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BRAZIL

I. MONETARY REFORM IN BRAZIL

The following is a summary of Brazil's monetary reform, unemployment insurance, and other recent legal developments.

In an effort to fight inflation, the Brazilian government passed legislation enacting monetary reform. The reform includes the abolition of the indexation system, used in Brazil since 1964, the creation of a new currency—the “cruzado” (its symbol is Cz\$)—to replace the “cruzeiro”; and a total price freeze for a period of one year.¹

The indexation system, established in 1964, constituted an imaginative solution for the economic problems that existed at that time. It provided an effective shield against the evils of inflation, and allowed the economy to run smoothly. The indexation system had several important features. First, it permitted a real return on savings, as interest was paid on the investment after monetary correction. This enabled individuals to deposit their savings in *cadernetas de poupanca* (savings accounts) which today account for a substantial amount of total savings. Next, the system permitted the development of a plan of indemnity for employees upon dismissal—the *Fundo de Garantia por Tempo de Serviço* (Compensation Fund for Period of Service (FGTS))—and thus resolved, to the satisfaction of both employees and employers, an acute problem which previously existed. It also aided the establishment of a plan for the construction of houses with long-term financing from the National Housing Bank (BNH). The system allowed the contracting of long-term transactions, by establishing prices in relation to the value of the Readjustable National Treasury Bond (*Obrigaç o Reajust vel do Tesouro Nacional* (ORTN)). Finally, the indexation system created a method for adjusting corporate profits by discounting the effects of inflation, thereby avoiding the creation of “paper profits.” As a result, taxes were assessed only on real profits.

1. Decree Law No. 2.283 of Feb. 27, 1986 was published in the Official Gazette of the Federal Executive on February 28, 1986. In response to criticism, the government issued, on March 10, 1986, Decree Law No. 2.284, which changed, corrected, and revoked Decree Law No. 2.283.

With growing inflation, however, the monetary correction system fueled spiraling inflation and the economy became distorted. Unnecessary purchases were made based on the expectation of higher inflation on one hand, and higher nominal income with which to pay for the purchases on the other. Price increases occurred almost daily. Attempts to impose price controls were ineffective and penalized the more organized sectors of the economy. Salaries were devalued on real terms with great speed: semi-annual adjustments were the rule, with a quarterly advance, more recently moving to a bi-monthly basis. This state of affairs benefitted only wealthy individuals while working to the detriment of the poorer individuals. An unfair transfer of income was the result.

The controversial idea of total desindexation (shock treatment) had been on the forefront for some time. One of its staunchest advocates was Octavio Gouvêa de Bulhões, an influential Brazilian economist who is a member of the Brazilian National Monetary Council, and the very person who created the monetary correction system. Despite his support, most of the population did not expect that total desindexation would be implemented, and thus, the news of its adoption came as a great surprise.

The Brazilian plan is somewhat similar to the plans adopted by Argentina and Israel, but a copy of neither. The system abolishes monetary correction and expressly prohibits any contractual provision for monetary adjustment in all agreements for terms of less than one year (article 7). The Readjustable National Treasury Bond (ORTN) is to be replaced by the *Obrigação do Tesouro Nacional* (National Treasury Bond (OTN)); the OTN's issued as of March 3, 1986, will have a fixed value of Cz\$ 106,40 (US\$ 7.71) until March 1, 1987 (article 6). The OTN will be corrected on March 1, 1987, pursuant to the Consumer Price Index (*Índice de Preços ao Consumidor* (IPC)), and its value may be either increased or reduced pursuant to the index (article 6). The frequency of subsequent adjustments of the value of the OTN will be determined by the National Monetary Council. Agreements for terms of one year or more may provide for correction pursuant to the value of the OTN in cruzados (article 7).

The law creating the cruzado states that one thousand cruzeiros will be converted into one cruzado on February 28, 1986. The cruzeiro will be devalued vis-a-vis the cruzado on a daily and cumulative basis by application of a 1.0045 conversion factor (article 8). This factor corresponds to an inflation index of 14.36%. The

exchange rate of the cruzado vis-a-vis the U.S. dollar has been fixed at Cz\$ 13,77 and Cz\$ 13,74 for US\$ 1.00 (buying and selling rates, respectively).

The payment of all obligations expressed in cruzeiros without monetary correction, entered into before February 28, 1986, will be tendered in cruzados on the date of payment, by dividing the cruzeiro amount then due by a conversion factor of 1.0045 (article 8). Interest and other charges due on such obligations will be computed in cruzeiros, for the purpose of determining the final amount due in cruzeiros, before conversion into cruzados. This is perhaps the most significant feature of this new law as it effectively transforms the cruzado into a hard currency.

Finally, to aid the monetary reform, all prices for sale on a cash basis were frozen at their existing levels on February 27, 1986 (article 35). Prices for sale on a credit basis cannot be used in the determination of the prices that are to prevail during the freeze period. Certain government agencies were entrusted with the enforcement of the price freeze (articles 36, 37).

The government requested the Brazilian population to aid in enforcing the price freeze (article 38). Initial reaction indicated that consumers will, in fact, play an important role in enforcing the price freeze. There were a few excesses as well, as is usually the case in such situations, and the government is taking appropriate action to curtail the same. Violations of the price freeze will constitute a crime subject to punishment. A law enacted in 1962 has been revived and will be used as a strong weapon to prevent violations of the price freeze. This law permits the government to take broad action designed to ensure the free flow of goods and services that are essential to the population. The action allowed includes the expropriation of stock.

II. UNEMPLOYMENT INSURANCE

Pursuant to Decree-Law No. 2.284 of March 10, 1986, the government introduced unemployment insurance for the purpose of providing temporary financial support to workers who are unemployed either because they were dismissed without just cause or laid off. Workers qualifying under article 3 of the Consolidated Labor Laws must meet various requirements in order to receive the insurance benefits. First, the unemployed worker must have contributed to Social Security for at least thirty-six months during the

last four years. Second, the worker must provide evidence of having been a salaried worker for a public or private legal entity in the last six months, by registration in the Work and Social Security Card. Finally, the worker must have been dismissed for more than thirty days before becoming eligible for benefits.

The benefits are paid for a maximum period of four months to the unemployed worker who does not have any other personal income sufficient to support himself and his family, and who receives no benefits from Social Security nor any other kind of unemployment payment. Refusal by the unemployed individual to accept other employment shall be grounds for cancellation of his unemployment insurance. Workers may only receive the unemployment benefit for four months in each period of eighteen months, whether in consecutive or intermittent periods.

The amount of insurance to be paid each month to the unemployed shall correspond to either fifty percent of the salary for those who were earning up to three times the minimum wage each month, or one and a half times the minimum wage for those who were earning more than three times the minimum wage. In order to determine the amount of the benefit, the worker's salary is deemed the average amount earned during the three month period prior to unemployment. In any event, the amount of the benefit may not be less than seventy percent of the established minimum wage.

III. NATIONAL MOTION PICTURES

The President of the Republic signed Decree No. 92.488 of March 24, 1986, defining the concept of national motion pictures. According to the decree, a national motion picture is a movie recorded or reproduced on a film, tape, video-disk, video-tape, or any other base for recording and reproducing sounds and images, with a duration of seventy minutes or more. To qualify as a national motion picture, the movie must have been produced by a company in which the majority of the capital or control is held by Brazilians, or foreigners who have resided in Brazil for more than three years, duly registered with the National Cinema Council, CONCINE. The dialogue must be spoken in Portuguese. Other languages will only be permitted if necessary to support an argument. The movie must have been directed by a director who is Brazilian or who has resided in Brazil for more than three years, and two thirds of its

technical and artistic staff must have been Brazilians. The technical services of soundtrack, mixing, developing, copying, transcription, and reproduction must have been performed in Brazil. CONCINE, however, may authorize the performance of such services abroad in order to obtain better quality or lower cost (DOU-I, March 25, 1986).

IV. STATE ENVIRONMENTAL SYSTEM

The Governor of the State of São Paulo signed Decree No. 24.932 of March 24, 1986, instituting the State Environmental System and creating the State Environmental Office. According to the decree, the State Environmental System shall, (a) provide for the preservation, improvement, and recovery of environmental quality; (b) coordinate and integrate environmental protection activities; (c) provide for the preparation and perfection of environmental protection regulations; (d) encourage the development research and technological processes to reduce degrading of environmental quality; and (e) encourage educational activities and participation of the community in the process of preserving the environment. The Governor then signed Decree No. 24.933 of March 24, 1986, which defined the Environmental Office's structure, duties, and authority.

V. FREE ZONE OF MANAUS

The President of the Republic signed Decree No. 92.534 of April 10, 1986, establishing the aggregate limit of imports to be made through the Manaus Free Zone in fiscal year 1986 at US\$ 550 million FOB. This aggregate limit does not include imports of wheat, oil and their derivatives, which are subject to special controls, or those imports made by government agencies or entities which are subject to the limitations established by the Economic Development Council (CDE). The President then signed Decree No. 92/560 on April 16, 1986, which extends the use of the tax exemptions granted to the Manaus Free Zone under Decree-Law No. 288/67 for another ten years. The exceptions contained in Decree-Law No. 340/67 are still recognized.

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