

PERU'S unfinished work



Lima City, Peru

Photo: Michael Reeve/Wikipedia.

Despite successful macroeconomic management and the good performance of its economy in recent years, structural reforms to ensure that government is more efficient and transparent and that the private sector is profitable are critical to Peru's sustainable economic growth.

Solange Monteiro, Rio de Janeiro

After consultant Guillermo Quintana completed his MBA in the United States, against his friends' expectations he returned to Peru, where since 2010 as director of Peru Ventures he has led economic development projects in

poor communities. "Today," he says, "terrorism has largely disappeared, and we have a very positive business environment and more credit."

Quintana is not alone. From 2007 to 2009, according to a study from the National Institute of Statistics

and Informatics (INEI), 76,500 Peruvians came back home. Although the international crisis spurred this re-migration, optimism about Peru's economy is also a factor: 30% of returned expatriates had lived in Chile, the prime destination for Peruvians who seek better living conditions and the country perhaps least affected by the American crisis.

Over the past decade, average growth in Peru has exceeded 6%, and poverty fell from 50% of the population to 31%. "Currently, Peru shows a stable and solvent economy," says Andrés Remezzano, an Argentine who is manager of economic studies at Deloitte and author of *Inkanomics, Notes on the Peruvian Economy*. The first six months of the Ollanta Humala government, he adds, demonstrated that the nationalist candidate is committed to macroeconomic discipline: "This is critical. Among the countries in the region that are most attractive for foreign investment, such as Brazil, Chile, and Colombia, Peru is still the poorest. Therefore it is very important to ensure the continuity of current policies, and to invest in strategic areas such as mining, communication, finance and infrastructure."

IF ALL GOES WELL

According to Remezzano, unless there is a drastic drop in the purchasing power of China and its major trading partners, Peru should grow by 5% in 2012.

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Last year, GDP grew 6.9%, driven mainly by private consumption and investment. Should the international outlook deteriorate, Juan José Marthans, former director of the Peruvian Central Bank and now director of the Center for Financial Markets Research at the University of Piura, points out that at a third of GDP, Peru's international reserves can meet demand for imports of goods and services for 18 months.

Peruvian model

High savings and investment have brought about higher GDP growth.

Years	Investment (% of GDP)	Domestic savings (% of GDP)	GDP (% change)
2001	18.8	16.5	0.2
2002	18.4	16.4	5.0
2003	18.4	16.9	4.0
2004	17.9	17.9	5.0
2005	17.9	19.3	6.8
2006	20.0	23.2	7.7
2007	22.8	24.2	8.9
2008	26.9	22.7	9.8
2009	20.7	20.9	0.9
2010	25.4	23.7	8.8
2011	25.6	24.3	6.9

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“Moreover, if the price of copper falls, we still have gold, which historically is a haven in times of volatility and can help offset losses [from copper],” he says.

Marthans believes that growth in consumption in Peru is based on prudent credit expansion and cites the high level of private investment, which in the last two years was about 19% of GDP. “We live in an environment of more profitable long-term capital flows, and we apply controls to mitigate distortions in the short-term market,” he says. “Here, controls include increasing taxes or bank reserve requirements. With a financial system that is small and unsophisticated—only 12% of GDP—efficiency is not achieved through monetary policy,” he says. In 2011, the reserve requirement was 25% for deposits in domestic currency and 55% for foreign currency deposits. “The exchange rate has been less volatile than for many currencies in the region, though there is occasional need for

central bank interventions,” according to Marthans.

Another factor boosting the economy, though to a lesser extent, is microcredit: the Peruvian model is one of the most successful in Latin America. The Inter-American Development Bank (IDB) ranks the country as the best environment for microfinance in the region, with the largest portfolio, totaling US\$4.9 billion.

BUT NOT ALL GLITTERS

Nevertheless, Peru still needs to overcome several shortcomings, some of them related to infrastructure. In diversifying exports, for example, one of the highlights is agricultural products like asparagus, of which Peru is the world’s leading exporter. To expand the agricultural sector, it would require heavy investment in seeking sources of more water to prevent the overexploitation of aquifers.

Lack of water also affects growth in the arid Lima region, which holds 88% of the population and only 1.8% of Peru’s available water. The threat of drought in Lima is also a reason for more development of the countryside, opening roads to other regions where water is plentiful, as in the Amazon. Remezzano identifies one problem, however: “Growth is not being accompanied by enhancement of the execution capacity of regional governments.” Quintana confirms that “Often the money is available,

but technical capacity is deficient.” The problem is generally recognized. A survey of Latin America done by the German Ifo Institute (Institute of Economic Research, University of Munich) and its partner the Getulio Vargas Foundation points out that the shortage of skilled labor is of more concern than such other important issues as competitiveness and even confidence in government policy.

What causes the greatest gridlock, however, is social and environmental movements against large mining and energy projects. The Humala administration has become less tolerant of such movements, though their members supported his election. Recently, for instance, there was a sequence of demonstrations against the Conga gold mine in Cajamarca. A joint project of the US Newmont and Peru’s Buenaventura, it is estimated at US\$4.8 billion; the plan to mitigate its environmental impact is currently being reviewed.

Without discussing their merits, Carlos León of the Institute of Political Science, Catholic University of Peru, says a big problem with the demonstrations is that “Each group has demands and they do not meet with each other,” which complicates negotiations. León believes the demonstrations are a reaction to the arrogance of some companies that have been operating in Peru. In an attempt to solve that problem, last September Humala promulgated the Law of Prior Consultation, which requires

Peru’s free trade agreements with countries on the Pacific rim make life more difficult for Brazilians.

companies to consult with indigenous peoples and other residents before projects begin that would directly affect their rights.

The uncertainty has also affected Brazilian companies. According to a survey by the Center for Development and Integration Studies (CINDES), in 2010 Peru was one of the main destinations for investment by Brazilian companies: more than US\$1.7 billion went for energy and ore projects, and another billion dollars was spent to buy a Peruvian mining company. CINDES indicates, however, that in 2011 Brazilian investment came to a halt and some projects were even canceled.

Eletrobrás (Brazilian Power Company) is studying the possibility of a 6,000 MW power project in Peru. The company said the new government is still redefining the energy agenda. Of the projects listed in the Energy Integration Agreement signed between Brazil’s Lula and Peru’s Alan García in June 2010, the most developed is the plant on the river Inambari in the south, which was in the final phase of the feasibility study

but was cancelled by the Peruvian government in June 2011.

ROOM FOR TRADE TO GROW

In the commercial arena, although as yet Peru takes in less than 1% of exports from Brazil, it is attracting attention from several Brazilian companies. Among them is the Metalli Milani, whose main export is copper parts for the steel industry. With customers in Chile, Mexico, and Spain, in 2011 Metalli decided to move into the Peruvian market. “The decision is part of our strategy to increase the export share of our revenues from the current 27% to 50% by 2013,” says Anderson de Araújo, supervisor of the company’s commercial area. In the food sector, the MBR Company at the end of last year began marketing within the region; until then, the company’s fresh fruit exports were all going to Europe. In 2011, MBR moved into Chile, where it is negotiating the sale of foods such as oils, fruit juice, and breakfast cereals. “Since then we have made our first contact in Peru with a preservatives and dyes industry looking for new suppliers for exotic products such as annatto, turmeric, and other seeds they usually import from Asia,” says Fernando Barbosa Ferreira, MBR executive.

Ferreira acknowledges, however, that proximity does not give it an advantage over competition from Asia. “Our logistics costs today are the same as



A businesswoman ready to take on the free market.

for a delivery in Dubai or Germany,” he says. Peru’s free trade agreements with countries of the Pacific make life more difficult for Brazilians. Last year, trade agreements with China, Thailand, and South Korea entered into force; in March, it will be the turn of Japan, paving the way not only for trade in goods and services but also for attracting direct investment.

To Marthans, however, the trade agreements do not dilute the importance of neighbors like Chile and Brazil. “We have an extraordinary potential, but we need partnerships, and especially the support of human capital in these countries,” he says. “The important thing now is to persevere with structural reforms to ensure basic services for the population, a more efficient and transparent government, and the profitability of the private sector.”