What is your view on the international integration of Peru today? What are the main constraints today and the priorities for tomorrow?

Peru has attained a robust macroeconomic performance in the last ten years. This is a necessary basis for our country to reach out to the world. Without it, we would not be able to attract both domestic and foreign investment, nor would it be reasonable to hope to improve our export competitiveness and diversify our export supply and destination markets.

According to data from the Ministry of Economy and Finance (MEF) of Peru, the Gross Domestic Product (GDP) has grown threefold in the last decade, and the average inflation has been the lowest in Latin America. Our public debt, as a percentage of the GDP, has been brought down to less than half, accounting for 21.2% of the GDP in 2011, and Peru has accumulated Net International Reserves (NIR) of nearly a third of its GDP. At the same time, the country has reaffirmed its commitment to fiscal responsibility, as reflected in the 2011 economic balance sheet of the General Government (including operations of the three levels of Government: national, regional and local) which was 1.8% of the GDP. In addition, the country’s total export value has grown sevenfold in this period, while the net inflows of Foreign Direct Investment (FDI) have been increasing yearly, from US$ 0.8 billion in 2000

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to US$ 8.1 billion in 2011. In 2011, FDI accounted for 4.7% of the GDP, outperforming Colombia, Brazil and Mexico.2

Another positive aspect is that, between 2001 and 2010, Peru’s average annual growth rate was higher than in the three previous decades. Today’s growth rate is over 6%; therefore, the country has one of the fastest-growing economies in the world. An important factor is that almost half of this growth may be accounted for by Peru’s increased productivity.3

Thus, Peru has had a sound and sustained macroeconomic management, has implemented an economic policy aimed at opening up to the world, and has strived to create an investment-friendly climate for domestic and foreign private capital. In fact, during this period, Peru has been raised to investment grade by the main risk rating agencies. However, there is no room for self-complacency, as the country still needs to tackle major challenges on different fronts.

Even though we have managed to substantially increase GDP per capita (equivalent to US$ 10,062 at purchasing parity power -PPP- 2011) and to significantly lower the poverty monetary rate (55% at the beginning of the decade vis-à-vis 28% in 2011), the social gap in the country is huge; therefore, it is imperative that the benefits of globalization reach out to the majority of the population, both rural and urban, within a decentralized development framework, with regard to which there is still much to be done. Narrowing and eventually bridging the infrastructure gap, particularly in the field of transportation, is a pending task in terms of the connectivity required to bring more products from the inland regions to the national and global markets under competitive conditions. The investment gap in public utility infrastructure estimated for the 2012-2021 period amounts to almost US$ 88 billion, i.e. 33% of the GDP, the most important sectors being energy (38%), transportation (24%), and telecommunications (22%).4

One challenge related to the above is the competitiveness of the economy. The Global Competitiveness Report 2012-2013 issued by the World Economic Forum, which ranks 144 countries, reveals that only four South American countries are above the average: Chile (ranked 33rd), Brazil (48th), Peru (61st), and Colombia (69th). Peru has made much headway, moving up in the ranking by 25 positions in the last five years, given that in the 2007-2008 assessment, Peru ranked 86th (of a total of 131 countries). However, we are still only halfway at the global level and there is still a long way to go in terms of competitiveness and of productivity as well.

Another important element relates to our condition as an exporter of natural resources. Peru is one of the most important mineral producers in the world (ranking 6th in gold production in 2011 and 2nd in silver, copper and zinc production).5 Mining investment and production have increased significantly in the last years. For example, considering the investments already made, the production volume of copper is expected to double in five years. In addition to the projects underway, an important portfolio of new mining projects has been announced for the coming years. One of the major challenges associated with the development of the mining

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2 Proinversión. 2012. “¿Por que Invertir en el Perú?”. November 8, 2012.
4 Association for the Promotion of National Infrastructure (AFIN). 2012. “Por un Perú Integrado: Plan Nacional de Infraestructura 2012-2021”, written by the Research Center of the University of the Pacific (CIUP) and the Institute of Regulations and Finance, Graduate School of Business (ESAN University). Lima. October.
sector in Peru is how to attain social and environmental sustainability in this activity through the socioeconomic development of the area of influence of the projects concerned and the implementation of effective policies designed to mitigate environmental impacts, which will help relieve any social conflict that may arise in relation to this sectoral activity.

Another challenge ahead is how to lessen the high exposure of exports to external shocks derived from commodity price fluctuations, due to the share of mining in total exports (around 60% of the total Peruvian export value in 2011). Efforts to diversify our exports and make higher-added value products gain a more significant share is a task yet to be accomplished. In this regard, Peru made progress in the last decade, but more is still needed.

Due to the remarkable boom of commodities, non-traditional goods lost relative ground in total exports -from 31% in 2001 to 22% in 2011. However, they did grow by 468% in value during such period, showing the progress attained. Moreover, the number of tariff items exported grew from 3,531 to 4,493 between 2000 and 2011. In addition, the number of exporters rose from 3,855 to 6,773 in the same period. This is because, among other reasons, Peru has managed to make the most of the opportunities opened up by trade agreements, as discussed below. No doubt, the country should hold on this policy.

Similarly, it is necessary to recognize the importance and get the best benefits possible of the widely available natural resources of Peru. Several developed countries have made good use of their abundant natural resources to benefit their population. The suggestion put forward by the Peruvian Ministry of Economy and Finance with regard to learning from the experience of Australia, Canada, Norway, and New Zealand in successfully managing their natural resources seems quite interesting. This is because these economies are dependent on their commodities -which account for a large share of their total exports (77%, 44%, 84%, and 73%, respectively, in 2009)- but have a much higher GDP per capita than Peru (measured in 2011 PPP terms): Norway (US$ 53.5 thousand); Australia and Canada (US$ 40 thousand each); and New Zealand (US$ 27.7 thousand). Consequently, there is ample room to learn from the lessons of these countries in the interest of Peru.

In the last years, Peru has followed a very active trade policy by entering into agreements with several countries and extra-regional markets, especially in the Pacific area. Even though this strategy can be accounted for in the light of the main export products of Peru, what is the progress made and what are the challenges ahead with regard to the development of non-traditional products with higher-added value?

At present, around 90% of our foreign trade is covered under some trade agreement (95% on the export side and 90% on the import side) -a clear sign of how dynamic the trade agreement negotiation policy has been in the case of Peru. As of October 2012, the trade agreement network established with other countries can be outlined as follows:

- Agreements in force: North America (the United States, Canada and Mexico), Asia Pacific (China, Singapore, South Korea, Japan and Thailand), Europe (EFTA), Central
America and the Caribbean (Cuba and Panama), South America (Chile, the Andean Community - CAN, and the Southern Common Market - MERCOSUR).

- Agreements signed and soon to come into force: Europe (the European Union), Central America (Costa Rica and Guatemala), South America (Venezuela).

- Agreements under negotiation: Central America (El Salvador and Honduras); the Pacific Alliance (Mexico, Chile and Colombia), with Costa Rica and Panama participating as observers; the Trans-Pacific Partnership (TPP) (Australia, Brunei, Chile, New Zealand, Singapore, the United States, Malaysia, Vietnam, Mexico, Canada).

The Pacific region is certainly a priority for our future development, but the country has entered into a wide range of negotiations with trade partners in different parts of the world. This is significant because if we had signed a free trade agreement with only one important partner rather than with all the others, trade-diverting effects could have been caused, when in fact the goal pursued is to create new trade opportunities, gaining access to as many foreign markets as possible.

Furthermore, the importance of these agreements lies in the fact that they open up new export opportunities on a sustainable basis rather than under temporary schemes, as were the systems of trade preferences used with the United States and the European Union. In addition, trade agreements serve as an anchor to a series of important economic reforms being introduced in the country with the purpose of strengthening its opening up policy. It should also be noted that the signing of trade agreements attracts investment flows into the country, which are expected to enlarge and improve its export base in the medium or long run.

Some aspects in the Peruvian foreign trade evolution that have taken place in the last decade are worthy of note, not only to show how dynamic they are, but also because there have been changes in the relative importance of our destination markets. The United States has lost its first position to China, as a result of an increase in the exports of Peruvian commodities to China during the decade. However, when non-traditional exports are analyzed, the US market is still our main destination market (23% of such total exports), hence the importance of the FTA with the United States.

It is significant that the second destination market for Peruvian non-traditional goods is formed by the South American countries, mainly Venezuela (9% of the export value of these products in 2011), Colombia (8%), Ecuador and Chile (6% each). Therefore, Peru’s neighboring countries are of the utmost importance when non-traditional exports are assessed. Some analysts have even proposed that the Andean Community has become a platform to facilitate the export of more sophisticated industrial products with higher value added. Exporting first to the Andean Community would help countries gain more competitive markets, such as the United States and the European Union, some time later. This so-called platform effect is perhaps turning the Andean market into a domain for upgrading and diversifying our non-traditional exports.\(^9\)

\(^9\) Source: Own calculations based on SUNAT data.

This, of course, does not mean that there is no need to renew our regional integration approach, as 40 years since its creation and after several “close integration” plans (to evolve from the free trade area to the customs union to the common market), the Andean Community is far from having achieved its goals. More pragmatic approaches are required when the economic models or visions of the countries do not match one another, and this involves bringing ambitions closer to feasibility and practicality. In the field of trade, this would be the equivalent of pursuing a free trade area.

In this regard, the Pacific Alliance is a good example of a renewal of approaches. Its importance is mainly related to the Peruvian goal of gaining competitiveness for its economic integration into the Pacific Basin, the dynamic area of the 21st century. In other words, this is not an intraregional approach (to reach the markets that form part of the Alliance) but one aiming at third parties (to reach out to the Pacific). On the other hand, this approach is not rooted in the concept of vicinity, as most Latin American integration schemes, but in coming closer to countries with more open economies and with economic policies deemed more compatible.11

Finally, Peru is faced with a challenge concerning the sectoral composition of its non-traditional exports. In 2011, two thirds of them came from the agricultural (28%), textile (20%), chemical (16%), and fishing (10%) sectors.12 Although it would be necessary to go deeper in the analysis to identify major products and industrial sectors, at first sight it might be said that the composition of our non-traditional exports is associated, basically, with sectors with a lower technological content.

An analysis at the South American level points in this direction. If the South American non-primary product exports are divided by their technological content, then in 2010 about 60% of such products were resource-based and an additional 18% were labor-intensive.13 Therefore, the challenge for non-traditional exports is to move up in the technological and innovation ladder -a challenge that is not only Peruvian but South American.

Does the importance attached by Peru to its relations with Asia Pacific mean that the importance attached to its trade and strategic relations with other Latin American countries -particularly with the South American countries- is declining?

That is definitively not so. As already stated, the policy of opening up to the world involves having multiple options available and, within this context, Latin America, and South America in particular, is one of the important areas for the external relations of Peru. On the other hand, the Pacific Alliance, which I have already mentioned, is a good example of the search for synergies between an intraregional complementation and cooperation strategy and the relations with Asia Pacific.

We also believe that the relationship between Peru and Brazil is a case in point in this approach, since the strategic importance of the integration between both countries does not only lie in their reciprocal markets and their relation as neighbors, but also in the desire to gain

12 Source: SUNAT and MINCETUR.
competitiveness to reach the Asia Pacific region. This case is, therefore, associated with the South American physical integration issue and, particularly, with the integration between Peru and Brazil as the main actors in the central region of the South American subcontinent. We will come back to this.

The importance of Latin America, in particular of South America, in Peru’s economic relations can be shown with some figures. A third of our imports comes from Latin America, which is the destination of 18% of our exports. Of the whole Latin America, South America is the most significant portion, with a share of 26% on the import side and of 15% on the export side, according to 2011 data. If we look at the individual countries, our most important partners can be easily inferred.

Chile has been the main destination market for our exports within South America throughout a decade, accounting for 29% of the South American total in 2011, while Brazil and Colombia rank second and third, respectively. On the side of imports, Brazil has become our leading South American supplier (25% of the regional total in 2011), doubling its share vis-à-vis 2001. As for our FDI stock, these three countries again are among the most important economic partners of Peru. Thus, the ranking of the first seven investors in Peru as of 2011, as a share of total FDI stock, is as follows: Spain and the United Kingdom come in the first place (20% each); the United States ranks second (14%); the Netherlands come in the third position (7%), followed by the three South American countries already mentioned -Chile (6%), and Colombia and Brazil (5% each).

Therefore, a net of investment and trade relations is being interwoven with Chile, Colombia and Brazil, which deserves to be analyzed in the future. It would also be interesting to observe how Peruvian FDI has performed in these countries. There are, of course, other significant trade partners for Peru in South America (Venezuela, for exports; Argentina, for imports; and Ecuador, for both).

In the political sphere, it is worth mentioning as well that Peru has been actively participating in the Union of South American Nations (UNASUR), currently holding its Presidency Pro Tempore. The “strategic alliance” between Peru and Brazil, forged in 2003 and embodied in the Presidential Statement of that year, has played a key role in the creation of the South American Community of Nations, in 2004, in the city of Cusco, and later evolved into the establishment of UNASUR, created in Brasilia in 2008.

What is the importance of the physical integration of South America? What physical integration projects currently underway have, in your opinion, a more significant strategic impact and relevance for Peru?

The importance of the physical integration of South America should be viewed from the perspective of its impact on both the domestic level and on the integration of South America into the global world.

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16 Source: Own calculations based on Proinversión, in: Santa Gadea, op. cit. September.
Concerning the former, the goal of social inclusion in our countries involves creating the conditions for rendering the South American inland areas -the poorest ones- economically feasible, and physical integration certainly contributes to this goal. This does not only concern the integration of border areas but of broader regions as well.

In the case of the road connections between Peru and Brazil currently being built, the strategic vision underpinning these projects is in line with building macro-regions in Peru that should have a geographically “transversal” nature and be economically viable due to their access to the Pacific and connections with Brazil. According to this approach, our goal is not trade alone but development. In fact, the Andean and Amazon highlands, the areas on the “other side” of the Andes, are the least developed in Peru in relative terms. The purpose is to link these areas to the national dynamics, and to connect them with the Pacific and the rest of the continent (particularly with Brazil). This approach does not challenge the country’s integration into the world; on the contrary, it is a road to attain this goal.

Thus, the Integration and Development Hubs (Ejes de Integración y Desarrollo - EIDs), devised a decade ago within the framework of the Initiative for the Integration of Regional Infrastructure in South America (IIRSA), not only are spaces to attain South American integration, but also -or perhaps essentially- act as national integration instruments for Peru. Therefore, the South American physical integration issue leads eventually to the management of infrastructure within the framework of territorial planning for development.17

Furthermore, Peru has worked on the South American physical integration issue assuming that the country can gain competitiveness in reaching out to the Pacific thanks to the possibilities of connectivity opened up by its own physical integration with Brazil. As for this second dimension, it is important to evaluate, from a realistic point of view, what chances Peru has of becoming a transit platform for the goods that Brazil sends to and receives from Asia and, based on this, to define what is yet to be done in addition to building the necessary infrastructure.

In this regard, some recent research works have carried out some measurements in relation to the (IIRSA Sur) Interoceanic Highway built by Peru to connect with Brazil. Similar though more preliminary estimations have also been made with regard to the Amazon Hub (IIRSA Norte), seeking a multimodal connection with the free trade zone of Manaus, in Brazil. The preliminary results indicate that, under the present conditions, exports to Asia through the Pacific from Porto Velho, Brazil, would be US$ 34 per ton cheaper than through the Atlantic, although the operations through the Matarani port, in the south of Peru, would take 11.5 days longer. In the north, if transportation costs in 20-foot containers are compared, the difference would be US$ 200 and 9 days less through the Pacific, from Manaus in Brazil through the port of Paita, in the north of Peru, vis-à-vis the traditional route through the Atlantic (but, as the logistics cost of the land-river stretch between Manaus and Paita should be added, this may offset the difference).18

The conclusion is that these are not very significant differences to justify a change in the short run in the traditional route of exports from Brazil to Asia, i.e. to shift from the Atlantic to the Pacific. The main reason is the connectivity difference between the Atlantic and Pacific

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coastline services in South America. There is much more connectivity in the Atlantic than in the Pacific ports. Therefore, there is much to be done in the logistics field, particularly to use the Pacific ports. As for the logistics costs, Latin America is well above the world average.

In brief, physical integration is essential in any efforts to improve the elements that lead to the competitiveness of the South American economies, because there is a direct relationship between competitiveness and infrastructure quality. But this is not the only aspect to consider, as this opens up the door to many others, namely: trade facilitation; investment promotion and climate; logistics services and platforms development; ports and airports modernization with a view to the establishment of regional hubs; export diversification; and incentives to the creation of production chains so that regional trade should not be restricted to finished goods only, among others. In sum, it is necessary to strive for competitiveness from a systemic perspective.

There are sufficient grounds to think that the relations between Peru and Brazil will continue expanding and will last in time, as they are built on solid foundations. But Peru must also continue deploying, with both vision and firmness, its own strategies to penetrate the Brazilian market in a decentralized manner, seeking at the same time that the non-tariff barriers still in place in Brazil be reduced. In parallel to this, it is necessary to continue striving for increasing our logistics competitiveness with regard to the Pacific Basin, enhancing Peru’s central geographic location in South America through, among other items, the physical integration with Brazil.

Transversal connections between Peru and Brazil -the so-called IIRSA Norte, IIRSA Centro and IIRSA Sur- are solid evidence of a logic of a South American eastern-western interconnection. The estimated investment in these connections preliminarily amounts to some US$ 5.5 billion for Peru, including roads, sea and river ports, logistics centers and waterways. The main projects are already underway.