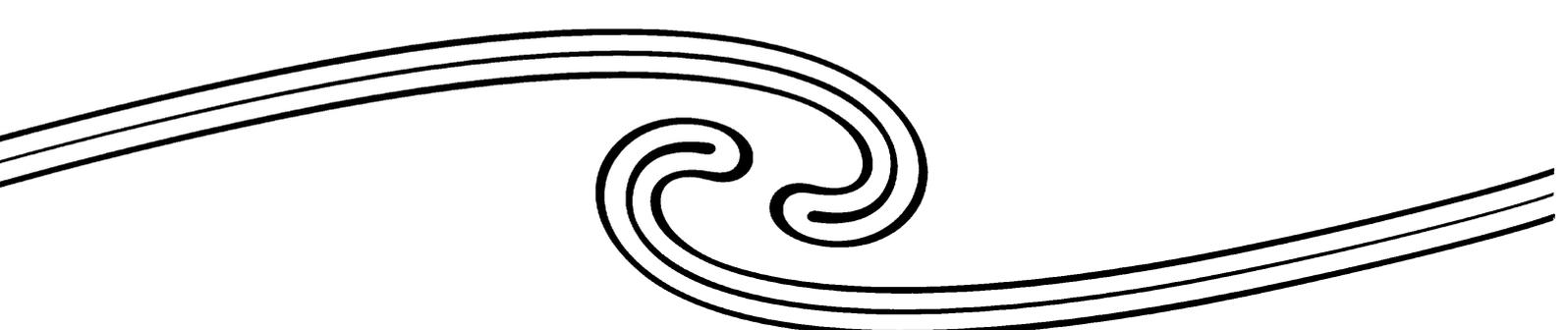


Market Analysis of Opportunities for New Zealand Business in Peru

*Report Prepared by
COMEXPERU
for the
NZ Embassy Santiago*

Executive Summary

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Peru is diverse with abundant natural resources and a booming economy. Peru is the third largest country in South America with a population of 29.4 million. Income per capita in Peru was US\$5,200 in 2010. This document summarises a comprehensive report commissioned from the International Trade Association of Peru (COMEXPERU) and funded by the New Zealand Government's Latin America Strategy Fund.

Peru's economy grew by 8.8% in 2010 and income per capita almost doubled between 2005 and 2010. Growth has been driven by improvements in productivity and strong increases in private investment. Peru's average inflation between 2006 and 2010 was 2.8%, the lowest in Latin America. Economic growth in Peru helped to reduce the poverty level by 15 percentage points to 34.8%. Flows of foreign direct investment are estimated to amount to 4.7% of Peru's GDP in 2011.

Over 90% of Peru's trade is covered by free trade agreements, providing duty free access for approximately 85% of Peru's exports. Peru's average tariff is 3.4%. New Zealand and Peru are currently negotiating a free trade agreement as part of the Trans Pacific Partnership Negotiations.

New Zealand exports to Peru grew strongly in 2010 to US\$56 million, while imports from Peru were valued at US\$13 million. Major New Zealand exports include milk powder, butter and butter milk, electrical products and fish and seafood.

Investment opportunities for New Zealand in Peru are found particularly in the provision of specialised services related to industries that are pivotal to Peru's economy and where New Zealand has expertise such as agriculture, forestry, energy. Nonetheless, it is worth noting that, given the high rate of growth of the Peruvian economy and the growing needs of a population of almost 30 million people with increasing incomes, investments of all scales, in practically every sector, can present attractive returns.

Additionally, Peru's location, strong network of free trade agreements, reasonable labour costs, abundance of natural resources, and friendly investment environment makes it an ideal operation centre either for business or production. Moreover, if production is destined for exports, government incentives such as Drawback and Free Trade Zones may apply and prove attractive.

In addition to direct investment, the analysis identified opportunities for increased exports of: machinery and seeds for agriculture; livestock related products such as hormones and vaccines; and capital goods in general.

Opportunities for New Zealand in Peru

Agriculture

- To export high-tech machinery and seeds.
- To provide consultancy services and training to agribusiness in Peru.
- To export livestock related products and know-how.
- To invest in agricultural land in Peru.
- To provide consultancy services and training for a sustainable forestry in Peru.

Fisheries

- To invest in factories that produce and export high value-added products, which are the most profitable but less developed in Peru.
- To invest in aquiculture; a profitable activity that requires a relatively low investment and offers many opportunities in Peru.
- To provide consultancy services and training to fisheries in Peru.

Mining

- To provide engineering consultancy services in areas such as environmental and geological consulting.
- To invest in exploration.
- To export high-tech machinery.
- To invest in mining related services, from catering to logistics in small Peruvian towns where mines are established.
- To provide consultancy services and training to miners.

Energy

- To provide engineering consultancy services in areas such as environmental and geological consulting.
- To invest in exploration for natural gas and oil fields.
- To export high-tech machinery.
- To invest in the development of geothermal, wind and hydro energy. Other sources of renewable energy, such as biodiesel and ethanol, are also attractive investments.

Education

- To promote undergraduate and graduate programs in New Zealand.
- To promote exchange programs at an undergraduate and graduate level.
- To promote technical courses in New Zealand.

- To offer technical courses in Peru.
- To offer training programs in New Zealand and in Peru to Peruvian businesses.

Summary of COMEXPERU Analysis

Strengths (of New Zealand)

- Knowledge and experience in industries that are very important to Peru's economy, which have grown significantly in the last years and with excellent prospects. These include agriculture, forestry, tourism, energy, particularly in the provision of related services.
- Experience in similar markets such as the Chile.
- Good international branding, no reason for rejection in Peru.
- Access to well-trained and qualified professionals.
- Knowledge of English reduces the language barrier compared with other countries in the Asia Pacific region.
- Access to a more advanced technology.
- Access to a relatively more developed financial market (cheaper credit).

Weaknesses (of New Zealand)

- Distance to Peru: High transportation costs.
- Low connectivity in terms of airline and maritime transportation
- Time difference.
- Cultural and language barriers.
- Very limited knowledge about the Peruvian market and business culture.
- New Zealand is relatively unknown to Peruvians, both in an economic and cultural sense.
- No embassy or official representation resident in Peru.
- Limited capital for big investments.
- Small-scale international operations.

Opportunities (for New Zealand)

- Peru is one of the fastest growing low inflation economies in the world.
- A market of 30 million with increasing incomes.
- Excellent geographical location: In the middle of South America's western coast and linked to Asia across the Pacific Ocean.
- Peru has an extensive network of free trade agreements that provide preferential and tariff free access to the most important markets in the world and to most countries in the American continent.
- Growing demand for specialised services and know-how in sectors in which New Zealand has broad expertise: Agriculture, Forestry, Tourism, and others.
- Recent changes in the Peruvian energy sources with emphasis in natural gas and high oil prices, represent an opportunity for investing in environmentally friendly and renewable sources such as hydro, geothermal, and wind energy.
- Increasing demand for education services at all levels: In general, Peruvians attach a high value to education.
- Equal treatment for domestic and foreign investment in all economic

- sectors.
- Estimated infrastructure gap of US\$ 38 billion opens many possibilities for investment.

Threats (for New Zealand businesses in Peru)

- Competition from other countries.
- Higher energy costs and, therefore, higher transportation costs.
- Peruvian political and social instability.
- Underdeveloped/ lack of infrastructure.
- Relatively high crime rates and drug trafficking.
- Bureaucracy and corruption.
- Lack of an efficient judicial system.
- Relatively high rate of informal economy, which is around 60% according to the World Bank (Doing Business Report 2008).

Doing Business in Peru (pages 20-41 of the report)

Peru has recently made significant progress in the Ease of Doing Business. Peru ranks 36 of 183 in the World Bank's 2011 Ease of Doing Business Report.

A "one-stop shop" has been created for company formation, within 3 days.¹ Similarly, work is underway on a Foreign Trade Single Window which will allow all import, export and transit procedures to be undertaken through a single website.

The Ministry of Environment has responsibility for environmental regulation through the General Environmental Law. Peru is a member of most of the international agreements covering intellectual property rights, with most regulations harmonised throughout the Andean Community.²

In some sectors, specific rules apply, for example to operate as an "authorized travel and tourism agency", these agencies shall request an application form from the competent regional authority or the Ministry of Foreign Trade and Tourism.³

Sectors of Possible Interest to New Zealand

Agriculture (pages 42-49 of the report)

Agriculture accounts for 4.5% of Peru's GDP. Peruvian agriculture is a sector of small producers in which 85% have less than 10 hectares. Peru has 7.6 million hectares with direct agricultural potential, but less than 3.6 million are properly used.

Traditional exports are coffee, sugar and cotton; but a diverse range of products are grown with a higher productivity than in other countries including: artichokes, asparagus, dry paprika, mangos, grapes, avocados, lemons and bananas.

Europe and the United States are expected to continue as the lead buyers of Peruvian agricultural products, which are beginning to be identifiable on their shelves (especially mangos and asparagus with the 'Peru' label). In the 900,000 hectares of the 50 valleys in the coastal, with temperate climate and availability of regulated water, the productivity in crop yields has increased steadily and two harvests are possible each year. The increased application of technology suited for Peru's geography will allow the country to further improve the productivity rates.

Trade is expected to increase considerably with the populous countries of Asia (such as China, Korea, Japan and India), due to the change in their middle class consumption patterns and tariff preferences that are well suited to the variety of products that Peru has to offer. According to estimates by the Ministry

¹ www.empresas.gob.pe/

² www.comunidadandina.org/ingles/intellectual_property.htm

³ <http://www.mincetur.gob.pe/newweb/Default.aspx?tabid=1050#prestador>

of Agriculture, Peruvian agricultural exports will grow at double digit rates over the coming years and the Government aims to double the sector's exports every 5 years.

Peruvian biodiversity enables the development of new agricultural exportable products, generating investment opportunities. Peru has many products not fully exploited that are attractive because of their high protein content, as well as their nutritional qualities; examples include Andean cereals such as the amaranth, quinoa, or cañihua tarwi. Furthermore, crops such as beans, corn and potato varieties little known outside the country, have considerable potential.

There is also significant potential for herbs and natural products with medicinal uses or high nutritional content, mostly from the heights of the Andes or the Amazon jungle. From the jungle there are also exotic fruits such as the soursop and the camu-camu, fruits of growing consumption in Asian countries, with potential to expand these markets. Apart from food, there is considerable potential for flowers – at present Peru only exports 1,600 of the 19,000 species existing in the country.

Tax concessions are in place for agriculture, with income tax applied at 15% (compared to the overall rate of 30%). Activities established at altitudes of greater than 2,500 metres are exempt from taxation.

Turning to products produced by New Zealand, Peru has one of the lowest levels of milk consumption and production in South America; consumption levels are lower than recommended by the FAO. Peru's milk production was 1.7 million tonnes in 2009 and was concentrated in the regions of Lima, Arequipa, Cajamarca and La Libertad.

Beef consumption per capita in Peru increased from 48.8 kg per person in 2001 to 60.75 kg per person in 2010. Nevertheless, levels are still below the average consumption in Andean countries. More than 90% of beef production is informal.

Sheep are farmed mainly by small producers in the highlands. The production of wool and meat is very low and prospects are not encouraging.

Fisheries (pages 49-53 of the report)

With 3,080 kilometres of seashore, 322 kilometres of sea boundary and zones with very ample continental platforms, Peru is a country with a wide range of territory to exploit and diverse marine species to develop. Peru is one of the world's principal fishing countries, second in terms of fish landings and the leading exporter of fishmeal and fish oil. This is due to the high yield and the nutrient rich waters near Peru, the diversity of species and the leadership of national and international enterprises with operations in the country.

Total production in 2010 was 1.255 million metric tonnes (TMB), of which fishmeal accounted for 62.6%, frozen fish 16.8%, crude oil 13.8%, canned fish

5.6% and salted fish 1.3%. Production declined by 37% in 2010, due to lower temperatures in Peruvian waters and tighter fishing quotas imposed by the Government. The internal sale of fisheries in Peru accounted for 29% of its total production in the last 10 years.

The private sector plays an important role in the fishing industry. Companies in this sector are making important investments in the frozen and canned industry, focusing on fishmeal.

Fishing quotas and other regulations are government by the Ministry of Production (PRODUCE). The Fisheries Technological Institute (ITP) is one of the public institutions working with the PRODUCE, and runs the National Service of Fishing Sanity (SANIPES). This organisation works to achieve an efficient administration of fishing resources, and to establish procedures which promote and certify the quality of the fishing products in order to protect public health.⁴

Peru's legal framework promotes aquaculture development including through income tax reductions (15% compared to the usual 30%), advanced sales tax return for the production stage and suspension of payment for aquaculture rights.

Tourism (pages 54-61 of the report)

Peru received almost 2.3 million tourists in 2010. Private investment has played a key role in the growth of the sector, particularly through the establishment of hotel chains and improvements in air links.

Surveys reveal that foreign tourists visit Peru to visit Pre-Colombian cultural sights (underpinned by Machu Picchu), colonial sights. There is a growing interest in nature travel, such as an interest in trekking by visitors from Canada, the UK, Germany and France. 19% of visitors to Peru undertook an "adventure" activity.

Education (pages 62-70 of the report)

In 2010, 783,000 students were enrolled in undergraduate studies with a further 56,000 undertaking postgraduate study in Peru. Between 1996 and 2010, undergraduate student increased by 6.2% annually and postgraduate student numbers by 12.5%. In 2010 there were 35 public universities and 65 private universities in Peru, with 39.5% of undergraduates attending public universities.

Popular undergraduate courses include Business Administration (71,681 students); law (70,861 students); accounting (68,241 students), systems engineering (46,816), teaching (40,434), civil engineering (37,962) and medicine (37,958 students).

Approximately one third of students (at both the undergraduate and postgraduate level) are considering further study abroad. Postgraduate study

⁴ www.itp.gob.pe/desarrollo-sanipes-procedimientos.php

options in Peru are limited, especially for science and medicine, and the quality of foreign institutions is perceived as higher than domestic institutions.

According to the 2010 Educational Census, 48.5% of undergraduate students in Peruvian private universities state that they speak English, while in Lima this percentage is 61.2%. The Peruvian Government does not currently have any policy that promotes learning English.

In 2010, 12.6% of the economically active population were instructed in non-university higher education. The supply of these courses is large but quality is, in most cases, poor. Less than 40% of the economically population has completed secondary school and there is demand for low cost training.

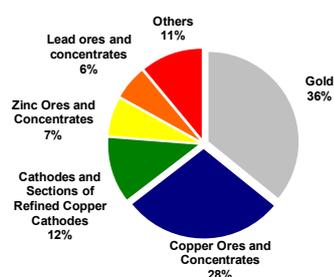
The Ministry of Education has noted that the agriculture, construction, energy, mining, fisheries and services sectors have an unmet demand for technical qualifications and there are not sufficient institutes and training centres catering to these specialties.

The Law for Promoting Investment in Education (Legislative Decree 882) allows any natural or legal person to offer private education, including the right to establish, promote, conduct and manage private educational institutions, with or without financial gain. Standard tax provisions apply to private educational institutions.

Mining (pages 71-78 of the report)

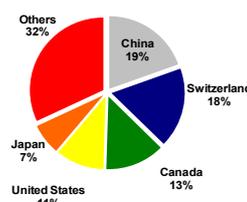
The US Geological Survey considers Peru to have the third largest reserves of gold, silver, copper and zinc in the world. Mining accounts for 5% of Peru’s GDP and 61% of Peruvian exports. The sector employs more than 600,000 and contributes 27% of Government revenues. Peru is the world’s largest producer of silver and the second largest producer of copper and zinc. Peru also is the third largest producer of tin and fourth largest producer of mercury and molybdenum. The graphs below show production and destinations of mining exports.

Graph 45. Main Products Exported of the Mining Sector in 2010



Source: SUNAT.

Graph 46. Main Destinations of Mining Exports in 2010



Source: SUNAT.

At present, there are 34,513 existing mining concessions in Peru which cover

an area of 14,767,834 hectares. The estimated investment portfolio in mining comprises 41 major projects, valued at US\$ 42,451 million. Most of the leading international mining companies, such as Xtrata, Freeport Macmoran, Newmont, Barrick, BHP Billiton, Shougang, Chinalco, Rio Tinto, Anglo American, Grupo Mexico and CVR, among others, are already investing in Peru.

There is also an important opportunity in offering related services to the mining activity. Extraction companies install in desert areas, so they are forced to bring with them all the resources they need to operate. These include catering for employees, transport services (i.e. helicopters, equipment trailers, etc.) and industrial power generators to illuminate large areas, among others. Professional knowledge in engineering is also needed to support these operations.

The main Peruvian institutions governing mining are: Ministry of Energy and Mines;⁵ National Society of Mining, Petroleum and Energy (SNMPE);⁶ OSINERGMIN which is in charge of the regulation, supervision and audit of the activities in electricity, oil and mining;⁷ and the Geological and Metallurgical Institute, INGEMET.⁸

According to ProInversión, the rules governing mining activity in Peru's guarantee legal stability and economic freedom. The companies in the sector can sign legal stability agreements with the Peruvian Government for periods of 10 to 15 years. It is also allowed the drag of net loss for 4 consecutive years, starting in the year that taxable income is registered.

Energy (pages 79-86 of the report)

Peru's energy resources make it an ideal place to invest in this sector. In 15 years, Peru has increased its hydrocarbon reserve level four-fold and its electricity generation capacity has risen by more than 70%. In spite of this progress, there is still much to be done to turn Peru into a real energy powerhouse, and private investments will play a key role.

The abundance of water resources and natural gas underpins Peru's electricity potential, which allows Peru to cover the local power demand growth (7% annually) and also allows Peru to export power to countries in the region. Peru has 58,937 MW of hydroelectric generation potential and domestic demand accounts for 4,000 MW of installed capacity.

Peru has an estimated potential to generate 3,000 MW of electricity through geothermal energy. Several studies are taking place in Tacna, in the South of Peru, for generation in Borateras and Calientes geothermal camps. These geothermal energy projects would help to develop an ecotourism project of hot springs in the area. Furthermore, they would boost agricultural areas with clean

⁵ www.minem.gob.pe/

⁶ www.snmpe.org.pe/0/home.aspx

⁷ www.osinerg.gob.pe/

⁸ www.ingemmet.gob.pe/

water. According to the previous Energy Viceminister of Peru, the return rate of these projects was estimated at 14%.

Peru produces approximately 150,000 barrels of liquid hydrocarbons daily. The investment made in this subsector both in terms of exploration, production, refining, trade and related activities has exceeded US\$ 9 billion in the past 15 years.

Peru's exploration and production is based on its 18 sedimentary basins with hydrocarbon potential (9 are located along the coastline, 7 in the jungle, and 2 on the highlands.) Over the past five years up to ten important discoveries have been made in the country: three of light crude oil, three of heavy crude oil, and four of natural gas, two of these in the presence of condensate.

More information about Peru and the opportunities that it presents can be found at:

NZ Embassy Website: <http://www.nzembassy.com/chile>

New Zealand Trade and Enterprise: <http://www.nzte.govt.nz/explore-export-markets/south-america/doing-business-in-peru/pages/doing-business-in-peru.aspx>

Ministry of Foreign Affairs and Trade: <http://mfat.govt.nz/Foreign-Relations/Latin-America/index.php>

Information on the Transpacific Partnership Negotiations: <http://mfat.govt.nz/Trade-and-Economic-Relations/2-Trade-Relationships-and-Agreements/Trans-Pacific/index.php>