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REPORT ON
INVESTMENT PROMOTION
IN PERU

AID/PRE PRIVATE SECTOR
RECONNAISSANCE TEAM

December 1983

December 16, 1983

Mr. Charles S. Gormly
Director, Office of Policy
and Program Review
Private Enterprise Bureau,
AID/PRE, Room 633 S.A. - 14
Agency for International Development
Washington, D.C. 20523

Dear Mr. Gormly

In accordance with the terms of the personal services agreement, dated November 2, 1983, with the USDA Graduate School, International Programs, covering work to be performed by me as a member of the AID/PRE Peru Reconnaissance Team, I am pleased to transmit my report on Investment Promotion in Peru.

The report is organized as follows.

- Section I. Introduction
- Section II. Understanding the Investment Promotion Problem in Peru
- Section III. The Target Group and Investment Priorities
- Section IV. Recommendations for a Proposed Investment Promotion Strategy and Related Projects

On the completion of this assignment, I want to express my appreciation to you for your leadership of the Team and wise counsel in guiding our activities. Particular recognition is due to Mrs. Andrea Mohn, who performed magnificently as Team Coordinator in helping us all get through a demanding schedule. My thanks to Bruce Bouchard and the USAID staff for planning a most productive encounter with public and private sector leaders. Finally, I enjoyed working with the other Team members from whom I learned quite a lot.

Thank you for including me in this important and challenging assignment.

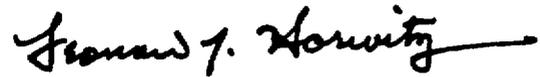
Mr. Charles S. Gormly

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December 16, 1983

I look forward to our Team review meeting on January 6.

Yours very truly,



Leonard J. Horwitz

cc. Dr. Michael Marquardt
Deputy Director, International Programs
USDA Graduate School
Suite 3134
600 Maryland Ave., S.W.
Washington, D.C. 20024

AID/PRE Private Sector Reconnaissance Team-Peru

Report on Investment Promotion in Peru

I. Introduction

The purpose of this report is to provide a general assessment of the current investment situation in Peru and to recommend to USAID/Peru an appropriate investment promotion strategy as well as specific AID projects for assisting the Government and the private sector to attract foreign investment. This report is responsive to the objectives and scope of work provided by USDA/Graduate School as an annex to the consultant contract.

The report is based on a review of relevant documentation provided by AID/PRE and on information obtained from interviews in Lima during the visit of the Private Sector Reconnaissance Team (November 26-December 4, 1983).

Certain definitions are in order at the outset. By the term "investment" as used throughout this report, I refer primarily to foreign investment in production, service, commercial or financial enterprises. Investment is broadly defined to include such diverse forms as

- o Foreign investment in a wholly owned subsidiary or branch
- o Joint ventures involving some formal (non-trade) business relationship between a Peruvian and foreign enterprise

- o Technology transfer arrangements involving patents/trade marks, franchises, licensing agreements, technical assistance services, etc.
- o International marketing arrangements
- o Management and service contracts

II. Understanding the Investment Problem in Peru

This section identifies and comments on certain key constraints to the expansion of foreign investment in Peru. Many of these constraints have been discussed in the Final Report--Peru--Private Sector Assessment, prepared by Coopers and Lybrand (May 1983).

A. The Investment Climate

The key climatic factors which condition a foreign investor's interest in locating a venture in a country include the following.

- o Political stability and public security
- o Predictability and continuity of governmental policies
- o Opportunity to obtain a satisfactory return on investment
- o Availability of a satisfactory foreign investment code and related incentives
- o Expeditious governmental review and approval of foreign investment proposals
- o Opportunity to increase market share over time in accordance with an investor's goals and strategy
- o A public administration providing a reasonable quality of service on an equitable basis to both domestic and foreign enterprises

- o Provision of satisfactory economic infrastructure (transportation, communications)
- o Minimum levels of government regulation and intervention in the private economy
- o Freedom of money transfer
- o Adequate sources of local financing
- o An adequate human resource base
- o Availability of important raw material resources (e.g., petroleum, minerals, etc).
- o *Favorable labor laws*

The same basic factors essential to domestic private investment also apply to attract foreign investment. It is unlikely that foreign investors will be attracted to a country where domestic private investment is stagnant.

The art of attracting foreign investment has often been compared to "courting a beautiful lady"--it has to be eagerly pursued, its interests and requirements accommodated and finally won over by words and deeds evidencing long term commitment and ensured by adequate incentives. In a word, investment promotion is pure salesmanship and employs a range of specialized marketing techniques.

Measured by the above cited climatic factors, the current investment climate in Peru is poor and constitutes the single most important current impediment to attracting domestic or foreign investment.¹ The climate is adversely affected by a

1. See Exhibit I-1--Clipping from The Wall Street Journal commenting on investment climate in Peru and other countries.

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JOURNAL.

WALL ST. JOURNAL
DEC. 8, 1983

WHITE OAK, MARYLAND

Business Bulletin

A Special Background Report On Trends in Industry And Finance

BUSINESS RISKS for U.S. companies are growing in several countries.

Chile, Peru, the Philippines, and Zimbabwe all will be "considerably more risky in 1984," say Frost & Sullivan forecasters. They cite deteriorating economies and growing opposition to regimes. Chile and the Philippines also crop up as two of the seven countries just added to Beri S.A. analysts' list of places to avoid doing business in. The other five are Brazil, Ecuador, Egypt, Indonesia and Kenya. The chief economist for TRW, a Cleveland-based manufacturer with global operations, says Brazil has lost most of its attractiveness for investors because its problems are expected to last at least three more years.

So, where's an attractive place to invest? Canada is perceived as less risky than a few years ago, according to TRW. Hilton Hotels recently picked Australia and Singapore for new hotels. And a Textron official says Singapore is "sort of an upcoming Switzerland."

Frost & Sullivan sees reduced risk next year in Costa Rica, Iran, Mexico, and Turkey.

* * *

← Let's get this list + check on Frost & Sullivan

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number of constraints well described in Coopers and Lybrand Report, Vol. I, pp. III-8 through III-12. These constraints relate to both external and internal factors.

The external factors stem from the current depressed world economic situation impacting most severely on the developing countries generally and on the depressed international markets for Peru's exports particularly.

The internal factors, include:

- o The critical economic situation in Peru
- o Political uncertainty stemming from the recent municipal elections and their implications for the presidential elections in 1985
- o Terrorism
- o Restrictive economic policies, laws and bureaucratic practices adversely affecting business
- o The small size of the domestic market
- o Dominance of the public sector in the economy
- o A lingering nationalist and anti-foreign investment attitude among important political groups which the present Government has tried hard to overcome
- o Memories of the wave of nationalizations during the military dictatorship which continue to haunt potential investors

There seems to be a consensus among private sector leaders interviewed that the investment climate is unlikely to improve in any significant degree over the next two to three years or before the Government to be elected in 1985 has defined its economic policies.

Success in attracting important flows of foreign investment depends primarily on a satisfactory investment climate and secondarily on effective promotion. However, even when a satisfactory investment climate exists, a developing country like Peru must still mount an effective international promotional effort since it has to compete for foreign investment with states in the U.S., the countries favored under the Caribbean Basin Initiative and other countries with favorable climates and attractive incentives.

Under special circumstances, some foreign investments may occasionally be made even in the absence of a satisfactory climate. A Peruvian businessman, after lamenting to me the poor investment climate in recent years, went on to say that investment climates are usually unsatisfactory and that, despite this, his firm had entered into several joint ventures with foreign investors in recent years which have turned out to be generally successful. He noted that when specific investment opportunities were presented with sound economic and financial plans and with reasonable projected payouts, he calculated his risks carefully and then decided to make the investments.

Moreover, when a foreign investor is interested in developing some important raw material resource (e.g., petroleum), the investor will likely calculate the risks and attempt to make a special deal with the Government. The Occidental Petroleum Co. investment in oil exploration is a case in point. For major investments of this type, the Government appears ready to be flexible in applying the investment code and incentives.

Finally, the lack of an OPIC investment guaranty bilateral agreement with Peru could be a major inhibiting factor in attracting foreign investment from the U.S. ~~This raises an~~ important policy issue for AID in deciding whether to support

investment promotion assistance. This issue will be discussed further below in Section IV-A. (Investment Promotion Strategy).

B. Lack of an Institutional Framework or Capability to Promote Investment

Up to recently, there has been no central governmental institution responsible for investment promotion. The National Commission on Investment and Foreign Technology, (CONITE) an organization in the Ministry of Economy, Finance and Trade has had responsibility for reviewing (from a legal viewpoint) and authorizing foreign investment and technology transfer proposals. In November 1983, the Government issued a decree expanding CONITE's responsibilities in the area of investment promotion. This decree was issued coincident with the Foreign Investment Forum, held in Lima and sponsored by CONITE, COFIDE and UNIDO.

Questions have been raised by some private sector leaders as to the suitability of CONITE to undertake the foreign investment promotion function. While they acknowledge that the current leadership of CONITE has a positive attitude toward the private sector and foreign investment, they point out that its past image as the administrator in Peru of the restrictive Andean Pact Investment Code (Decision 24) will make it difficult for it to gain the confidence of the private sector or foreign investors. They also note that CONITE lacks a staff capable of undertaking investment promotion activities or dealing effectively with potential investors.

COFIDE (the Development Finance Corporation) and some of the Government owned development banks (The Industrial Bank, the Agricultural Bank, the Mining Bank) have all engaged, to some

extent, in foreign investment promotion in their respective fields.

The lack of an effectively functioning investment promotion organization, staffed with trained professionals, and providing "one stop shopping center" services to investors constitutes a serious constraint to Peru's efforts to attract foreign investment.²

even if had good, with china?

The experience of AID, OPIC and other international development agencies indicates that investment promotion assistance has limited benefit in the absence of a functioning host country investment promotion agency capable of generating well prepared projects, conducting investor search and follow up on opportunities identified and managing the process of nurturing them to successful conclusions.

Moreover, there is no formal and operational investor information system by which the needs of Peruvian firms for capital, technology, market access, management skills and training can be linked to appropriate foreign firms interested in meeting these needs through joint-venture relationships. A key ingredient of any investment promotion program is a functioning mechanism for facilitating interaction between domestic and foreign enterprises.

2. The "one stop shopping center" is a concept commonly used in investment promotion to refer to a single government agency responsible for a range of investor services including project identification and development, provision of investor search services and arranging for expeditious governmental approval of investment proposals.

C. Lack of an Adequate Institutional Structure in the Private Sector

While Peru is fortunate in having significant number of dynamic entrepreneurs, the institutional structure of the private sector appears weak, fragmented and incapable of providing the unified leadership essential for defending its interests and enhancing its role in the development process.

There are more than a dozen national business organizations representing different sectors of the economy (e.g., industrial, agricultural, mining). However, there is no national business confederation grouping these sectoral organizations (such as the Business Council in the U.S.) which could serve to unite the private sector and permit it to speak with one voice on public policy issues affecting its common interests. At present, each business organization goes its own way, pursuing its own interests with no formal mechanism for coordinating their activities or policy viewpoints with other organizations. The resulting institutional disarray in the private sector often tempts the Government to play off one business group against another to the detriment of the entire sector. Likewise, the disunity of private sector organizations inhibits a constructive dialogue with the Government on key policy issues affecting business which could permit the sector to contribute to national policy formulation. There is presently no private sector research and policy analysis organization, such as the American Enterprise Institute or the Conference Board in the U.S., which could perform technical studies on key issues affecting the private sector and formulate constructive recommendations for dealing with these in ways which accommodate both public and private sector interests.

The lack of an adequate institutional structure in the private sector constitutes an important constraint to USAID's efforts to enhance the role of the private sector in the development process. Until the Peruvian private sector get its act together and mobilizes its resources to defend and promote its common interests, USAID's efforts to assist may have limited impact.

III. The Target Group and Investment Priorities

A. Target Group

It is important to define the private sector target group to which proposed AID assistance in investment promotion would be directed. We need to know whom we are trying to help and why.

There are two private sector groups which presumably would utilize Peruvian investment promotion services

- o Foreign investors seeking information on investment opportunities, investment codes and incentives, economic, financial, social conditions and local business practices and requirements
- o Peruvian businessmen seeking joint venture relationships with foreign investors to obtain capital, technology, market access, management services, or licensing arrangements.

In respect to Peruvian businessmen, it is necessary to identify precisely which type of enterprise is most likely to be seeking foreign investment and in using the proposed investment promotion services.

On the basis of conversations with several Peruvian businessmen, information was obtained permitting a very rough

estimate of the degree of likely interest in investment promotion services. In Exhibit III-1, the results of this informal survey are charted.

It is estimated that there are about 500 companies in Peru which would be interested in foreign investment or be of possible interest to foreign investors. This group does not include the many thousands of small Peruvian firms primarily serving the domestic market which are not normally of interest to foreign investors.

The target group for investment promotion services is estimated at about 175 medium sized firms (Group 3) or about 35% of the total. If we assume that some 25 of the larger well-established firms in Group No. 2 may use investment promotion services for information on joint venture partners in different industries than those in which they are presently operating, then the total potential number of target firms could rise to 200.

It is noteworthy that some 65 percent of the total number of firms reportedly have established relationships and contacts among foreign financial, industrial and commercial groups. This tells us something about the Peruvian private sector. In general, it is a sophisticated and dynamic private sector, with significant entrepreneurial talent and with extensive international relationships. The Peruvian private sector, unlike those in other less developed countries does not appear to need special assistance in undertaking investment comparative advantage studies, in identifying projects, or in preparing feasibility studies. Many have good experience in these areas and those that

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Relative Interest of Peruvian Firms in Utilizing Investment Promotion Services

Group No	Type of Firm	Degree of Interest in Using Investment Promotion Services	Estimated Number of Firms	Percent of Total
1	Firms associated with multinational companies	Little interest since they have direct relationship with multinational company	75	15
2	Well-established major Peruvian firms with international experience	Little interest since they have well-established foreign relationships and contacts in their own industry. May have interest in using services to obtain information about investment in other industries	250	50
3	Medium-sized Peruvian firms, mostly family owned, with interest in joint ventures with foreign firms.	Great interest in using investment promotion services since these firms do not have foreign relationships or contacts and need help in all aspects of obtaining joint venture partners. This is the target group	175	35
Totals			500	100

do not can obtain these services locally.³ Rather, the target group appears to need assistance in making contact with foreign investors who may be interested in joint ventures to improve their capitalization, to obtain market access or modern technology.

Given a satisfactory investment climate, the Peruvian private sector can be expected to respond rapidly to attractive investment opportunities. In the late 1950s and early 1960s, Peruvian investors, many in association with foreign partners, developed a fishing and fishmeal industry which achieved world-wide preeminence before it was nationalized by the military regime in the late 1960s.

B. Investment Priorities

As indicated above, an Investors Forum was recently held in Lima organized by CONITE, COFIDE, and the Industrial Bank with the support of UNIDO. Some 180 projects were presented from Peruvian firms seeking equity capital, loans, technology, market access, management know-how and training. A COFIDE Report, included as Annex 1 to this report, contains summary tables of the projects presented to the Forum classified by investment requirements, by availability of project studies, by types of investment needs from both established and new firms, by sectors and by geographic location.

3. The Inter-American Development Bank has a pre-investment studies project which assist Peruvian firms in preparing feasibility studies for investment projects.

Table No. 3 in Annex 1 provides a breakdown of the projects presented by the industrial sector which provides a useful indication of what Peruvian entrepreneurs consider to be their investment priorities. The principal industrial project priorities are the following

<u>Industrial Activity</u>	<u>% of Projects Presented</u>
Agri-Industry	31.66
Chemical	14.43
Forest Products	9.43
Non-ferrous Mineral extraction	7.78
Hotels	7.22
Metal Working	6.11
Textile	5.56
Non-metallic minerals	4.44
Others	<u>13.37</u>
	100.00

In Annex 2 there is included a listing of specific investment projects presented at the Forum. COFIDE is presently contacting project sponsors to assess progress in their interaction with potential foreign investors. An evaluation report will then be prepared. COFIDE has assumed responsibility for following up on projects which have attracted foreign investor interest.

This basic project list provides a useful basis for advancing Peru's investment promotion program. COFIDE should continue to monitor these projects to try to come up with a short list of the most promising prospects and undertake a diligent follow-up to try to nurture joint venture opportunities.

This investment project list should also be carefully reviewed by public and private sector groups concerned with export promotion, and the development of free trade or enterprise zones since some portion of the projects presented may involve export production or be candidates for location in trade zones to be established.

IV. Recommendations for a Proposed Investment Promotion Strategy and Related Projects

A. Proposed USAID Investment Promotion Strategy

The Coopers and Lybrand Report sets forth a comprehensive USAID strategy or economic development in Peru. It also provides a useful and realistic framework for a related investment promotion strategy. The principal elements of the proposed strategy follow.

1. Short Term (1-2 years)

- o Concentrate on assisting the Government in the areas of national economic policy formulation and management as a crucial prerequisite for creating a climate attractive to domestic and foreign investment. The Coopers and Lybrand Report provides a number of specific suggestions for activities in this area. Emphasize efforts to promote more flexible administration of existing investment and labor laws if it proves impossible to modify these laws.
- o Assist the institutional strengthening of the private sector to enhance its capacity to influence public policies in favor of growth and an improved investment climate.
- o Continue to explore alternative approaches to negotiating an OPIC Investment Guaranty bilateral

agreement ⁴. With some negotiating flexibility on both sides, progress in reaching an acceptable solution may be possible. Consider linking AID willingness to provide major long term assistance to Peru's investment promotion activities to progress on OPIC bilateral negotiations. AID should be willing to make modest assistance available for investment promotion institutional development over the short term (2 years) but make a decision on the OPIC policy issue before committing major resources for longer term assistance in this area.

- o Begin to assist the Government in the institutional development of a national investment promotion organization to provide a range of promotional and authorization services to both domestic and foreign investors. Short-term assistance should be limited to assisting the establishment and functioning of the investment promotion entity and training its staff. This process should take about two years. Emphasis should be placed on obtaining an active private sector participation in the investment promotion process. USAID should ensure that the institutional development of the investment promotion entity is well advanced and that progress is being made in the economic policy/investment climate area before committing major resources to an active international promotion effort.
- o Assist the Government in the establishment of industrial free trade or enterprise zones where joint ventures with foreign investors can be attracted due to more favorable investment and operating climates than those in other parts of the country. Give priority to supporting efforts for free zone legislation which permits exoneration from restrictive labor stabilization and industrial community laws.
- o USAID should allocate modest technical assistance resources to undertake special short-term studies or activities directly related to investment promotion. Examples of such activities will be set forth below.

4. Peru recently reached agreement with Japan to settle claims in Swiss courts. This agreement may provide a model for OPIC-Peru negotiations.

2. Medium to Long Term (3-5 years)

Toward the end of the second year, USAID should evaluate Government progress in carrying out the investment promotion strategy. If inadequate progress is revealed in the areas of economic policy/investment climate, and in the institutional development of the investment promotion entity, then USAID support for short term projects should be reduced or phased out. An important policy issue to be faced in the evaluation should be whether or not AID should commit important long-term resources to assist Peruvian investment promotion in the absence of an OPIC bilateral agreement. If meaningful progress is made in obtaining the objectives of the strategy and of the short term projects, then USAID should be prepared to commit significant resources in supporting the investment promotion effort. Examples of medium to long term projects to support this effort could include,

- o Financing a contract with an international consulting or investment banking firm to assist the Peruvian promotion entity in an active investor search program. Priority should be given to targeting a few major investment opportunities and then organizing a carefully planned marketing campaign to attract pre-selected foreign companies to make investments.
- o Provide an AID contribution to a proposed COFIDE/Banco Industrial Venture Capital Fund to finance new industrial enterprises.

A fuller description of medium to long-term projects in support of the proposed strategy appears below.