreover, if, for comparative purposes, we take the dates when the second-wave countries removed their general derogation (rather than when they adhered to the Code), the number of reservations they used was higher than that used by the third-wave countries; again, this is in relative terms, but for specific countries in absolute terms as well. Greece, for example, had 17 reservations in place at the time it dropped its general derogation.

16 This sub-section benefited from Solanes (1999).

17 Restrictions on portfolio and short-term outflows were also in place during this period.

18 See Dedek (1999) for a detailed account of capital account liberalization in the Czech Republic.

19 The OECD had, on the insistence of the Czech authorities, allowed the use of such interest-free reserve requirements on inflows for a time-limited period (personal interview).

20 In the 1980s, preliminary steps had already been taken , with foreigners being permitted to invest in the Korean stock markets through investment trust funds (Park and Song, 1998).

21 Personal communication.

22 This paragraph is based on interviews with Korean officials and academics.

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