BUSINESS PERSPECTIVE

FOREIGN INVESTMENT CLIMATE IN BRAZIL

DUANE L. HUGHES*

1. INTRODUCTION

Foreign investors have become very concerned with the current economic and political climate in Brazil.¹ The failure of the Cruzado Plan in 1986² drained Brazil's foreign exchange reserves and prompted a moratorium on repayment of $67 billion owed to foreign commercial

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* Joint M.B.A./M.A. candidate, 1988, Lauder Institute of Management and International Studies of the Wharton School of Business, and Graduate School of Arts and Sciences of the University of Pennsylvania; B.A., 1986, Howard University. The author was employed during the summer of 1987 in the São Paulo, Brazil branch of Citicorp Investment Bank.

¹ See Suzuki, Creadores Japoneses Temem Prejuizo com a Moratória [Japanese Creditors Fear Losses from the Moratorium], Folha de São Paulo [hereinafter FOLHA], July 19, 1987, at A39, col. 1; Bancos Estrangeiros se Procupam Sobre o Constituinte [Foreign Banks Are Worried About the Constitution], FOLHA, June 5, 1987, at A27; see also Special Report: How U.S. Banks View Their Brazilian Loans, Brazil Watch, Sept. 7/21, 1987, at 4, 5 (stating that Brazil’s smaller creditors have lost patience with attempts to solve Brazil’s debt crisis and would prefer to sell their loans outright).

² Brazilian President José Sarney introduced the Cruzado Economic Stabilization Plan on March 1, 1986 in an effort to control Brazil’s rampant inflation. The plan operated by: (1) replacing Brazil’s previous unit of currency, the cruzeiro, with a new one, the cruzado, (2) eliminating previous price indexation by freezing all wages and prices, (3) imposing a fixed exchange rate between the Brazilian cruzado and the United States dollar and (4) proposing decreases in government spending. Riding, Brazil Freezes Wages and Prices in Sweeping Anti-Inflation Drive, N.Y. Times, Mar. 1, 1986, at A1, col. 4. Imposition of the plan caused dramatically increased levels of consumption in Brazil, shortages of goods and pressure to raise prices. Instead of slowly unfreezing prices in June or July of 1986 as originally planned, President Sarney succumbed to political expediency and delayed lifting the price freeze until just after the nationwide elections held on November 15, 1986. Riding, Protestos Engulf Brazil President, N.Y. Times, Nov. 29, 1986, at A1, col. 5.

As a result, hyperinflation returned, and the Brazilian business community suffered a dramatic loss of confidence in its government. Both the original Cruzado Plan and its successor, the Cruzado Plan II, are generally regarded as failures. See Brazil Back to Square One with Price Adjustments and Return to Indexation, Bus. Lat. Am., Feb. 9, 1987, at 41; Riding, Big Price Increases Shock Brazilians, N.Y. Times, Jan. 2, 1987, at D1, col. 3; Brazil’s Cruzado II Disappoints, Rundt’s Weekly Intelligence, Nov. 20, 1986, at 13.
banks. The merits of debt-to-equity exchanges as an appropriate solution have been actively debated in the Brazilian Press. Nonetheless, Brazil’s Central Bank, (Banco Central do Brasil), has yet to make provisions for converting debt to equity. Investors also await Brazil’s proposed new constitution. The Congress to Establish a New Constitution (Constituent Assembly) is not expected to present a new constitution until well into 1988. In the constitutional debate, politicians of both the center and of the left have proposed severe restrictions on foreign investment. Such proposals ignore Brazil’s need for foreign investment in both the present and the future.

This paper has four objectives: (1) to review current Brazilian law on foreign investment, especially with respect to financial issues such as debt-to-equity exchanges, capital repatriation and profit remittance, (2) to comment on the Brazilian legal system in practice, (3) to summarize the arguments presented in the constitutional debate with respect to foreign capital, and (4) to suggest some changes that may be mutually beneficial to Brazil and its foreign investors.

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5 The Banco Central do Brazil [hereinafter Central Bank] recently proposed a plan to allow the conversion of up to $1.5 billion annually of Brazil’s foreign debt to equity. The plan would grant priority to certain industry sectors (such as export-oriented projects, high-technology projects and tourism) and would continue existing governmental preferences for certain geographic regions (such as Brazil’s northeast). Truell, Brazil Sets Up a Plan to Swap Debt for Equity, Wall St. J., Nov. 18, 1987, at 29, col. 1.

6 The Congress to Establish a New Constitution [hereinafter Constituent Assembly] was elected on November 15, 1986 and will address many areas in addition to foreign investment as it drafts a new constitution. Riding, Brazil, in Transition, Votes for Congress, N.Y. Times, Nov. 16, 1986, at A3, col. 4. For accounts of Brazil’s political situation as it approaches a new constitution, see Cohen, Distillationism Grows in Brazil After Return To Civilian Control, Wall St. J., Nov. 18, 1987, at 1, col. 1; Cohen, Brazil’s Ruling Party Headed for Breakup, Wall St. J., July 21, 1987, at 28, col. 1.

2. COMPARISON OF DEBT AND EQUITY INVESTMENT IN BRAZIL

2.1. Historical Background

In the past, it made sense for foreigners to loan to Brazilian companies rather than to invest in equity. Debt offered these advantages: (1) the return was a fixed amount, (2) Brazil’s nonresident withholding tax could be shifted to the Brazilian borrower, (3) payment of interest abroad on registered loans did not require prior government authorization and (4) lenders often accepted conversion to equity whereas stockholders were seldom willing to trade their equity stake for debt. Until 1985, the Brazilian authorities also provided a forty percent rebate on the withholding tax for interest payments abroad. Furthermore, it was thought that “the repatriation of capital tend[ed] to be more difficult than that of loans and [would] be subject to a temporary government embargo if serious balance of payments problems [would] arise.”

Now, however, debt’s advantages over equity have been reduced. One analyst recently stated that “[w]ithin the context of the moratorium, political negotiations and crises in debtor nations, the expectations of receiving profits are much greater than the expectations of receiving interest.” Brazil’s creditors are anxious to exchange debt for equity, while both private and public sector firms in Brazil thirst for

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8 Brazilian Income Tax Reg., Decree Law No. 1.598, art. 16 (Dec. 26, 1977); see also T. ARAÚJO, INVESTMENTS IN BRAZIL: BASIC LEGAL ASPECTS 18-19 (6th ed. 1987). This frequently updated treatise presents information on all aspects of the Brazilian legal system of concern to foreign investors. It is prepared by a member of the São Paulo, Brazil law firm of Araújo & Policastro and published by Brazil’s Instituto de Desenvolvimento Industrial de Minas Gerais [Institute of Industrial Development of the State of Minas Gerais].

9 T. ARAÚJO, supra note 8, at 18-19.

10 Foreign loans must be registered with the Central Bank in order for the lender to remit interest payments abroad. Law No. 4.131, art. 3 (Sept. 3, 1962). The Central Bank affords separate regulatory treatment to: (1) loans made directly between foreign lenders and Brazilian borrowers, (2) loans made through Brazilian financial institutions acting as intermediaries and (3) loans primarily intended for import financing. See Rosenn, Regulation of Foreign Investment in Brazil: A Critical Analysis, 15 LAW. AM. 307, 318-21 (1983). In all cases, regulation is aimed at curbing inflation, assuring that interest rates are reasonable and requiring that capital remain in Brazil for a minimum amount of time. Id.; see also T. ARAÚJO, supra note 8, at 44-47.

11 On July 1, 1985, this rebate was reduced to zero percent. Central Bank Resolution No. 1033 (July 1, 1985).

12 T. ARAÚJO, supra note 8, at 19.

13 Schwartz, Conversão Está nas Alternativas de Negociação da Divida [Conversion is One of the Alternatives in Debt Negotiations], FOLHA, July 19, 1987, at A41, col. 1.

14 See, e.g., Truell, supra note 5; Sotero, As Metas do Citicorp, [Citicorp’s Goals], G.M., June 1, 1987, at 30; Cunha Anuncia Intenção de Elevar Volume de Conversão da Divida [Bank of Montreal Announces Its Desire to Convert Debt], G.M., May 27,
foreign capital.\textsuperscript{15} However, since July 1984, the Brazilian Government has imposed severe restrictions on debt-to-equity conversions. Usually, debt can be converted only if: (1) the original creditor acquires equity in the original debtor, (2) the exchange is approved by the Central Bank, (3) the investment remains in Brazil until the debt's maturity date, (4) the exchange is performed by financial institutions and (5) ownership of a Brazilian enterprise is not transferred to a third party.\textsuperscript{16} Even with these restrictions some deals have been finalized.\textsuperscript{17} The Central Bank is now considering a new debt-to-equity program at the time of this writing.\textsuperscript{18}

\subsection*{2.2. Brazilian Reservations Regarding Debt-to-Equity Exchanges}

On July 11, 1987 the Constituent Assembly overwhelmingly approved a motion that would impose a constitutional ban on conversion of any foreign debt into equity.\textsuperscript{19} This motion reflected fears on the part of many Brazilian politicians and economists that exchanges would lead to a series of problems: inflation, denationalization of the economy, a balance of payment's deficit, disincentives for new foreign investment and overspeculation in the capital markets. Additionally, some commentators argue that Brazil actually has a long-term balance of trade surplus that will enable the country to pay interest and grow simultaneously.\textsuperscript{20} A Group of Thirty report cautions that debt-to-equity exchanges would create a legal loophole permitting foreign firms to remit profits that would otherwise be required to remain in Brazil.\textsuperscript{21}
Most Brazilian businessmen, however, believe that debt-to-equity exchanges are an excellent idea. Although such exchanges are not a complete solution to the debt crisis, their potential drawbacks could be overcome by proper governmental regulation. More specifically, inflation could be avoided by gradually phasing the converted debt into the economy. Denationalization of Brazilian industry is also an unfounded fear. Under existing law the stock resulting from debt-to-equity exchanges would be preferred stock without voting rights; control of the companies, therefore, would remain with the original owners.

Allowing conversion from debt to equity need not cause more capital flight than is already occurring. The Central Bank will probably require that equity resulting from conversion of debt principal remain in Brazil for fourteen years, and that equity resulting from conversion of accrued interest remain for eight years. If debt were converted into equity, remittance of profit would occur only if the Brazilian economy achieved prosperity, whereas remittance of interest on debt would occur regardless of swings in the economy. Although there is no guarantee that profit remittance will be less than interest remittance, most foreign investors in Brazil have chosen to reinvest their earnings in Brazil. Doing so increases the registered capital base upon which future remittances are calculated. Conversion of debt into equity is, therefore, un-

22 See supra note 14.
24 For discussions of proposals to impose monthly limits on new money entering the Brazilian economy, see A Dívida na Onda da Conversão: O Governo Estuda a Regulamentação dos Swaps [The Debt on the Brink of Conversion: The Government Studies the Regulation of Exchanges], Exame, June 10, 1987, at 26; Brasilpar Defende "Ação Efetiva" para Atrair Capital Estrangeiro [Brazilpar Defends "Effective Action" to Attract Foreign Capital], G.M., June 6, 1987, at 19. For a description of similar limits on conversion imposed by Chile, see Marton, The Debate over Debt-for-Equity Swaps, INSTITUTIONAL INVESTOR, Feb. 1987, at 116.
26 Capital flight is already at high levels. See Franco, Continua Elevado o Volume de Remessas de Lucros ao Exterior [Foreign Profit Remittance Continues at High Levels], G.M., July 31, 1987, at 3 (estimating that remittance of profits and dividends abroad will amount to $1.4 billion in 1987, as contrasted with $1.23 billion in 1986 and $1.05 billion in 1985).
27 See Debt to Equity Conversion, Brazil Watch, Oct. 19/Nov. 2, 1987, at 12.
29 During the last 10 years, the average annual level of dividends remitted abroad was less than five percent of the amount of registered foreign investment in Brazil. T. Araújo, Seminar on the Brazilian Economy 24 (Nov. 1986) (unpublished manuscript available from the law firm of Araújo & Policastro, Sao Paulo, Brazil).
likely to cause a worsening of Brazil's balance of payments position.

Instead of operating as a disincentive for new money, a liberal debt-to-equity program would attract new foreign investment. Most investors believe in the long-term future of Brazil’s economy despite the current crisis. In order to guarantee additional capital for Brazil, nationalists wish to impose a mandatory “new money requirement” on foreign investors seeking to exchange debt. Such a requirement would force an investor to supply an additional dollar of fresh capital for every dollar of debt exchanged. This proposal would, however, reduce the benefits which accrue to investors and borrowers from the debt’s secondary market discount.

Some critics fear that converting debt to equity through the stock market would create speculation and add to market instability and uncertainty. Eduardo Azevedo, President of the Sao Paulo stock exchange, takes a contrary position to the effect that the creation of additional equity would benefit the stock market. He believes that portfolios should be established for companies who want to reduce their debt exposure by investing directly in Brazilian companies. To reduce any destabilizing effects of the new money in the market, Azevedo believes that new equity investments should remain in the country for at least ten years. He states, “[c]apital cannot enter and then flee the country.” Converting debt into equity would inject much needed capital into the Brazilian market. Brazil’s current stock market capitalization amounts to only sixteen percent of its gross domestic product, compared to comparable statistics of over fifty percent for the United States and

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33 A simple example will show how this secondary market discount offers advantages to be shared by lenders and borrowers. If a foreign investor originally loaned $1.00 to a Brazilian company, his loan is now worth only about $.50 on the secondary market. A debt-to-equity exchange based on the $1.00 face value offers a potential $.50 gain; this gain amounts to 50% of the original $1.00 investment. In negotiating their exchange, the foreign creditor and Brazilian debtor will bargain as to how much of this gain each will receive.

If, however, the borrower were required to put up an equal amount of new money, his total investment would be $2.00. The potential gain of $.50 would then represent only 25% of this investment. This smaller percentage of profit would reduce the advantage available to the parties and lessen the chances that they would arrive at a mutually acceptable transaction.

34 See supra note 7.
35 Carvalho, Ganho de U.S. $2 Bilhões por Ano [Profit of U.S. $2 Billion Annually], G.M., July 9, 1987, at 16. Azevedo also argues that all sectors of the Brazilian economy should be open to investment and that more than 200 public sector companies should be privatized. Id.
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Malaysia.\(^{36}\)

In addition, no restrictions should be imposed on which entities may take part in exchanges. More participants will increase liquidity in the debt market and lower the secondary market discount of Brazilian obligations.\(^{37}\)

3. PARTICIPATION OF FOREIGN CAPITAL IN THE BRAZILIAN EQUITY MARKET

Currently, investment of foreign capital in the Brazilian equity market must be conducted through Central Bank approved investment companies.\(^{38}\) Foreign capital is negotiated in São Paulo and managed in special "1401 mutual funds," named after their regulating statute, Decree Law No. 1.401.\(^{39}\) At the time of this writing, seven such funds existed with a total capitalization of about $21 million.\(^{40}\) In order to make foreign investment in the Brazilian stock market more attractive, remittances abroad of capital gains have been free from both corporate and supplementary taxes.\(^{41}\) The Central Bank does, however, impose restrictions: foreign capital must remain in Brazil for at least ninety days,\(^{42}\) not more than ten percent of the portfolio can be invested in any single corporation and total investments in shares cannot exceed five percent of the voting capital or twenty percent of the total capital of any single company.\(^{43}\) All Brazilian mutual funds are subject to very similar ownership restrictions.\(^{44}\)

Recently, the Brazilian securities regulating agency, Comissão de

\(^{36}\) Growth with Equity, ECONOMIST, July 11, 1987, at 15. This article makes three significant points regarding the potential advantages of debt-to-equity exchanges for the Brazilian economy: First, if Brazil matched Chile's record in facilitating exchanges, the principal amount of Brazil's $110 billion external debt would be decreased by $16.5 billion, and annual interest payments would be decreased by $1.5 billion. Second, if the ratio between the capitalization of Brazil's stock market and Brazil's gross domestic product were as large as the ratio in Malaysia, Brazil would possess an additional $90 billion of equity capital, an amount almost equal to Brazil's entire foreign debt. Third, if Brazil allowed foreign investors to provide 20% of that extra investment, they would bring $18 billion of fresh capital into Brazil. Id. at 16.

\(^{37}\) Id.

\(^{38}\) Interview with Pedro Paulo Longuini, Capital Market Specialist, Citicorp Investment Bank, in São Paulo, Brazil (Aug. 10, 1987) [hereinafter Pedro Longuini Interview].

\(^{39}\) Decree Law No. 1.401 (May 7, 1975) (as modified by Decree Law No. 1.986 (Dec. 28, 1982)). For a brief summary of important provisions of these laws, see PRICE WATERHOUSE, DOING BUSINESS IN BRAZIL 89-90 (1986).

\(^{40}\) Boletin Diário de Informações, July 30, 1987, at F1.

\(^{41}\) Decree Law No. 1.401, art. 38 (May 7, 1975).

\(^{42}\) Id. art. 30.

\(^{43}\) Id. art. 45.

\(^{44}\) Pedro Longuini Interview, supra note 38.
Valores Mobiliarios (CVM), published rules for the Brazil Fund, a new fund to be traded in New York.\(^45\) The Brazil Fund will have initial capital of $100 million with a fixed number of shares.\(^46\) In contrast to 1401 mutual funds, this initial capital will not be able to leave Brazil for ten to twenty years.\(^47\) There will, however, be secondary market trading in New York, where profits can be realized immediately.\(^48\) The CVM has also recently published rules for a third option for foreign capital: the Investment Fund — Foreign Capital.\(^49\) This fund will possess the advantage over 1401 funds that its shares will be traded abroad.\(^50\) The CVM recently approved funds of this type for Banco Bozano, Chase Manhattan Bank and Unibanco.\(^51\) Through the Brazil Fund and the Investment Fund — Foreign Capital, the CVM's President, Luiz Octavio da Motta Veiga, hopes to inject $300 million into the Brazilian stock market.\(^52\)

Although the rules governing mutual funds are becoming less stringent, foreign investors want to invest directly in the Brazilian capital market.\(^53\) To encourage the return of flight capital, the Brazilian authorities should accelerate the process of establishing direct foreign investment in the stock market. Decree Law No. 1.401 was a first step, the Brazil Fund a second, and the Investment Fund — Foreign Capital a good third. Direct foreign participation in the Brazilian stock market would be an excellent fourth step towards liberalization.


\(^{46}\) Magalhães, supra note 45.

\(^{47}\) Pedro Longuini Interview, supra note 38.

\(^{48}\) As Perspectives Que se Abrem com o Fundo Brasil [The Perspectives That Open with the Brazil Fund], G.M., July 21, 1987, at 4, col. 1; Magalhães, Fundo Brasil no Boston [Brazil Fund Goes to First Boston], G.M., July 20, 1987, at 20. The First Boston Corporation will lead manage this fund during its first year of operation. Id.

\(^{49}\) Central Bank Resolution No. 1224 (Jan. 6, 1987).

\(^{50}\) Id.


\(^{52}\) Id.

\(^{53}\) James Walker, Director of Yamaichi Murray Johnstone, Ltd., an association of Japanese and Scottish institutional investors, recently stated that he would like to invest £1 million directly in Brazilian blue chip firms over the next four years. Magalhães, Estrangeiros Querem Investir Diretamente nas Bolsas Brasileiras [Foreigners Want to Invest Directly in Brazilian Financial Markets], G.M., May 12, 1987, at 18. Murray Johnstone entered a 1401 mutual fund in 1975, but left in 1986 at the first signs of weakening of the Cruzado Plan. Id.

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4. OBSTACLES TO RETURN OF FOREIGN INVESTMENT FROM BRAZIL

4.1. Repatriation of Capital

Although equity investments are currently more economically attractive than they were in the past, capital repatriation may present problems. After registering an investment with the Central Bank, a foreign investor will receive a certificate of registration for the investment’s value in foreign currency. If the investment is later sold, the foreign party will be able to repatriate untaxed the cumulative amount of the registered capital certificates. If the investment’s book value at the time of repatriation is less than the certificate’s amount, then the foreign investor will be allowed to repatriate only the book value without taxation. Problems arise when the Central Bank examines the firm’s books and disagrees with the investor’s valuation. The Central Bank will often demand rigorous documentation of the firm’s value. These additional unwritten regulations can severely delay the repatriation process. If the foreign investment has a new net worth greater than the value of its registered capital base, the gain will be subject to Brazil’s twenty-five percent nonresident withholding tax.

4.2. Remittance of Dividends

Dividend remittance tends to be more straightforward than capital repatriation. All dividends are freely remittable, subject to Brazil’s

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54 Law No. 4.131, art. 3 (Sept. 3, 1962).
55 Law No. 4.390 (Aug. 29, 1964) (as modified by Decree No. 55.762 (Feb. 17, 1965)).
56 Interview with Wlademir Lisso, Partner, law firm of Araújo & Policastro, in São Paulo, Brazil (Aug. 10, 1987) [hereinafter Wlademir Lisso Interview] (Mr. Lisso stating that an appraisal of a company’s worth from a well-known accounting firm can reduce obstacles to tax-free repatriation of capital and that most foreign firms have been satisfied with Brazil’s foreign capital repatriation procedures); Interview with José Luis Leite Doles, Attorney, Citicorp Investment Bank, in São Paulo, Brazil (July 20, 1987) [hereinafter José Luis Interview].
57 French, Brazil’s Profit Remittance Law: Reconciling Goals in Foreign Investments, 14 LAW & POL’Y INT’L BUS. 319, 413 (1982). In some instances, the Central Bank requires a balance sheet for the past year, in other instances, for the past three years. Id.
58 Id. at 413-14. Even when repatriation is allowed, the value is often much less than the foreign party would like. José Luis Interview, supra note 56.
Remittances of gains in excess of 12% of the registered capital base are also subject to a supplementary tax at graduated rates. Law No. 4.131, art. 43 (Sept. 3, 1962). Remittances between 12% and 15% of registered capital are taxed at a rate of 40%, those at levels between 15% and 25% are taxed at a rate of 50% and those at levels over 50% are taxed at a rate of 60%. Id.
twenty-five percent withholding tax imposed on the entire remittance and to a steep supplementary tax imposed on any part of the remittance exceeding twelve percent of the registered capital base. In practice, this twelve-percent limit is seldom a problem, because it is calculated over a three-year period.

4.3. Payment of Technical Fees Abroad

Foreign investors find it much harder to remit patent royalties than dividends abroad. Initial establishment of a valid patent with the Brazilian Patent Office, Instituto Nacional de Propriedade Industrial (INPI), is a difficult process that can easily require eight years, and the patent's lifetime of ten to fifteen years is calculated from the time of first filing. Between filing and approval, the holder can neither remit fees abroad nor sue third parties for infringement. Final approval will, however, allow remittance of accrued fees. Both the INPI and the Central Bank must approve any remittance of fees abroad. Remit-
tances are limited to five percent of net sales in Brazil, and branches or controlled subsidiaries of a foreign parent cannot remit fees to that parent.

Unlike the case with patents, royalties paid by a Brazilian licensee for use of a foreign trademark may not exceed one percent of net sales. If a foreign applicant fails to file his trademark within a "period of priority" of six months, the trademark falls into the public domain to be granted to the first applicant.

4.4. Use of the Joint Venture Arrangement

In order to facilitate payment of fees abroad, a foreign investor can elect to undertake a joint venture with a Brazilian partner. As a minority partner, a foreign investor can contribute technology to the venture and receive payments from the Brazilian partner via the Central Bank. Because these remittances are not considered repatriated dividends or profits, only the regular twenty-five percent nonresident withholding tax applies. Brazil also encourages joint ventures with minority foreign ownership by providing subsidized financing, tax incentives


Law No. 4.131, art. 12 (Sept. 3, 1962). The Brazilian Government may administratively impose different percentage limits on specific technology areas. See Rosenn, supra note 10, at 321-28.

Law No. 4.131, art. 14 (Sept. 3, 1962).

Brazilian law generally defines a firm as a foreign-controlled subsidiary if the majority of its voting shares are owned by foreign residents. Law No. 4.728, § 4 (1965). Other definitions exist, however, for special purposes. See, e.g., Law No. 7.232, art. 12 (1984) (restrictive definition of what constitutes Brazilian control of firms in informatics industry).

Firms controlled by Brazilian nationals receive special tax advantages and other legal preferences denied to firms controlled by foreigners. The proper definition of what constitutes a Brazilian national firm has, therefore, become a topic of heated debate both in the Constituent Assembly and in the Brazilian press. See, e.g., Greenlees, As Definições Econômicas do Partido para a Constituinte [The Party's Economic Definitions for the Constitution], G.M., July 21, 1987, at 5; Greenlees, Abertura ao Capital Estrangeiro, uma Tese que Produz Conflitos [The Opening for Foreign Capital, an Idea That Produces Conflicts], G.M., June 5, 1987, at 5.

Instituto Nacional de Propriedade Industrial, Normative Act No. 15, ¶ 3.2.1 (Sept. 11, 1975); Finance Ministry Resolution No. 436 (Dec. 30, 1958); see T. Araújo, supra note 8, at 29.

IPC §§ 17, 30. Brazilian trademark doctrine has another peculiarity that may injure unwary foreign investors. An established user who fails to register his trademark in Brazil possesses (contrary to the rule in most other countries) no rights against a competitor who makes first registration. See T. Araújo, supra note 29, at 15.

See generally Rowland, supra note 66, at 51-62 (giving overview of the joint venture arrangement's advantages in dealing with Brazilian legal obstacles to foreign investment).

Id. at 53; José Luis Interview, supra note 56; see supra notes 59-60 and accompanying text.
and permission to operate in geographic and industrial sectors reserved for national companies. In addition, legislation passed in 1976 significantly increases the legal protection available to minority shareholders.

Since 1964, minority ownership in joint ventures has been the only means by which foreign banks may do business in Brazil. In practice, the Central Bank has authorized such participation only in investment banks. Those foreign-based institutions, such as Citicorp, which established a substantial presence in Brazil prior to 1964 continue to enjoy a comparative advantage over later entrants.

5. PRACTICAL ASPECTS OF BRAZILIAN LAW

Although Brazil's foreign investment laws have been more stable and less restrictive than those of other Latin American countries, uncertainty over which laws are actually in force creates difficulties and uncertainties for investors. Each new piece of legislation generally includes an article declaring that "all laws inconsistent with this law are hereby revoked." In fact, investors employ the services of "despachantes," who are official red tape cutters who specialize in bureaucracy and paper exchange. Professor Keith Roseann of the Uni-

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73 See Rowland, supra note 66, at 51-62.
74 The Corporation Law, Law No. 6.404 (Dec. 15, 1976). This law affords substantial protection to the rights of minority shareholders. These rights include the following: (1) the right to receive compulsory dividends at a rate equal to at least a certain percentage of the firm's annual net profits, id. art. 202; (2) the right to minority representation on the firm's administrative council under certain circumstances, id. art. 141; (3) the right to call a shareholders meeting, id. art. 123; and (4) the right of minority shareholders to withdraw and be compensated for the value of their shares if the firm changes its capital structure or participates in a merger. Id. arts. 45, 137, 221, 230, 252, 256, 264, 298. See T. Araújo, supra note 8, at 51-61; Rosenn, supra note 10, at 346; Rowland, supra note 66, at 55-56.
75 Law No. 4.595, art. 10, § 2 (1964). In addition, if the country in which a foreign bank is headquartered imposes restrictions upon the operations of Brazilian banks, that foreign bank's permissible ownership of any Brazilian financial institution is further restricted to no more than 30% of voting stock. Law No. 4.131, art. 51 (Sept. 3, 1962); see T. Araújo, supra note 8, at 14-15.
76 T. Araújo, supra note 8, at 15.
77 See House, How Citi Coins it in Brazil, INSTITUTIONAL INVESTOR, March 1986, at 219. Of the foreign banks which entered Brazil before 1964, Citibank has the largest presence with a dozen branches. Id. at 220. Since that time, other foreign banks have encountered difficulty gaining a foothold in Brazil. For example, in 1985 Fernão Bracher, then President of the Central Bank, denied a bid made by American Express for Brazil's struggling Maisonnave Bank because the proposed shareholders' agreement included an administrative contract giving American Express executive control. Id.
78 See T. Araújo, supra note 8, at 13-14.
80 Id. at 180.
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The University of Miami Law School estimates that the acquisition of a Brazilian export license requires the performance of a total of 1,470 legal actions by fourteen government agencies.\(^\text{81}\)

In practice, the policies of various government agencies may respond more to political influence than to the written law. Such uncertainty with regard to actual policies led Rosenn to state that “knowing the law is not nearly as important as knowing the policy of a given regulatory agency, and more importantly, knowing how to convince that agency to accord favorable treatment to your case.”\(^\text{82}\) He concluded that the Brazilian regulatory style “grants untrammeled discretion to the bureaucracy to do justice to one’s friends and to apply the law to one’s enemies.”\(^\text{83}\)

6. EFFECT OF THE NEW CONSTITUTION ON FOREIGN INVESTMENT

As it considers the proposed constitution, the Constituent Assembly is actively debating the proper role of foreign capital in Brazil. Several politicians of the majority party, Partido de Movimento da Democracia Brasileira (PMDB), and parties of the left have argued in favor of: (1) imposing greater restrictions on foreign banks,\(^\text{84}\) (2) creating more stringent limits on profit remittance\(^\text{85}\) and (3) defining what constitutes a national firm more narrowly so as to prevent many joint ventures from gaining subsidized financing from the Brazilian Government.\(^\text{86}\) On the other hand, President Sarney and other leading con-

\(\text{81}\) Id.

\(\text{82}\) Id. at 174. For example, in 1983, Rhodia Pharmaceuticals made a proposal to Brazil’s Council for Industrial Development (CDI) to expand production of aspirin by four thousand tons a year. In September 1985, after Rhodia had invested over half of the project’s proposed $15 million cost, CDI cancelled Rhodia’s authorization on the grounds that the project was inconsistent with Brazilian industrial policy. CDI transferred the project to another firm, Nordeste-Carbonor, which firm proposed increasing annual aspirin production by only two thousand tons with the help of subsidized financing from a Brazilian Development Bank. \textit{Mudancas para Atrair Capital Externo [Changes to Attract Foreign Capital]}, Estado do São Paulo, June 6, 1987, at 6, col. 1.

\(\text{83}\) Rosenn, \textit{supra} note 79, at 204.

\(\text{84}\) See \textit{supra} notes 75-77 and accompanying text.

\(\text{85}\) See \textit{supra} notes 7, 60-62 and accompanying text.

\(\text{86}\) See \textit{As Bases para uma Nova Ordem Econômica [The Basis for a New Economic Order]}, Jornal da Tarde, June 12, 1987, at 13, col. 1 (reporting proposals to define national firms as including only those companies with 100% Brazilian ownership).

On the other hand, Severo Gomes of the majority party, Partido Movimento Democratico Brasiliero [hereinafter PMDB], has proposed that national firm status be given to any company headquartered in Brazil. He also believes that foreign banks should not be allowed to offer accounts denominated in any currency other than that of Brazil. Because Brazilian currency has been subject to high rates of inflation, this proposal would severely hamper the operations of international banks such as Citibank. Gomes supports limiting remittance of profits abroad and continuing official prefer-
gressmen have asserted that, because foreign investment is essential to Brazil's continued development, the country must undertake financial deregulation and open its doors to foreign capital. Most observers conclude that the final version of the constitution will leave the position of foreign capital relatively unchanged.

7. SUGGESTIONS FOR CHANGE

Current Brazilian law on foreign investment has the advantage of allowing foreign capital to contribute to development while subjecting it to sufficient regulation to make it politically palatable. Nonetheless, in order for Brazil to participate fully in the modern international economy, its foreign investment laws should be made more liberal in substance and more predictable in application. The following proposals are aimed at this goal:

(1) Equity investment should be encouraged by reducing legal obstacles to debt conversion to direct foreign investment in the stock market and to repatriation of capital. The current debt crisis presents Brazil with an unprecedented opportunity to encourage new equity investment.

(2) Foreign investment should be indexed or monetarily corrected according to the inflation rate of the currency in which the initial investment was for Brazilian firms in certain sectors of the economy. See Constituinte: O Debate Sobre a Nova Ordem Econômica [Constitution: The Debate over a New Economic Order], G.M., June 2, 1987, at 13, col. 1; Nacionalização, Uma Ameaça Contra Bancos, [Nationalization, A Threat to the Banks], G.M., May 13, 1987, at 6.

The author's interviews with Brazilian investors and lawyers confirm that, because the success of Brazil's economy depends on access to foreign capital, Brazil's laws regulating foreign investment are unlikely to be substantially changed. Wlademir Lisso Interview, supra note 56, Fabio Barbosa Interview, supra note 62; José Luis Interview, supra note 56. In particular, the mandatory registration of foreign investment allows the government to guard against remittance of excess profits and to exert some control over Brazil's balance of payments. See, e.g., Law No. 4.131, art. 28 (Sept. 3, 1962) (empowering Brazil's Office of Currency and Credit to restrict importation of foreign capital and remittance of profits abroad when a deficit in Brazil's balance of payments exists or is likely to arise).

See supra notes 16-37 and accompanying text. See supra notes 38-53 and accompanying text. See supra notes 54-59 and accompanying text.

See Retirada Proibição aos Bancos [Remove the Restriction on Banks], G.M., June 9, 1987, at 6 (reporting views of Congressman José Serra of the PMDB that foreign capital should be granted liberal treatment).

President José Sarney himself has stated that "the profit remittance law will not change; hence, Brazil will remain open, but some internal details will change." Safatlo, Frota Admite Que Sarney Está Disposto a Assumir Negociacão da Divida [Frota States That Sarney is Inclined to Resume Debt Negotiations], G.M., June 27, 1987, at 19. See supra note 61.

See supra notes 16-37 and accompanying text. See supra notes 38-53 and accompanying text. See supra notes 54-59 and accompanying text.

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invested. The increased value of the registered capital base will reflect economic reality and avoid taxation of purely inflationary gains.\(^9\)

(3) The twelve-percent level above which the supplementary tax applies should be raised for service-oriented firms which have relatively low capital base requirements. The uniform level which is currently in effect discriminates unfairly against service firms such as consulting and engineering companies.\(^9\)

(4) Brazil should consider negotiating a tax treaty with the United States which would reduce the withholding tax on United States entities investing in Brazil.\(^9\)

(5) Transfer of technology should be facilitated by allowing patent royalties in excess of five percent to be remitted abroad and by calculating the percentage on gross rather than on net sales.\(^9\)

(6) Brazil should continue to encourage joint venture arrangements, especially in technology areas where they are currently restricted.\(^9\)

(7) The extreme nationalist measures proposed for the new constitution, such as total domestic ownership of financial companies, should be rejected.\(^9\) Instead, the restrictions prohibiting foreign banks from operating in areas such as commercial lending should be lifted.\(^9\)

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\(^9\) See Rosenn, supra note 10, at 387; Stroeter, Trench & Veirano, supra note 62, at 19.

\(^9\) See supra notes 59-61 and accompanying text.

As of July 1987, Brazil had concluded tax treaties with 16 other nations, including major exporters of capital and technology such as Japan and West Germany. T. Araújo, supra note 8, at 81.

\(^9\) See supra note 67 and accompanying text.

\(^9\) See supra notes 71-74 and accompanying text.

\(^9\) See supra notes 7, 84-88 and accompanying text.

\(^9\) See supra notes 75-77 and accompanying text.