

TRADE POLICY REVIEW

PERU

Report by the Government

Pursuant to the Agreement Establishing the Trade Policy Review Mechanism (Annex 3 to the Marrakesh Agreement Establishing the World Trade Organization), the policy statement by the Government of Peru is attached.

TABLE OF CONTENTS

	<u>Page</u>
I. EXECUTIVE SUMMARY	4
A. RECENT DEVELOPMENTS	4
B. OUTLOOK	5
II. TRADE AND ECONOMIC POLICY ENVIRONMENT	5
A. TREND IN THE ECONOMIC ENVIRONMENT	5
B. TRADE POLICY OBJECTIVE	7
C. REINFORCEMENT OF THE OPENING UP OF THE PERUVIAN ECONOMY	7
D. RELATIONS WITH MAJOR TRADING PARTNERS	8
III. TRADE POLICY TRENDS 1994-2000	8
A. COMPLIANCE WITH COMMITMENTS IN THE WTO	8
B. PERU AND THE ANDEAN COMMUNITY	9
C. PERU AND THE LAIA	9
D. NEGOTIATIONS ON THE FTAA	10
E. PERU AND THE APEC	10
IV. FUTURE POLICY DIRECTION	10

I. EXECUTIVE SUMMARY

A. RECENT DEVELOPMENTS

1. Over the past six years, Peru has continued to intensify its economic reforms and trade liberalization with a view to strengthening its integration in the world economy. To that end, it has not only made the adjustments required to meet its multilateral commitments, but has also reinforced the liberalization of its external goods and services market through trade negotiations.

2. Peru became a Contracting Party to the GATT in 1951, participated in the Uruguay Round negotiations and was an original Member of the WTO. It adapted its domestic legislation to the Agreements adopted at the conclusion of the Uruguay Round, and has thus respected its multilateral commitments. Since 1 April 2000, Peru has applied the WTO Agreement on Customs Valuation to 100 per cent of its imported goods.

3. In the context of trade liberalization, tariff levels have been lowered and tariff spread reduced, while various restrictions on free trade have been eliminated. There are currently two tariff levels for imports (12 and 20 per cent) and temporary surcharges for certain agricultural products.

4. During this period, the Government's conduct of economic affairs has been marked by prudent management of fiscal and monetary policy, enabling it to balance the budget in 1997 and create suitable conditions for the promotion of investment.

- With respect to monetary policy, the sole objective is price stability, so there is an independent Central Bank which has opted for the monetary base as an intermediate target. From the outset, a floating exchange rate system was also adopted.
- With respect to fiscal policy, the Government continued the tax reform process, simplifying the tax regime in 1994 by retaining only four taxes: the general sales tax, income tax, the selective consumption tax, and the import tax. This reform was marked by stringent fiscal discipline and in 1997 resulted in the first surplus in the public sector accounts for 30 years.

5. These reforms, coupled with a suitable legal framework and sound economic management, have enabled the country to be considered attractive for foreign investment. The share of investment in GDP terms rose from 15.6 per cent in 1990 to 24.4 per cent in 1997, dropping to 21.7 per cent by the end of 1999 owing to the 1998 and 1999 crises. As regards the foreign debt, the agreements signed with the Paris Club and the commercial banks between 1996 and 1997 led to the regularization of Peru's relations with its creditors.

6. As a result of this situation, the Peruvian economy grew at an average annual rate of 5.5 per cent during the period 1994-1999, while inflation fell to 3.7 per cent in 1999. Meanwhile, exports and imports increased by an average annual rate of around 9.7 and 8.4 per cent respectively.

7. In parallel with its domestic reforms, the Government consolidated its involvement in trade integration mechanisms at various levels.

- Peru formally became a member of the Asia-Pacific Economic Cooperation forum (APEC) in November 1998.
- At the Americas level, Peru is taking an active part in the negotiations on the Free Trade Area of the Americas (FTAA).

- At the regional level, the integration process within the Latin American Integration Association (LAIA) is continuing.
- At the subregional level, Decision 414 of the Andean Community (CAN), which facilitates Peru's full reintegration into the Andean Free Trade Area and sets a timetable for progressive reductions in tariffs for its members, entered into force in July 1997. In 1998, Decision 439 approving a framework agreement for the liberalization of trade in services was adopted.

B. OUTLOOK

8. Over the next few years, Peru's economic policy will be aimed at promoting sustained growth in GDP with a view to achieving annual increases of over 6 per cent and lowering inflation to international levels so as to achieve economic and social progress in Peru. In order to do so, Peru considers it essential to maintain a balance in public finance and a cautious monetary policy, and to pursue the structural reform process.

9. Peru will maintain its commitment to a free trade regime, the free movement of capital and a floating exchange rate, and to further reforms in foreign trade and the customs regime.

10. Peru welcomes the initiative on a new round of multilateral trade negotiations provided that a consensus is reached on a broad and balanced agenda which reflects the interests of all Members and that transparent working methods are adopted so as to guarantee equitable participation by all Members concerned.

11. For Peru, it is particularly important to strengthen a stable, transparent and predictable trade environment that allows greater access to international markets for Peru's exports.

II. TRADE AND ECONOMIC POLICY ENVIRONMENT

A. TREND IN THE ECONOMIC ENVIRONMENT

12. The favourable trend in the Peruvian economy's major economic indicators since 1994 has to a large extent depended on prudent management of fiscal and monetary policy and the dynamic structural reform process initiated in the early 1990s. As a result of the new economic environment, inflation fell from 7,600 per cent at the beginning of the 1990s to one-digit levels of between 3 and 4 per cent by the end of the decade. In 1997, fiscal balance was achieved after a period of deficits exceeding 10 per cent of GDP at the end of the 1980s and the proper conditions were in place to encourage investment on a permanent basis and achieve sustained growth of economic activity. This process was stimulated by Peru's reintegration into the international financial system, the pacification process, a series of structural reforms and the adjustment programme which reduced the Peruvian economy's country risk and resulted in a substantial flow of foreign capital, mainly over the medium and the long term, which has financed a large part of the growth in production without endangering the viability of the external accounts.

13. During this period, the sole objective of monetary policy has been to stabilize prices, as established in the 1993 Constitution and the Organizational Law on the Central Bank. Since 1994, the Bank has announced target ranges of inflation for the year in order to reaffirm its commitment to lowering inflation and bringing it down to the level of the industrialized countries. In order to achieve this ultimate objective, the monetary authorities have opted for growth in the monetary base as an intermediate target. Another important element in this process has been the adoption of a floating exchange rate system which has allowed Peru to face crises such as the drop in the terms of trade without suffering traumatic effects. Interventions in the foreign exchange market are mainly to

prevent unjustified fluctuations in the exchange rate. These interventions led to a strengthening of the Central Bank's foreign exchange position, which went from a negative situation in July 1990 to around US\$2,500 million at the end of 1999, amounting to 1.8 times the monetary base.

14. In the area of fiscal policy, after the initial programme in 1990 eliminated the major sources of imbalance, particularly the financing of the Central Bank, in 1992 the Government adopted a series of measures to simplify the tax regime and restructure the tax administration. The result of this process was that in 1994 the tax regime only comprised four taxes: the general sales tax, income tax, the selective consumption tax, and the import tax. This policy, combined with careful management of fiscal spending, meant that in 1997, the public sector accounts showed a surplus after 30 years. In 1998 and 1999, the events which occurred due to external crises and the El Niño phenomenon had an impact on fiscal performance.

15. At the end of 1999, the Government adopted a Law on Fiscal Prudence and Transparency which *inter alia* provides that the fiscal deficit may not exceed one per cent (1%) of GDP as of 2002 and that the increase in the Government's non-financial spending should not exceed two per cent (2%) in real terms. It should be noted that between 1996 and 1997, the Government reached an agreement with the Paris Club and the commercial banks that regularized relations with its creditors. It should also be emphasized that the privatization process, which has been on a large scale since 1994, has contributed a sum of around US\$9,000 million through the sale of enterprises.

16. It is important to emphasize that the reforms undertaken such as the liberalization of foreign trade, the foreign exchange market, the capital account and the financial system, together with privatization and reforms in the labour market and legislation on foreign investment, have given economic activity an important boost, particularly investment. Investment's share of the GDP rose from 15.6 per cent in 1990 to 24.4 per cent in 1997. Following the crises in 1998 and 1999, however, the figure fell to 21.7 per cent at the end of 1999.

17. It should be emphasized that the larger amount of investment has had an important impact on foreign trade as it has not only made for a greater supply of goods for export but has also led to higher demand for imported goods. This situation meant that the deficit in the balance-of-payments current account rose from US\$2,648 million in 1994 to US\$3,790 million by the end of 1998, falling subsequently to US\$2,030 million in 1999. It is important to note, however, that during the period 1994-1999 over two-thirds of this deficit was financed by long-term private capital (excluding the revenue generated by privatization).

18. The preservation of the economic foundations and the legal framework for foreign investment have enabled Peru to be considered an attractive place for foreign investment over the past decade and have complemented the efforts made at the domestic level to restore sustained growth after the international crises.

19. Article 63 of the 1993 Constitution gives foreign and domestic investment equal treatment. Furthermore, current legislation gives total freedom to repatriate profits and dividends abroad, lease technology, pay trademark rights, and also allows for the possibility of private investment in public services. The Government has signed bilateral agreements which allow foreign investors to insure their investments against non-commercial risks with organizations such as the Multilateral Investment Guarantee Agency (MIGA) and the Overseas Private Investment Corporation (OPIC) and to sign tax stabilization agreements with the Government.

20. Foreign investment flows increased significantly throughout the decade. From a level of close to US\$13 million in 1990, they rose to around US\$1,600 million in 1994 and US\$2,200 million

at the end of 1999, even though flows of investment to Peru fell in 1998, as they did in a large part of Latin America. During the period 1994-1999, the main sources of foreign direct investment were Spain, United States of America, United Kingdom, Canada and Chile. The sectors which received the major part of the accumulated flow of foreign direct investment during this period were communications, energy, mining, industry and finance.

21. As a result of this situation, during the period 1994-1999 Peru's economy grew at an average annual rate of 5.5 per cent, while inflation fell to around 3.7 per cent in 1999. In this new environment marked by greater economic stability foreign trade was boosted, partly as a result of the improvement in Peru's terms of trade. Consequently, exports and imports increased between 1995 and 1999 at average annual rates of around 9.7 per cent and 8.4 per cent respectively.

22. In 1998, as a result of the impact of El Niño and of the financial crises in Asia and Russia on Latin America's emerging economies, the fall in the price of exports of primary goods led to a decrease of 13 per cent in the terms of trade compared with the average for 1997, affecting consumption and private investment in particular due to the negative expectations regarding future income. The drop in domestic demand, 0.6 per cent in 1998, meant that Peru's economy showed only 0.3 per cent growth in GDP during that year. The value of exports and imports of goods fell by 16.1 and 4.1 per cent respectively in comparison with 1997 levels. Nevertheless, throughout the year, the Central Bank pursued its efforts to achieve price stability, so the inflation rate continued to fall and in December 1998 reached a cumulative rate of around 6 per cent.

23. Peru's economy has been showing signs of recovery since the last quarter of 1999, recording growth in GDP of 3.8 per cent for the year, the highest rate in Latin America. Exports once again experienced vigorous growth and rose by 6.6 per cent, even though there was a 5.2 per cent reduction in the terms of trade, while the value of imports fell by 18.1 per cent. In terms of goods and services, the value of Peru's exports rose from US\$7,487 million in 1998 to US\$7,793 million in 1999 (an increase of 4.1 per cent), while imports of goods and services fell from US\$10,492 million to US\$8,857 million (15.6 per cent).

24. In addition, efforts to reduce inflation to international levels continued. In 1999, inflation was 3.7 per cent, the lowest rate recorded in Peru's economy over the past 40 years and the second lowest in the past 60 years.

B. TRADE POLICY OBJECTIVE

25. Peru's trade policy of openness and liberalization seeks to integrate Peru in the global economy so that it can take advantage of specialization in international markets. Peru therefore pays particular attention to strengthening a predictable international trade system based on fair competition, the development of comparative advantages and less protectionism.

26. The trade policy objective is to help lay down the bases for sustained growth and the modernization of the Peruvian economy, seeking to enhance its efficiency and productivity in order to guarantee internal and external competitiveness and greater participation in global trade flows.

C. REINFORCEMENT OF THE OPENING UP OF THE PERUVIAN ECONOMY

27. One of the foundations of the structural reforms was trade liberalization. In order to make international prices the catalyst for efficient production and ensure that the domestic market faced external competition, tariff levels and spread were drastically reduced and all quantitative restrictions on foreign trade were abolished. At the end of the past decade, there were 39 tariff rates (with an average of 70 per cent) and, if existing surcharges are included, the total was 56 effective tariff rates,

which distorted the efficiency of domestic production and the development of export activities. As part of the process of reinforcing the opening up of trade, in April 1997 the two tariff levels were reduced from 25 to 20 per cent and 15 to 12 per cent respectively. At present, 85 per cent of tariff headings are subject to a rate of 12 per cent and the remainder to 20 per cent, so that the average weighted tariff for the whole of the NANDINA classification fell from 15.3 per cent in December 1996 to 13.1 per cent after the aforementioned tariff reductions. It should be added that there are temporary surcharges on some agricultural products. Certain restrictions which affected free trade have also been abolished.

D. RELATIONS WITH MAJOR TRADING PARTNERS

28. Peru's major trading partner during the period 1994-1999 was the United States of America, which accounted for 33 per cent of its trade in 1998. Exports and imports from the United States amounted in each case to 33 per cent of the relevant totals. Trade with the United States has been given renewed impetus by the Andean Trade Preferences Act since Peru was made eligible for this preferential scheme in 1993.

29. The second trading partner in terms of importance is the European Union, which accounted for 22 per cent of Peru's total volume of trade in 1998. The share of Peruvian exports to the European Union fell from 31 per cent in 1994 to 22 per cent in 1998. The share of imports from the Union rose from 16 per cent to 22 per cent in the same year.

30. The LAIA countries' share of total trade during this period remained steady and in 1998 represented 22 per cent. Countries belonging to the Andean Community play an important role and account for 8 per cent of trade, corresponding to 8 per cent and 7 per cent of exports and imports respectively; next come the MERCOSUR countries, which in 1998 accounted for 7 per cent of Peru's trade, corresponding to 4 per cent for exports and 9 per cent for imports.

31. Lastly, other important foreign trading partners are Asian nations such as Japan and the People's Republic of China. After a period of sustained growth (17.1 per cent) in the value of exports of goods to these countries during the period 1994-1997, in 1998 the volume fell sharply (53.4 per cent), while the rate of growth in imports of goods from these countries, which was 5.8 per cent over the period 1994-1997, fell to 3.2 per cent in 1998.

III. TRADE POLICY TRENDS 1994-2000

A. COMPLIANCE WITH COMMITMENTS IN THE WTO

32. Over the past six years, Peru has intensified economic reform and liberalization in order to reinforce its integration into the global economy. It has not only made the requisite adjustments to meet its commitments at the multilateral level, but has also undertaken further liberalization of its domestic market for goods and services through trade negotiations. The following are the major achievements in trade policy since the last Trade Policy Review, in 1994:

- Peru has met its commitments under the Uruguay Round. It has duly adopted the legal rules and provisions needed to incorporate the agreements fully into the national legal structure and has lined up its domestic legislation in such matters as anti-dumping, subsidies and countervailing measures, safeguards, intellectual property, among others. Since 1 April 2000, Peru has been applying the WTO Agreement on Customs Valuation to 100 per cent of imported goods, following a one-year waiver requested within the framework of this Agreement.

- Peru has played an active part in the liberalization efforts within the WTO since its inception in 1995. It has further liberalized its market for services, playing an active role in the negotiations on financial and telecommunications services, making offers that have helped to consolidate its unilateral opening-up in those sectors. In telecommunications in particular, it has fulfilled the commitment to abolish the monopoly on fixed telephony telecommunication services, one year ahead of schedule.

33. Following the outcome of the Seattle meeting, we believe it essential for the WTO's methods of work and negotiating procedures to be the subject of an in-depth evaluation this year and for proposals to be developed on appropriate mechanisms to ensure the equitable and effective participation of all Members, as well as discussions on when to hold a new round and the agenda of issues that would be negotiated.

B. PERU AND THE ANDEAN COMMUNITY

34. At the subregional level, Peru belongs to the Andean Community, which also comprises Bolivia, Colombia, Ecuador and Venezuela and the bodies and institutions of the Andean Integration System.

35. Under this subregional integration scheme, reforms have been undertaken with a view to strengthening the Andean integration process, harmonizing economic policies and defining common social policies designed to raise the standard of living of the population.

36. At the trade level, intra-subregional trade in goods has been further liberalized under Decision No. 414 (July 1997). This Decision fully reintegrated Peru in the Andean Free Trade Area and laid down a timetable for tariff concessions that will be completed in the year 2005; it should be noted that the major part of trade, over 80 per cent, has already been liberalized.

37. Subsequently, in 1998, in Decision No. 439, a framework agreement was adopted for the liberalization of trade in services so as to achieve full liberalization at the Andean level in 2005.

C. PERU AND THE LAIA

38. Within the broader framework of Latin American integration, the 1980 Montevideo Treaty, which lays down the objectives, principles and mechanisms for the regional integration process, has not undergone any major changes, except with regard to the regime of origin, which has been improved through new decisions and agreements by the Committee of Representatives of the Latin American Integration Association (LAIA), and a consolidated and coordinated text was adopted in Resolution No. 252 of 4 August 1999. Moreover, the LAIA now has a new member, Cuba, which became a full party to the Treaty in December 1998.

39. The regional integration process has continued within the LAIA. On 22 June 1998, Peru signed an Economic Complementarity Agreement with the Republic of Chile on the establishment of a free trade area between the two countries in which goods, services and production factors would circulate freely. Trade between the two countries will be totally tariff-free by the year 2016. Negotiations have recently been concluded on a protocol amending the Economic Complementarity Agreement between Peru and Mexico, which added new products to the liberalization programme, set up a dispute settlement system, and extended the Agreement until 30 June 2002.

40. In August 1999, the Andean Community countries signed an Economic Complementarity Agreement with Brazil for a period of two years, in the context of the Andean Community –

MERCOSUR negotiations initiated earlier; negotiations are being held with Argentina with a view to reaching a similar agreement.

D. NEGOTIATIONS ON THE FTAA

41. At the level of the Americas, together with 33 other countries in America and the Caribbean, Peru is negotiating the establishment of the Free Trade Area of the Americas (FTAA). It is taking an active part in nine negotiating groups (market access, agriculture, services, investment, competition policy, intellectual property, anti-dumping and subsidies, settlement of disputes, and government procurement) and in three committees set up to examine issues such as electronic commerce, participation by small-scale economies and by civil society in the process. During the preparatory stage of negotiations on the FTAA, in 1996 Peru became the Chairman of the Working Group on Competition Policies in recognition of the leadership it had shown on this issue in this part of the Americas, and it was reappointed for the first stage of the negotiations, which ended in October 1999.

42. At the Ministerial Meeting held in Toronto in November 1999, Peru was appointed Vice-Chairman of the Negotiating Groups on Services and on the Settlement of Disputes. To date, the FTAA negotiations have led to many trade facilitation measures, particularly in respect of customs matters, as well as to a large amount of documentation on legislation and practices in the participating countries concerning most of the issues dealt with during the negotiations.

E. PERU AND THE APEC

43. One event of fundamental importance to Peru was the invitation to join, and its subsequent formal membership of, the Asia-Pacific Economic Cooperation Forum (APEC) in November 1998. Within this regional cooperation scheme, Peru is promoting the liberalization and facilitation of trade, investment and the exchange of large-scale cooperation in areas which go beyond trade and have a direct impact on the development of Peru's production sector. There can be no doubt that this participation will facilitate Peru's competitive integration in the international economy.

44. Within the framework of the APEC, Peru is currently Chairman of the Group on Competition Policy and Deregulation, and Vice-Chairman of the Subcommittee on Economic and Technical Cooperation (ECOTECH). Peru's active participation in APEC's subforums allows it to disseminate widely its economic reforms and make Peru available to advise other member economies interested in reforming their economic policies, among other matters.

45. Through the APEC, Peru is promoting successful and participatory negotiations within the framework of the WTO in order to strengthen the multilateral trading system.

IV. FUTURE POLICY DIRECTION

46. Peru's sustained economic growth, with stable macroeconomic conditions for private investment, will allow annual increases of more than 6 per cent in its GDP. In order to achieve this goal without further distorting the allocation of resources, it is essential that there should be a balance in government finance and a responsible monetary policy designed exclusively to bring inflation down to international levels.

47. The objectives of Peru's economic policy will continue to be sustained growth of GDP, reinforcement of external sustainability and the lowering of inflation, in order to contribute to economic and social progress.

48. The sole objective of monetary policy will continue to be price stability, as guaranteed by the Constitution, reaffirming the commitment to pursue a responsible monetary policy. This will enable the Peruvian economy to achieve levels of inflation similar to those in industrialized countries.

49. Peru will also direct its efforts towards implementing a stringent fiscal policy so as to restore balance in the public sector accounts. The recent enactment of the Law on Fiscal Prudence and Transparency (December 1999) fixes a ceiling of one per cent (1%) for the fiscal deficit as from the year 2002 and an increase in non-financial spending by the Government not exceeding two per cent (2%) in real terms.

50. Peru will complete its structural reform process, including the reform of the State, privatization and concessions. Private investment and domestic savings will improve as a result of the structural reforms, and will increase the private sector's share of the economy.

51. As part of the overall strategy to strengthen the network of social aid, Peru will improve the focus of social spending to include basic infrastructure programmes, food and nutrition, for the poor sectors of the population, taking action to enhance the efficiency of such programmes.

52. Peru will remain committed to a free trade regime, free movement of capital and a floating exchange rate and will pursue and intensify reform of foreign trade and the customs regime.

53. Peru's objective is continually to enhance Peruvian participation in all the international trade organizations in which it takes part.

54. The legal framework established within the WTO constitutes a fundamental element of Peru's trade policy. In this respect, Peru will continue to take an active part in all the matters related to the Uruguay Round Agreements, in negotiations on the accession of countries not yet members of the WTO, as well as the negotiations on agriculture and services already initiated. Peru supports the initiation of a new round of multilateral trade negotiations; in this connection, it hopes that a consensus will be reached on a broad and balanced agenda which meets the interests of all the Members of the WTO and takes into account the practical implementation of special and differential treatment for developing countries. It also believes it is essential to establish appropriate mechanisms to ensure the equitable and effective participation of all Members in negotiations within the WTO.

55. With regard to the Free Trade Area of the Americas (FTAA), following an initial phase in which the negotiations have produced their first concrete results, Peru will continue to take an active part in the various negotiating groups and committees. It will also continue to collaborate in the process so as to achieve the goal set by the Presidents and Heads of State at the Miami Summit and complete the negotiations on the establishment of a free-trade area that is consistent with the relevant WTO provisions by the year 2005.

56. As to APEC, in the short term Peru is seeking to promote its image and the successes and progress achieved in recent years by opening up trade and the economy. It also expects to benefit from the various economic and technical cooperation programmes offered by the APEC. In the medium and the long term, Peru's objective is to attract investment from Asia and the Pacific. It intends to become the strategic partner of the APEC economies in South America, in other words, to become the "bridge" between South America and Asia and the Pacific.
