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## BRAZIL

*The following is a review of legal and economic developments in Brazil.*

### LEGISLATIVE AND ADMINISTRATIVE RULINGS

#### *New Treasury Bonds as Inflation Control Measures*

Thus far, the Sarney Administration's various attempts to halt, or at least reduce, current high inflation rates have relied on price freezes. On June 14, 1989, facing a threatened inflation rate of nearly thirty percent, the federal administration released new rules on price adjustments and indexation of financial statements and balance sheets. Simultaneously, the administration announced the issue of two new federal bonds.

The first bond, created by Provisional Measure No. 68, is the Fiscal National Treasury Bond ("BTN" or "Fiscal BTN"), a treasury bond with a face value updated daily by the Ministry of Finance in accordance with the consumer price index ("IPC"). As a result, these bonds indicate the inflation rate on a daily basis. Created to replace the Obrigações do Tesouro Nacional ("OTNs"), the administration intended the BTNs to function as a parameter for indexing purposes, indicating the monthly inflation rate. The Fiscal BTN will generally be used to correct contract prices. However, it cannot be used to update salaries, rents, school tuition or prices and tariffs subject to government control. It is expected that the market will widely adopt the Fiscal BTN, thus avoiding the hyperinflation which recently occurred in Argentina.

The second federal bond announced is the Foreign Exchange BTN which is indexed to the U.S. dollar. The purpose of this BTN is to give companies and individuals the ability to hedge against an inflation rate that has reached approximately thirty percent per month. Rules on the new U.S. dollar-indexed BTN were specified by the Minister of Finance in Ordinance No. 147 of July 3, 1989. The main features of the Foreign Exchange bond are: 1) a two-year redemption period; 2) a six percent interest rate calculated on the adjusted value on the date the interest is due; 3) an interest payment date of every six months; and 4) a registered and transferable form.

The rules require this new BTN to be issued in book-entry form and registered in the name of the respective holder at the Special Liquidation and Custody System ("SELIC"), an organization administered by the Central Bank of Brazil. On the redemption date, holders of this new BTN may elect to have its face value adjusted according to the variation in the IPC or the exchange rate for new cruzados and the U.S. dollar from the date of issuance until the redemption date.

### *Reindexation of the Economy*

In light of the failure of another plan to take the economy off of indexing, the federal government reintroduced monetary corrections in the economy through Provisional Measure No. 68 of June 14, 1989. Provisional Measure No. 68 promulgated rules on the indexation of financial statements and tax liabilities.

Regarding financial statements, Provisional Measure No. 68 repeats the well-known system of monetary correction used in Brazil since 1976. A crucial difference between the established system and the new measure is that this new monetary correction will be based on the daily variation in the BTN or any other index that the administration legally adopts.

The new system provides monetary correction of fixed assets and net worth values. This system diverges from the earlier system by including in the accounts subject to correction those accounts which represent advances to suppliers of goods that are subject to monetary correction, unless the supply contract has specified credit indexing.

The new rules on monetary correction of corporate accounts raise the same questions that the previous system posed concerning the constitutionality of taxing amounts which do not correspond to actual taxable income. Taxation of unrealized inflationary profits and the so-called interim dividends are examples of this incongruity. Nevertheless, the rules consider inflationary profit realized at five percent annually and tax such profit accordingly. Furthermore, corporations must post interim dividends to an account deductible from net worth. The resulting balance will be monetarily corrected, resulting in taxation to the legal entity that distributed the dividends.

Provisional Measure No. 68 introduces new treatment for the revaluation reserve, which can only be used to offset tax losses

when the revalued asset is actually realized. The revaluation reserve does not entitle the company to offset tax losses if there has been no realization of the revalued asset. Thus, it is no longer feasible for companies to offset losses by absorbing the revaluation reserve in an amount equal to the losses. Based on the principle that assets written off in the course of the fiscal year should be monetarily corrected up to the write-off date, the government determined retroactively (with dubious constitutionality) that any write-offs made between December 31, 1988 and the date of Provisional Measure No. 68 should be monetarily adjusted if the transactions involve transfers to the net worth of associated or controlled companies.

Overall, the reintroduction of the balance sheet monetary correction system has been generally well received.

#### *Price Freeze*

After almost three months of a complete price freeze, the executive branch authorized the Minister of Finance to review and authorize price adjustments of products, services, and contracts. The Ministry implemented the adjustments through Provisional Measure No. 51 of April 27, 1989. Since this date, the Ministry has readjusted prices, services, and contracts to take into account the inflation rates determined since January. Indeed, inflation for the first five months of 1989 had reached approximately 120 percent.

Meanwhile, the executive branch also issued Provisional Measure No. 52 which amended Article 11 of Delegate Law No. 4 of September 26, 1962. Enacted in the early 1960s, when government intervention in the economy was essential, Delegate Law No. 4 regulated the intervention of the federal administration in the pricing and supply of market goods and services. As amended, Article 11 establishes a pecuniary penalty for any person who violates any of its twenty-three items which range from the sale of products (in accordance with official price lists) to a series of activities considered harmful to the public economy. The amendment now implemented by Provisional Measure No. 52 updates the pecuniary penalties imposed by Delegate Law No. 4. The penalties now range from 500 to 200,000 National Treasury Bonds (approximately US\$530 to US\$213,000).

Finally, the Executive issued Provisional Measure No. 54 which establishes rules governing the price adjustments authorized

under Provisional Measure No. 51. Provisional Measure No. 54 limits the maximum increase allowable to thirty-five percent of the January 1989 price.

### *Price Readjustment*

The Minister of Finance, acting under his authority to issue rules on federal laws, promulgated Ordinance No. 137 of June 15, 1989 which created rules governing price readjustment.

Ordinance No. 137 divides all products available in Brazil into two categories: Exhibits A and B. If a product is listed under Exhibit A, the Price Council ("CIP") must expressly approve any price adjustments. If a product is listed under Exhibit B, the CIP must specify the documentation to be submitted in support of any price adjustment. Exhibit B products must have their prices adjusted subject to the rules of Ordinance No. 116, which allow automatic price adjustments upon the filing with CIP documents in support of the increase.

The price readjustment rules set forth by the federal administration attempt to introduce some flexibility into the Brazilian markets which have been subject to a price freeze since January. The price correction rule governs only those industries strictly regulated by the federal government.

CIP subsequently issued Resolution No. 502 on June 22, 1989, establishing provisions concerning approval of the prices of products listed in Exhibit A.

The Minister of Finance also issued Ordinance No. 142 on June 22, 1989, allowing leasing payments to be readjusted as provided in the respective leasing agreements. The measure allowed the leasing industry which was at a virtual standstill since January 1989, to finally return to normalcy.

### *1990 Federal Budget*

The executive branch enacted a new Budget Guideline Law on July 10, 1989. Law No. 7800 provides rules and guidelines that will regulate the 1990 budget which the executive branch will submit to Congress. Considered an important weapon in controlling the federal deficit, Law No. 7800 contains specific rules and general guidelines which the legislative and executive branches must observe when preparing, voting on, and approving the 1990 budgets.

These rules include:

1) the full 1989 inflation to be taken into consideration when adjusting the 1990 budget;

2) no expenses for the acquisition, construction or expansion of property, and for new rents or leases of real estate, including residential properties, will be allowed, except those related to budget priorities and expressly specified in Law No. 7800;

3) no funds will be allocated for the acquisition of furniture and equipment for residential units, except to replace furniture and equipment totally lost in accidents and/or covered by military programs;

4) no expenses will be allowed for the acquisition and maintenance of vehicles, except those of the heads of the executive, legislative, and judicial branches, the ministries, and the members of the higher courts;

5) no funds may be allocated to programs, construction projects, activities or other projects within the state and municipal administration responsibilities;

6) no expenses may be incurred without identifiable, adequate sources of funds; and

7) fiscal and investment budgets of all state and mixed-capital companies controlled by the federal government will be included in the budget.

The 1990 budget submitted to Congress will cover the fiscal, monetary, and social security budgets. Law No. 7800 specifies detailed rules governing each of these budgets.

Article 36 required that, five months prior to the closing of 1989, a legislative bill would be submitted to Congress to, *inter alia*: 1) review the social security taxes so as to allow the allocation of funds to new expenses and benefits related to social security and health; 2) reduce by fifty percent all exemptions and tax incentives; and 3) review the Tax on Manufactured Products ("IPI") in order to permit taxation of nonessential products.

Law. No. 7800 also includes a list of priorities to be observed by the 1990 federal budget.

#### *Foreign Currency Obligations*

The Central Bank of Brazil, using its powers as the federal

exchange and monetary authority, released Circular No. 1504 on June 30, 1989, stating that the assumption of any obligations which result in a request for a transfer abroad of foreign currency made by individuals and companies residing and domiciled in Brazil must be preceded by approval from the Central Bank, except in cases expressly provided for in current laws and regulations. Any such transfer, depending on the relative interest to Brazil, may be authorized through the administered rates market, the floating rate market or gold exchange compensation.

### *Foreign Currency Deposits*

Resolution No. 1601 of April 27, 1989, authorized the Central Bank of Brazil to receive foreign currency deposits from foreign and domestic financial institutions. Resolution No. 1601 repealed Resolution 637 of August 27, 1980, which had allowed the Central Bank of Brazil to receive foreign currency deposits for foreign trade financing.

### *Labor Legislation*

The new Constitution, enacted in October 1988, freed the right to strike from various restraints imposed upon it over the last few decades. Since then, strikes have become a fact of life in Brazil, usually triggered by escalating inflation rates as high as twenty-eight percent per month.

Wary of the multitude of strikes occurring, the executive branch issued Provisional Measure No. 50 to attempt to reduce the number of strikes declared in Brazil. Provisional Measure No. 50 required in order to validate a strike resolution the presence of at least one-third of the union members and a majority vote of members present. The measure also listed thirteen activities considered essential in which employees were required to notify employers forty-eight hours before commencement of a strike and designate the employees necessary to the continuity of the services.

Congress, however, did not approve Provisional Measure No. 50 and prepared its own strike law. The congressional bill, Law No. 7783 was passed and on June 28, 1989, the President signed it into law. Law No. 7783 defines a strike as a legitimate exercise of the constitutional right to collectively suspend work temporarily and peacefully. The law also requires notifying employers forty-eight

hours, seventy-two hours in the case of essential activities, in advance of any strike or work stoppage.

Further, Law No. 7783 allows the union to regulate calling a meeting to decide whether to strike as well as designating quorum requirements for passing a strike resolution. The measure prohibits employers from adopting measures to compel employees to return to work or censor union releases to employees.

Most important, Article 7 of the Law mandates that a strike suspends employment contracts, and thus, the employer may not rescind these contracts. The employer may not hire substitute workers during a strike, unless the employer and workers reach no agreement, and only if this agreement is necessary to avoid damage to equipment and machinery.

Under Law No. 7783, the following activities are considered essential, and workers are therefore required to render such necessary services to the community and notify the employer seventy-two hours prior to any strike: water and sewage treatment, and production and distribution of electric power, gas, and fuels; medical and hospital services; distribution and marketing of foodstuffs and medicines; funeral services; collective public transportation; collection and treatment of sewage and garbage; telecommunications; storage, use, and control of radioactive substances, nuclear equipment, and materials; data processing in connection with essential services; flight control; and clearing systems.

The congressional bill eliminates the presidential authority to demand collective or individual provision of services or the use of certain movable property, which union leaders and congressmen viewed as authoritarian.

#### *New Rules on Collective and Individual Bargaining*

Law No. 7788 of July 3, 1989 establishes guidelines for wage policies in Brazil and introduces two unprecedented provisions that repealed all previous legislation. The first provision, Article 7, eliminates suspensions required during appeals of regional labor court decisions in collective bargaining proceedings. The second provision, Article 8, refers to the rights of unions to act as procedural substitutes.

Article 7 provides that "under no circumstances will appeals filed in collective bargaining proceedings have suspensive effects."



All collective bargaining negotiations originate when a union representing a certain category of employees submits a list of claims to the local Regional Labor Office, an agency within the Labor Ministry. This negotiation phase is considered to be an administrative proceeding. If the employers and employees fail to reach an agreement, the Regional Labor Office forwards the case to the Regional Labor Court which sets a date for a conciliation hearing. If no compromise is possible, the case is then submitted for judgment. Once the Regional Labor Court renders a decision, the losing party may appeal to the Superior Labor Court. This appeal phase has traditionally granted the appellant the possibility of requesting a stay of judgment, that is, the employer does not have to comply immediately with the decision under appeal. Before this law was enacted, the court usually granted this suspension of performance. Under Law No. 7788, however, this temporary suspension will no longer apply.

Under the new law, collective bargaining procedures should continue to be the same, although the termination of suspensive effects will have various practical consequences. After the decision of the Regional Labor Court, employers will be obligated to give the decision full effect. This obligation may create problems for employers because the Superior Labor Court could subsequently overturn portions of the decision already executed. Because it would not be feasible for employers to be reimbursed by the employees for any benefits received under the initial decision, prejudice against employers appears likely. In fact, even if such reimbursement were substantially likely, employers and employees could dispute the reimbursement because it would conflict with the constitutional principle of wage irreducibility.

The second provision of Law No. 7788 concerns procedural substitution, which occurs when a person spontaneously seeks rights on behalf of third parties without a power of attorney. Article 8 of Law No. 7788 provides that "pursuant to item III of Article 8 of the Federal Constitution, unions can act as procedural substitutes for the categories, and individual desistance, waiver or settlement shall have no effect thereon."

The ordinary legislation regulating this constitutional provision granted unions nearly absolute powers regarding their rights to act as procedural substitutes. Under previous legislation, such powers were only possible in exceptional cases, concerning the issue to be discussed in court and the possibility of individual waiv-

ers or settlements, which are commonly accepted by the judicial branch.

Previously, pursuant to the Consolidated Labor Laws (Article 872) and specific other laws (Law No. 6708 of October 30, 1979 and Law No. 7239 of October 29, 1984), unions could act as procedural stand-ins only when the issue under debate concerned wage adjustments. In contrast, under current legislation, any issues can be handled in a suit filed by a union as a procedural substitute. The employee who is being substituted cannot intervene in the proceeding, either to reach a settlement or to desist. Because this provision appears to violate an individual's constitutional right to freedom of decision, the constitutionality of this measure is somewhat dubious.

#### *Export Processing Zones*

On July 4, 1989, the executive branch signed Law No. 7792, limiting to ten the number of export processing zones that can be created in Brazil.

Export processing zones are free-trade areas, isolated from the rest of the country by trade and exchange barriers. Decree-law No. 2452, of July 29, 1988 created these zones to attract foreign industries through tax and exchange incentives. The same decree-law established an Export Processing Zone Council to oversee, monitor, and regulate the creation and functioning of the export processing zones. On March 30, 1989, the Export Processing Zone Council issued the following resolutions:

1) Resolution No. 5, specifying the minimum expenses to be incurred in the Brazilian market in the acquisition of services and equipment by foreign companies established in export processing zones;

2) Resolution No. 6, detailing the required documentation for submission to the council by persons interested in creating an export processing zone; and

3) Resolution No. 7, listing conditions for the creation of special customs warehouses in export processing zones.

In addition to the preceding regulations, on April 28, 1989, the President issued Executive Decree No. 97703 which established the Export Processing Zone of Ilhéus, in the State of Bahia.

*Gold Investment Funds*

On June 1, 1989, the Central Bank of Brazil, acting under its authority as the federal banking and currency regulatory agency, ordered the temporary suspension of authorization for the formation of gold investment funds which are essentially mutual funds investing primarily in gold certificates and federal debt instruments. The Central Bank also ordered the liquidation of all gold investment funds and gold investment clubs (smaller investment funds) within fifteen days. Basically, the Central Bank made this decision because a majority of savings was being channeled into these vehicles to avoid the expected thirty percent inflation in the month of June 1989 because monetary correction had not been re-introduced and investors were simply unable to hedge against hyperinflation.

*Taxation of Gold*

Under Article 155 of the Federal Constitution, state and municipal taxes shall not apply to certain transactions involving gold. The specific transactions not subject to taxation by states and municipalities are transactions in which gold is a financial asset or an exchange instrument, as defined by law. After the enactment of the 1988 Constitution, no action was taken to define situations in which gold was to be considered a financial asset or an exchange instrument. Finally, on May 11, 1989, Congress approved and the Executive Branch enacted Law No. 7766, regulating these gold transactions.

Under Article 1 of Law No. 7766, gold of any purity, when traded on the financial market or used for execution of the national exchange policy, in transactions involving companies within the National Financial System, shall be considered a financial asset or exchange instrument provided that the rules set forth by the Central Bank of Brazil are observed. Article 1 also covers any gold transaction executed on any commodity or futures stock exchanges or over-the-counter markets with the intervention of authorized financial institutions. Article 1 also provides that the Central Bank of Brazil must authorize miners' cooperatives or associations to deal in gold. Accordingly, gold involved or used in any such transactions is only subject to a tax on credit, exchange, and insurance transactions, at the rate of one percent to be paid by the purchaser upon the first acquisition of the gold. Capital gains and income

from gold transactions are subject to the same tax rules applicable to capital gains and income in the financial market.

*New Environmental Legislation*

On July 10, 1989, the President enacted Law No. 7796, creating the Regional Coordinating Commission for Amazon Research ("CORPAM"). The purpose of CORPAM is to assist the Special Technology and Science Office to set forth guidelines, to allocate federal funds, and to follow up on the implementation of the Humid Tropic Program, a special federal research program focussing on the Amazon region. The commission will have eighteen members representing various federal agencies, the Brazilian Society for the Progress of Science, environmental entities, and the Brazilian states in the Amazon region.

On the same date, the President also signed Law No. 7797, establishing the National Environmental Fund for the purpose of developing projects for the rational use of natural resources, including the maintenance, amelioration, and recuperation of the environment. The fund will receive financial resources from the federal government, private entities, and individuals. Contributions to this fund will be tax deductible.

*New Pesticide Law*

On July 11, 1989, the Legislature enacted Law No. 7802 regulating pesticide research, experimentation, production, packaging, labeling, transportation, storage, marketing, advertising, importation, exportation, and final residue disposal.

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