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(Over) Regulation of the (Financial) Markets

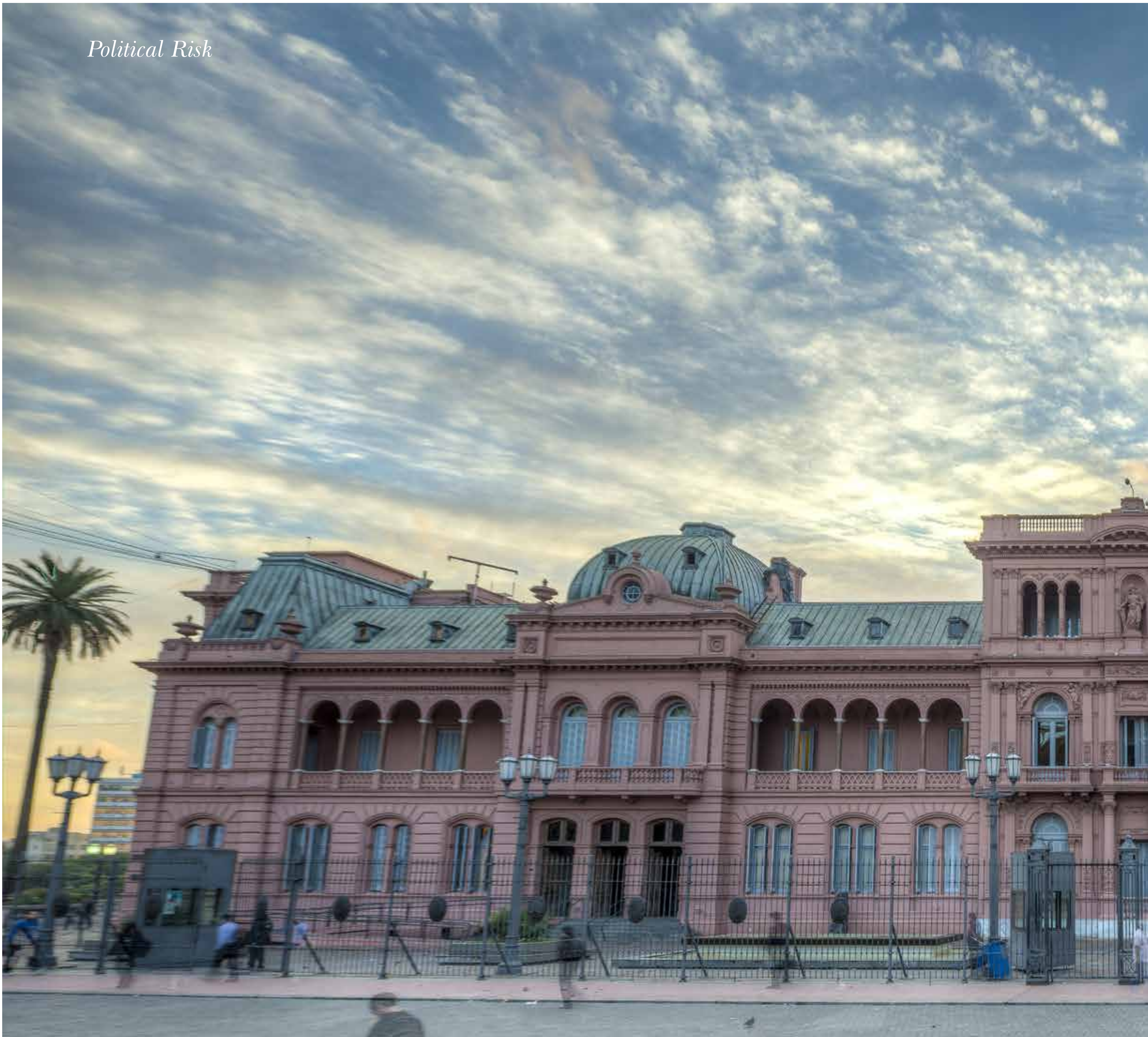
Is It Working? Where Are We Going?

In recent years we have seen an increase in the regulation in the markets in general and in the financial markets in particular. Many legislative initiatives have been initiated, such as Sarbanes-Oxley in the US, initiatives of Organization for Economic Cooperation and Development like the Financial Action Task Force, and various rules implemented in diffferent international financial centers. Is this approach really working? Has the public in general benefited from these regulations? Have the economies benefited from this increase in regulation?

In order to approach a possible answer, we will focus on the case of Argentina, a country that has shifted from a relatively liberal economy to a highly regulated economy in the past decade.

Exchange controls

In October 2011 Argentina imposed exchange controls. This move was intended to prevent money laundering, and it began with the tax authorities requiring the filing of certain forms and documents in order to allow the purchase of foreign currency by Argentine residents. The regulation was implemented as a consequence of commitments agreed to by Argentina under the FATF. Any Argentine resident who wanted to purchase foreign currency had to request authorization from the tax authorities and establish the origin of the funds. After this measure was imposed, Argentines who wanted to purchase foreign currency (mainly US dollars) went running to the banks to file the required forms in order to obtain approval for the purchase of foreign currency. Most of the transactions were rejected by the tax authorities, and the issue became public when a famous TV personality commented on the air that although she had substantial income, the tax authori-

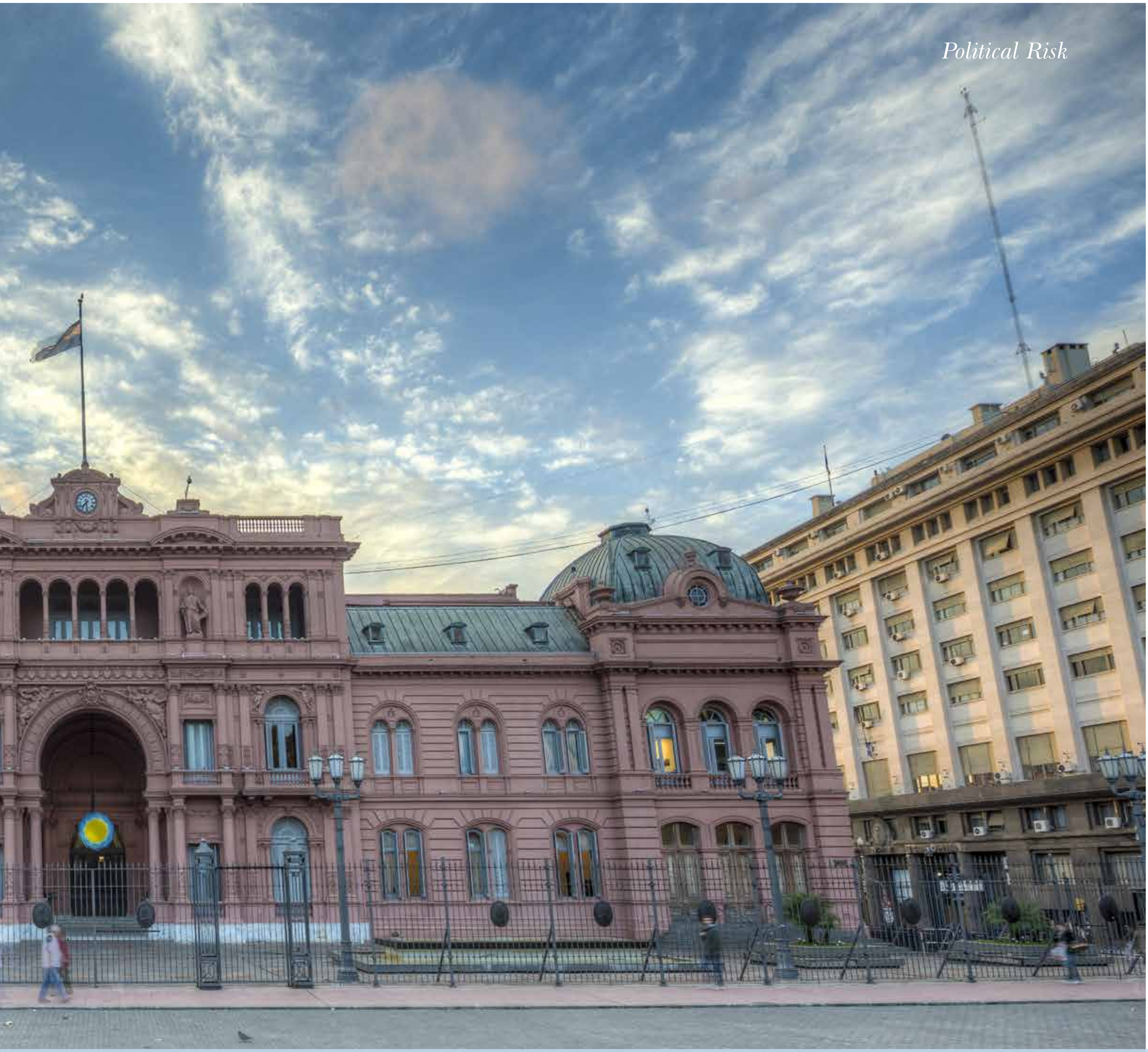


ties had rejected her request to purchase foreign currency.

In addition, there were no clear standards as to who would be authorized and who would not. In fact, one officer of the tax authorities stated that “it is not the Coca-cola formula, but it is very similar,” and that “it is a formula that changes periodically, it has ingredients of the Central Bank, of the tax authorities and other ingredients put forth by God.”

Of course, the system was evolving, and this obviously had consequences. The first consequence: a black market for the US dollar. When these regulations and requirements did not exist, there was no difference between the official and the unofficial rates of exchange, but as soon as the regulation was imposed, a black market was created. Before the regulations were imposed the dollar was exchanged at 4.15 pesos per dollar. When the regulations were imposed (October 2011) the dollar was exchanged at 4.28 pesos per dollar and the unofficial exchange rate was 4.67.

The gap between the official and the unofficial rates varies according to the time and measures imposed between a difference of 50% and 78%. Currently, the official rate is 8.40 pesos per dollar for the official rate and 14.70 pesos per dollar for the unofficial rate.



Other consequences: people started withdrawing money from ATMs overseas. The response of the government was more regulation: you could no longer withdraw money with debit cards. More consequences: people started withdrawing cash from credit cards. Consequently, the government set up a limit on withdrawing money using credit cards overseas.

Then they said, wait, why don't we discourage the legal purchase of foreign money by taxing it? So they introduced a 20% withholding tax on money spent on credit cards overseas, but soon 20% was not enough because the difference between the official and the black market rates was too big, so they increased that to 35%. (They could not increase this further because it would have exceeded the highest rate of income tax at 35%.)

These measures were imposed with the aim of preventing money laundering and avoiding FATF sanctions. Did the government manage to do this? Not really. Argentina is still on the FATF gray list. In the mutual evaluation report of the FATF Argentina was rated non-compliant (NC) or partially compliant (PC) on all of the core and key recommendations of the FATF. As a result of this lack of compliance with the core and key recommendations, the FATF Plenary placed Argentina in an enhanced follow-up process. The follow-up process is a desk-based review that monitors whether a country takes the necessary steps to strengthen its AML/CFT framework. Thus far, Argentina has not addressed all the issues raised by the FATF.

But one could argue that in fact the exchange regulations were imposed to protect the reserves of foreign currency in the Central Bank, to prevent inflation, and to prevent a run on the peso.

Let us see the consequences:

- Reserves of the Argentine Central Bank when the regulations were imposed (October 2011) were US$47,523 million; now (September 2014) they are at US$28,385 million.
- Inflation (according to private reliable sources) in 2011 was 22.80% and in 2014 it will be 40.8%; and
- The peso was at 4.28 per dollar in October 2011 and is now (September 2014) at 8.40 per dollar.

Restrictions on international trade

We have seen that government regulation does not always serve its direct or indirect purposes. We have seen the case of exchange controls that were imposed with the stated goal of preventing money laundering (and indirectly, to preserve reserves, control inflation and prevent a run on the peso). We saw that none of those purposes was accomplished.

There is another area into which the Argentine government decided to intervene and regulate in order to improve it, and that is the international trade sector.

Again, in January 2012 the Argentine tax authorities provided for an "informative" system called "Anticipated Sworn Statement for Imports" or "DJAI." This system provides that before importing any goods (or services) into Argentina, importers have to make a filing with the tax authorities in order to proceed with the relevant import.

It is still unclear what was the actual purpose of this regulation. The regulation states that its purpose is "insuring and facilitating world trade through the anticipation of information in order to obtain transversal coordination of the different areas of the government, which will optimize efficiency in the government's affairs." In spite of this nice declaration of principles, nothing of the kind has happened. This regulation has caused imports to fall sharply in 2012-2014, which resulted in a very significant reduction in exports of manufactured goods.

We have to admit that in the case of Argentina, excessive regulation was in fact disguising economic measures of another type, so as a matter of fact the regulation was aiming at something different.

Excessive regulation

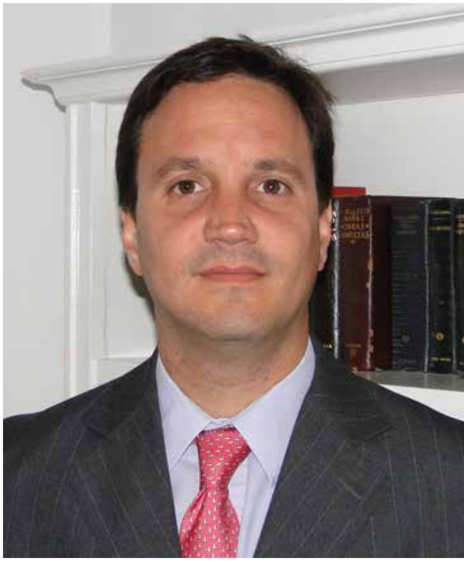
This debate is very current, and it is important to have it. In fact, there are some laws that will be approved soon in Argentina aiming at more and more government intervention and regulation, and the results may be the same as those noted above.

There are currently three legislative proposals that will provide for more power and intervention by the government in the lives of its citizens. I refer to the law for the establishment of courts for consumers, the law that creates an "observatory of prices and services," and the amendment to the "supply" law. These pieces of legislation will enable the government to intervene with companies in the setting of prices.

But the real debate is whether these laws really work or if, in fact, they provide an opportunity for corruption and government abuse. We prefer "government abuse" to corruption, because in fact every act of corruption is an abusive use of the power or funds of the government.

Country	Ease of Doing Business Rank	Corruption Index (Transparency International)
Chile	34	22
Venezuela	181	160
Uruguay	85	19
Argentina	126	106
Peru	39	83
Bolivia	162	106

The question then is whether there is a relationship between excessive regulation and government abuse. Let us take six Latin American countries in order to see whether this is an issue and, if so, whether this a particlarly Latin American issue. Consider Chile, Venezuela, Uruguay, Argentina, Peru and Bolivia. We will also use two widely accepted indexes for the ease of doing business for 2014 (or the less regulated economy) and the corruption index of Transparency International (latest available for 2013). Paradoxes of the regulation, or in fact a clear-cut relationship between government abuse and government regulation?



About the Author

Javier Canosa is a partner in the BA firm Canosa Abogados. his practice develops in corporate law issues, advising several national and foreign companies in various corporate matters, including investment vehicles, corporate management, directors' duties and responsibilities, audits, risks detection and distribution, documents, policies and corporate contracts, and design and implementation of a suitable corporate form for each business.

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