



# **London Metropolitan University - BSc Shipping, Trade & Transport**

## **Bachelor Thesis**

Contemporary Transport TL3P04

### **Free Trade Agreement Peru – European Union: Importance and Positive Impact for Peru**

**This Bachelor Thesis was prepared to fulfill the final requirement to obtain the Degree Bachelor of Science in Shipping, Trade & Transport given by London Metropolitan University.**

Author: Giancarlo Jorge Pitta Destéfano

Tutor: Prof. Dr. Mervyn Rowlinson

Hamburg, January 2014



*To my parents and my little brother, who believe in me  
and my will to make my dreams come true.*

*This one is for us.*



## Acknowledgments

---

I want to thank all that helped me, inspired me and supported me in the process of writing this thesis and make it real.

First of all I want to thank God, for giving me the life and opportunity of seeing a world that too many people in my country cannot even dream to see.

To God I also owe my beloved family, who helped me be now myself and my own strength, but were the pillar to my life when I thought I could not continue. Thank you for coming to see me when I was laying in hospital, thank you for not letting my hand go and for all sleepless nights and restless days you all decided to have to accompany me during my disease. I cannot see more reasons than you three to explain why I am still here.

I owe my deepest gratitude to Prof. Dr. Rowlinson and Prof. Dr. Glen who gave their consent to the topic of this thesis and advised me to overcome the difficulties presented by the research topic. I want to thank as well London Metropolitan University and HST Akademie for letting me be the first Latin American student to complete this Bachelor Program. I am also grateful to the teachers, former teachers and advisers that contributed with their academic expertise to make this work possible as it is.

Moreover I want to show my gratitude to Mr. Urbina, Mr. Gonzales and Mr. Zehnle, who provided me with their time, information and ideas to have a wider and better view of the topic.

To finalize, I offer my sincerest gratitude to my school and teachers in Lima, where I took my first steps towards this goal.



## Declaration of Authorship

Last Names: Pitta Destéfano

First Names: Giancarlo Jorge

I declare that the work presented here is, to the best of my knowledge and belief, original and the result of my own investigation, except as acknowledged, and has not been submitted, either in part or whole, for a degree at this or any other University. It has been completed in fulfilment of the BSc Shipping, Trade and Transport at London Metropolitan University and HST Akademie.

Formulations and ideas taken from other sources are cited as such. This work has not been published.

Lima, January 2014

Signature





## **Abstract**

Fostering trade by reducing legal and economic barriers is seen as a major driver to the development of a country and its development. In the most recent decades, many developing (or third world) countries have joined the trend and have relied on this strategy to travel the path to becoming developed economies. Nonetheless, many of these countries do not have the economic and political infrastructure to become competitive and their growth ends up relying on a non-developed trade: export of raw materials and import of industrial products. It is true that trading is the only way to grow as a country, but how beneficial can it be for a developing economy to start trading with a major established world economic force? The purpose of this research is to analyze this situation for the recently signed Free Trade Agreement (FTA) between Peru and the European Union: to what extent it is important for Peru and its development and to what extent it could be counterproductive.

Since this agreement became effective on March 1<sup>st</sup> 2013, there are no final studies on its real impact on Peruvian Economy and Trade. It is not the purpose of this work to provide an ultimate statement on whether the previously mentioned agreement will be beneficial or not in the end, but to provide a basis for further critical analysis on the topic. The methods used for this goal were using secondary academic sources to find theory supporting Free Trade, collecting all available figures on the topic to date using them as basis and sampling primary data by interviewing experts on the matter. The combination of all gathered information and concepts will provide the basis for the qualitative analysis this research will make.

Results show that FTAs can be very beneficial for Peru: they offer the chance of entering new huge markets as well as acquiring technologies not available in the country with less difficulty. This FTA is also a step further in Peru's goal to attract direct foreign investment and it provides a clear a safe framework. However, it is necessary to implement better policies on infrastructure to business, in order to achieve a certain level of industrialization that allows country and local producers to really exploit the chance given by the new market by enlarging its exports product offer.



## **Table of Contents**

<b>1 Chapter One: Introduction.....</b>	<b>1</b>
1.1 Determining Research Topic .....	5
1.1.1 About Peru .....	5
1.1.2 International (Free) Trade .....	6
1.1.3 Peruvian Economy .....	8
1.1.4 Peru in Economic Blocs and Free Trade Agreements .....	10
<b>2 Chapter Two: Selection and Definition of the Research Topic .....</b>	<b>12</b>
2.1 Free Trade Agreement between Peru and the European Union .....	12
2.2 The Research Problem .....	12
2.3 Hypothesis .....	14
2.4 Limitations of the Research Work.....	15
2.5 Importance of the Research Work .....	15
<b>3 Chapter Three: Research Methodology and Literature Review .....</b>	<b>17</b>
3.1 Methodology .....	17
3.2 Literature Review .....	18
3.2.1 Antecedents about the creation of international trade .....	18
3.2.2 Free Trade, Trade Agreements and Trade between emerging and developed economies .....	24
3.2.2.1 Considerations for and against free trade .....	25
3.2.2.2 Trade Agreements .....	26
3.2.3 Theoretical reasons that speak in favour of signing FTAs between developing economies and developed economies .....	27
3.2.4 The Foreign Direct Investment as important element to create and diversify trade .....	28
3.3 Chapter's conclusions and relationship between literature and hypothesis..	30

<b>4</b>	<b>Chapter Four: Free Trade Agreement &amp; Trade between Peru and the European Union .....</b>	<b>34</b>
4.1	Importance of the European Union as trade partner for Peru .....	36
4.2	Trade Peru – European Union 2008 – 2013.....	38
4.2.1	Trade before Free Trade Agreement .....	39
4.2.2	Trade after Free Trade Agreement .....	42
4.3	Chapter’s Conclusions .....	52
<b>5</b>	<b>Chapter Five: Previous Experiences of Free Trade Agreements between developing and developed economies .....</b>	<b>55</b>
5.1	Free Trade Agreement Peru – USA .....	55
5.2	Free Trade Agreement Chile – European Union .....	58
5.3	Chapter’s conclusions and application of results to the researched topic...	59
<b>6</b>	<b>Chapter Six: Summary, Conclusion and Recommendations.....</b>	<b>62</b>
6.1	Summary and Conclusion .....	62
6.2	Recommendations .....	68
<b>7</b>	<b>Chapter Seven: Reference List .....</b>	<b>72</b>
<b>8</b>	<b>Chapter Eight: Bibliography .....</b>	<b>79</b>
<b>9</b>	<b>Chapter Nine: Appendices .....</b>	<b>82</b>
9.1	Summary: Interview with Mr. Urbina, Director for North America and Europe at the Peruvian Ministry of Foreign Trade and Tourism (June 27 <sup>th</sup> 2013) .....	82
9.2	Summary: Interview with Mr. Gonzales, Manager of Economic Studies at ADEX, Peruvian Exporters Association (January 7 <sup>th</sup> 2014) .....	84
9.3	Summary: Interview with Mr. Zehnle, Mr. Jörg Zehnle, Director Manager of the German-Peruvian Chamber of Industry and Commerce in Lima, (January 9 <sup>th</sup> 2014) .....	87



## **Register of Tables**

Table 1: Production of Peruvian Economy .....	8
Table 2: Trade Peru-World in USD million .....	9
Table 3: Peruvian Trade with World's Regions % .....	11
Table 4: Comparison EU-Peru .....	13
Table 5: Absolute Advantage Example .....	21
Table 6: Comparative Advantage Example .....	22
Table 7: Export of non-traditional products to the EU January-November 2012/2013 in USD FOB .....	45



## **Register of Graphics**

Graph 1: EU FDI in Peru by sectors 1980-2012 .....	37
Graph 2: Trade Balance Peru-EU 2008-2012 .....	39
Graph 3: Peruvian Exports to the EU 2008-2012 in USD million .....	40
Graph 4: Peruvian Imports from the EU 2008-2012 in USD million .....	41
Graph 5: Peruvian Exports January-November 2012 & 2013 in USD.....	44
Graph 6: Peru's Breach of Infrastructure 2012-2021 in USD million .....	69





## **Glossary**

FTA: Free Trade Agreement

FDI: Foreign Direct Investment

EU: European Union

CAN: Comunidad Andina / Andean Community

APEC: Asia Pacific Economic Cooperation

FT: Free Trade

WTO: World Trade Organization

SGP PLUS: Generalized System of Preferences

MINCETUR: Peruvian Ministry of Foreign Trade and Tourism

FOB: Incoterm - Free on Board

CIF: Incoterm - Cost, Insurance & Freight

BCRP: Banco Central de Reserva del Perú / Peruvian Central Bank

ADEX: Asociación de Exportadores / Peruvian Exporter Association

PROINVERSION:

ATPA: Andean Trade Preference Act

ATPDEA: Andean Trade Promotion and Drug Eradication Act

PYMES: Pequeñas y micro empresas / Small and micro Enterprise

COMEX: Sociedad de Comercio Exterior del Perú / Peruvian Society of Foreign Trade

AFIN: Asociación para el fomento de la Infraestructura Nacional / Peruvian Association for Promotion of National Infrastructure

PISA: Program for International Student Assessment

SENATI: Servicio Nacional de Adiestramiento en Trabajo Industrial / Peruvian National Service for Training in Industrial Work

PROMPERU: Peru Export and Tourism Promotion Board



## 1. Introduction

*“You have to be very rich or very poor to live without a trade.”*  
- Albert Camus

As part of a near 20-year-long continuous policy of opening to globalization and achieving development through International trade and private investment, Peruvian Government started seeking for a Multipart Trade Agreement –from now on Free Trade Agreement (FTA)-with European Union since 2007, when the Andean Community (CAN for its Spanish name) and the European Union (EU) started negotiations for a Bloc Agreement on Politics, Cooperation and Trade. Due to the fact that negotiations were not successful, Ecuador, Colombia and Peru together (not as CAN) started negotiations for a Trade Agreement. On April 2011, Colombia, Peru and the EU announced the successful end of negotiations of the agreement, which was finally subscribed in Brussels on June 26<sup>th</sup> 2012.

On March 1<sup>st</sup> 2013 this FTA was taken into force by Peru and the EU (in the European Union the process of ratification of the agreement had not yet been ratified by all 27/28 members; Colombia had to ratify it locally -The Agreement is a Multipart Trade Agreement between Peru, Colombia and the European Union, but to the purpose of this research the analysis will be made on trade between Peru and the EU, and it will be named Free Trade Agreement between Peru and the European Union-). Since then, 99% of Peruvian agricultural products and 100% of Peruvian industrial products benefit from 0 tariffs to enter the European Market (Mincetur –Peruvian Ministry of Foreign Trade and Tourism-, 2013). Further products will gradually achieve the same tariff benefit in a period between 2 to 10 years.

According to the Peruvian Official Newspaper, many local economists expected Peruvian total exports to increase due to this FTA by almost 10%, having an impact on GDP of around 1.7% (Campuñay, 2013). However, in the period January-September 2013, exports had dropped (compared to the same period in 2012) from -FOB value- USD 34,504,9 million to USD 30,679,4 million, which means a reduction of 11% (Mincetur, 2013). Moreover, this fact could reduce Peru's positive balance in foreign trade, which had been dropping in the last few years. Even though a first quick look into

the before mentioned results could lead to the easy conclusion that this FTA is not going to benefit the country, it is mandatory to point out that Peru's decision to start negotiations with the EU (even after bloc to bloc CAN-UE negotiations were unsuccessful) bases on the confidence and positive experiences that the country has had with other FTAs, that include another big economy like the USA.

It is undeniable that trade is one of the keys for the whole development of a country, but the question remains if Peru's trade agreements that are believed to have boosted the economy in the last few decades are actually good, since this rapid growth has been decreasing in the most recent years (Mincetur, 2012). Besides, in this specific case, aside from the fact that this FTA could or could not be important for Peru, one of the main aspects to consider is the size difference between the two parties. Can Peru -an emerging economy, whose main exports to the EU are traditional mining and agricultural products- actually benefit from trade with a much bigger economic bloc in the long term? For this analysis it is also important to consider that Peru mining and agricultural exports contain a wide offer, including almost every mining product important in the international market, as well as a variety of agricultural products that are hard to find somewhere else (Cámara Nacional de Comercio, Producción y Servicios – Peruvian National Chamber of Commerce, Production and Services-, 2011).

As this is a very recent topic, there are no studies on the actual effect or impact of this FTA for Peru. Government's official study will be first released in March 2014 (Urbina, D. Interview, 27<sup>th</sup> June 2013). That is the reason why this research will first explore the benefits and possible risks of a FTA, especially when a party is significantly smaller. Then, available figures on the topic, as well as previous studies supporting the subscription of this agreement, newspaper articles, and data from similar experiences will be briefly outlined and summed up in order to draw an own conclusion. Results of comparison of Peru's (and another South American country: Chile) similar experiences will support the conclusions drawn from the data analysis.

The aim of this dissertation is to provide a basis for further analysis on the topic. It is not possible to actually calculate and measure to what extent this agreement is beneficial for the country, because the full data is not available and such an analysis

would require a global evaluation of the development in long term. This work will not apply economic models and/or calculations trying to make a forecast. However, this work seeks to provide a critically analyzed basis on the benefits, risks as well as political implementations that (should) come together with this experience by analyzing available information and previous forecasts, considering antecedents and theory about free trade between developing-and developed countries. This study will be relevant to local analysis of this FTA and Peru's exploitation of opportunities and will be a first step in the evaluation of the FTA between Peru and the EU by identifying trends between similar cases to be able to identify possible problems or downsides. Summing up, these are the objectives that will support the aim of this work along the research: Use theory to support the believe that free trade is positive and important to a country's development; show that Free Trade Agreements in general are convenient for Peru even if it is a developing country making a Free Trade agreement with a developed economy, by finding reasons that led Peru to the researched FTA, identifying its benefits and risks and comparing previous experiences of developing economies' FTAs with much bigger trading partners. An evaluation of available figures to date will support the importance and positive impact of the FTA in question. The hypothesis to start this research is that this FTA is important and positive for the country's development.

After an outline about Peru's economic situation and brief mention of the country's recent history (that should help the reader to understand the relevance of this work) the literature review and research methods sections will sum up the academic work that helped implementing the theoretical framework for this thesis; afterwards, there will be a brief discussion of the link between theory and reality. In the next sections this research will explore Peru's trade with the European Union before and after the enforcement of the FTA. Later, and in order to support the statements made in the previous chapter, there will be a summary of two examples where developing economies opened to economic integration with much bigger and developed partners: Peru's Free Trade Agreement with the US, and Chile's Free Trade Agreement with the EU. The statements made after the analysis of figures on the FTA in question, the ideas and information provided by the experts interviewed for this research, and the results of the analysis of similar experiences will support the thesis and its hypothesis.

Results show that this (or any) FTA can bring several benefits for Peru: It can help in the economic development and widening of trade exports. However, subscription of this agreement has to come with coherent implementations of policies and adequate investment that help widening export offer by developing industries, in order to increase export of products with added value. This will help to be less dependent from exportation of raw materials and therefore provide Peru with a chance for further development. The development comes simultaneously with more job and work opportunities that combine the requisites that this FTA imposes on Peru in terms of social and environmental aspects, and enables altogether an improvement to the living standard of the country's population. Following chapters will guide through the facts and analyses that led this research to formulate the hypothesis and the conclusion.

## **1.1 Determining Research Topic**

### **1.1.1 About Peru**

Peru is a country with a population of around 30 million people located in the western central part of South America; it has a surface of 1,285,216 km<sup>2</sup> and has 2,547 km of coast next to the Pacific Ocean (National Geographic, 2004). The coast has some ports already handling international trade and the main port of the country, Callao, is located at one hour drive from Lima, Peru's capital and the most populated city in the country, with more than 8 million people (El Comercio, 2013).

Peru declared its independence from Spain on July 28<sup>th</sup> 1821. However, unstable situation in South America regarding territory and natural resources ended up with the War of the Pacific; Peru was defeated, occupied and invaded, but Chilean troops left the country and a treaty was made. After the war there was social and political instability but the government started reforms towards the rebuild of the country and the recovery of the war. The process continued and parallel political parties started to arise; these had political disputes that ended up with a military coup in 1948. After 8 years, the government allowed elections and a new president was elected. New elections took place in 1962, but claims of fraud ended up with the military supporting a transitional government that organized new elections, where Mr. Fernando Belaúnde Terry was elected as new president in 1963.(Tamayo, 2010).Nonetheless, the military overthrew the government and General Velasco Alvarado became president from 1968 to 1975, who was replaced by General Morales Bermúdez due to social and economic problems that were caused by reforms (like the agrarian reform) Velasco had made. Morales called elections in after a new Constitution in 1979 and Belaúnde became president again in 1980 (Tamayo, 2010). 1985 a new president was elected democratically, Mr. Alan Garcia. He faced terrorist movement, Shining Path, which had gained acceptance and had been able to spread while the country faced governmental problems in the previous years. García's mismanagement in economic policies led to hyperinflation that had by the end of his government a cumulative total of 2,200,200% in 1990 (Crabtree, 2005) . That same year Mr. Fujimori was elected. He faced the terrorism as well as the economic problems with hard strategies, including dissolving the congress, drastically



changes towards neoliberal economic policies and making a new constitution (Pease & Romero, 2013). After the defeat of Shining Path, the country started a process of economic and political recovery from previous decades. Fujimori was reelected in 1995 but had to resign the country's presidency in 2000 after people made demonstrations due to his unconstitutional second reelection fraud and dictatorship. A transitional government conducted new presidential and Congress elections in 2001. Alejandro Toledo was then elected as Peru's president (Contreras & Cueto, 2013).

Nowadays, after recovering political stability and maintaining predictable and stable economic policies no matter the political party in office, Peru has achieved international recognition as it is pointed out as a stable and developing economy recommended for investment, becoming the second safe country to invest in Latin America (Black Rock Investment Institute, 2014). Between 2010 and 2012 the average growth of Peruvian economy was of 7.3%; and even in a year like 2013, it has grown more than 5% (Gestion, 2014). Peru has other advantages such as its geographical location that can allow it be the axis for trade between South America and Asia. Moreover, as information in this research will show later, Peru has a wide variety of natural resources like gold, copper, silver or fruits and agricultural products (Cámara Nacional de Comercio, Producción y Servicios, 2011).

This brief revision of Peru's history intends to show the importance of political stability for the development of a country. Peru has achieved its current situation after decades of radical changes and political and social problems due to differences in economic and social policies different governors have applied. As this research will show later, a key to analysis the importance of International and trade agreements is the juridical level they have in Peruvian law. In order to understand the topic of this research, it is necessary to have some knowledge about the country's development to date.

### **1.1.2 International (Free) Trade**

It was mentioned in the introduction that foreign trade is key to the overall development of countries. It has played a major role in the search to grow and gain economic strength and stability. Between 1960 and 1980 many countries have looked to

obtain the benefits of trading across national borders; this has logically increased the amount of international business transactions (Rugman, 2009).

From Hill's work (2011) it is possible to interpret that this are 4 main reasons that are encouragements for any country to start/increase its international trade:

- 1) Increases quantity and quality of goods for the local population, due to the arrival of new players.
- 2) Triggers specialization and makes the production of those products more effective, as in the same time it eliminates less or non-competitive industries.
- 3) Allows access to technologies otherwise unavailable
- 4) It is possible for local companies competing with foreign players to become internationally competitive in the long term, which in the end has an effect on the local economy.

The fact that international trade is the key to the development of economic powers is not new. A look into history shows that the Roman Empire, the Spanish Corona, the British Empire, or the USA and probably every powerful nation was (is) an important trader. Nowadays, companies look for raw materials, production facilities, sale and purchase of assets in different countries. Today's speed of transportation and communication systems is cause and consequence of this trend. Clothes, laptops, cars come from production centers all around the world and the pieces or parts needed for the production come from different places at the same time.(Hill, 2011) Therefore,it is unthinkable that any country could grow and develop providing welfare to its population without participating in the international market: opening to international trade. The globe's current most powerful economies are the ones that first decreased trade barriers and hence opened to international free trade. This example should be followed by developing countries looking to improve their economic and social situations.

The desire to improve national economies and consequently the living standards of local population were 2 of the main reasons that led the world to agree that international trade was the most powerful tool to achieve the aforementioned goals. Negative events like World War II changed the minds of the world's leaders who started looking for

cooperation between one another (Bandera and Ortega, 2003). The end of the Uruguay Round in 1994 led to the creation of the World Trade Organization -WTO- as a valid entity to solve controversies and to have the General Agreement on Trade and Tariffs (GATT, created originally in 1947) as a basis (Bandera and Ortega, 2003). This is ground for countries negotiating free trade agreements and has also enabled the intensification of trade inside home regions (Europe, Asia). The Regionalization and formation of big economic blocs even with customs unions like the European Union, has led to free trade agreements like NAFTA -North American Free Trade Agreement- (Dominguez, 2007).

### 1.1.3 Peruvian Economy

Peruvian GDP accounts for only 0.3% of world's GDP and the country's exports account for 0.1% of global exports (Parker, 2013). The Peruvian economy is a small one and the purchasing power of its population is limited. This is why one big possibility for production and competitive capacities of Peruvian industries is to aim at external markets. The following chart shows the production capacity of the main sectors in the Peruvian economy:

<b>Economic Sector</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Agriculture	6.90%	7.76%	7.64%	8.47%	7.48%
Fishery	6.60%	7.27%	6.45%	6.19%	6.13%
Mininghydrocarbons	68.30%	68.40%	70.82%	70.70%	69.20%
Manufacture	15.30%	13.45%	12.25%	11.71%	12.48%
Rest	1%	0.99%	0.81%	0.81%	1.86%
Notclassified	1.90%	2.12%	2.03%	2.12%	2.86%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: BCRP 2008, 2009,2010,2011,2012

Table 1 shows that from 2008 to 2012 (as well as in previous years not described in that table) the main sector of Peruvian Trade is by far the mining sector, that accounts

for more than 50% of the total amount every year. The second largest sector is manufacture, but it is very small compared to the first one. Agriculture and fishery complete the structure of the main parts of Peruvian trade. These facts show that Peru is basically an exporter of mining raw materials; it is the export of these products that have supported a big part of the export growth during the last decade. Peruvian exports have been constantly increasing and therefore improving the country's trade balance, which at the same time offers favorable signals to the perception of the country's risk for international investors:

	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Export FOB</b>	30,628	27,073	35,806	46,319	46,363
<b>Import CIF</b>	29,882	21,818	29,972	37,904	42,166
<b>Trade Balance</b>	746	5,255	5,834	8,415	4,197

Source: Mincetur, Sunat

Table 2 shows that exports have developed in the last few years. 2009 is an exception due to the crisis that Peruvian main markets in Europe were facing. Nonetheless, it is possible to state that the growth gives the chance to accumulate wealth, knowledge and human resources due to the introduction of technological development, which in the end will benefit the economy and return the investment. Even though trade balance decreased from 2011 to 2012, the strong increase of imports is not negative: as explained in the theory, and as this research will show in chapter 4, imports are necessary too, if they contribute to the development of industries or provide the population with necessary and or better goods.

In order for Peruvian Exports to keep on growing, there is the need for a better local workforce that is more capable and has more technology, in order to remain competitive in the global market. Besides, there is the need for local infrastructure that provides competitive advantage (rather than disadvantage) to local industries. For example,

Nelson (2008) stated that a reduction of 10% in transportation costs in South America would mean an increase of 39% in exports to the US that has always been the major trading partner for the region. Even with the geographical proximity, lack of ports and transportation infrastructure put products coming from South America at a disadvantage compared to products coming from Asia: Callao -the main port of Peru and most important one in South American Pacific waters- is a clear example for this. By 2008 it was receiving vessels that had one third of capacity not in use due to the fact that the port could not handle the full capacity. Nowadays, due to private investments and a concession to APM Terminals since 2011 -North dock- (APM Terminals, 2013) and DP World since 2010 -South dock- (DP World, 2013) the port has started overcoming this gap.

Nonetheless, it is still necessary to acquire advantage and assure trade relationships with other countries that will allow overcoming infrastructure problems and helping developing trade while this one is solved. In that sense, trade and economic relationships provide also a risk that must be avoided: as a minor economy, for Peru it is mandatory to establish clear and firm trade and economic relationships with other partners, that provide at the same time clear and safe framework for investments in the country, as well as a road to develop exports and imports at reduced costs that should help local industries to remain competitive.

There are examples of several Asian countries that opened to trade and gained economies of scale and more effective industries. This led to an increase in exports that in the end benefited the trade balance and the country's economy, providing more resources to invest in education and a capable work force that responded to the needs of the export market.

#### **1.1.4 Peru in Economic Blocs and Free Trade Agreements**

Nowadays, Peru is one of the countries more open to international trade in the region. Since 1990's Peru started following a continuous strategy of openness to international (free) trade that led to FTAs with USA, Chile, Mexico, Canada, Korea, Japan, Singapore, European Union, among others (Leon, 2013). The main trading partners for Peru are China (in Asia) and USA (in America).

<b>Table 3: Peruvian Trade with World's regions</b>			
<b>%</b>			
<b>Region</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Asia	25.90	26.60	29.20
US	27.10	23.30	22.10
EU	18.40	18.70	17.40
CAN	11.00	11.40	12.30
MERCOSUR	3.20	3.30	3.60
Rest	14.40	16.70	15.40
Total	100	100	100

Source:BCRP 2010,2011,2012

Table 3 shows how Peruvian trade is divided by regions in the world. From China, the country has purchased products, such as zinc, iron, copper and fishmeal: total exports to the country increased by 219% since 2009, only in the first year of this FTA, exports increased by 39% and 213 new products were exported, 96% of them were non-traditional (Leon, 2013). Peru has imported machinery, mobile phones, and automobiles.

Peruvian exports to the US were agricultural products and textiles products with added value (T-shirts) (ADEX Data Trade, 2014).

Resulting from Peru's participation in APEC (Asia-Pacific Economic Cooperation) since 1998, local exports to that economic bloc account to date for close to USD 24,720 million, while imports total USD 22,218 million, having China and US as Peru's main trading partners in that sector (ADEX Data Trade, 2014). APEC has a population of more than 2,700 million inhabitants 54% of world's GDB and 44% of world's trade (Dirección General de Negociaciones Multilaterales y Regionales de Mexico, 2012). This economic bloc is a large market that Peru has started to exploit: this is the same it attempts with the FTA with the European Union. As described, the country has more FTA's; their results, most of them positive, will be summed –more detailed though- in a future chapter.

## **2. Selection and Definition of the Research Topic**

### **2.1 Free Trade Agreement between Peru and the European Union**

Negotiations for a Free Trade Agreement between Peru / Colombia and the European Union ended on February 28<sup>th</sup> 2010, in Brussels, and the agreement was subscribed on June 26<sup>th</sup> 2012. Afterwards, and having revised the legal framework, the agreement finally came into force in March 2013 (Mincetur, 2013).

The EU is one of the main trading partners of Peru. Only in 2011, it accounted for almost 18% of the country's exports and was the main source of direct foreign investment in the country, with more than 51% (Mincetur, 2013). As a market opportunity, the EU represents a market with more than 500 million inhabitants that have on average a high standard of living and a high purchasing power. (Mincetur, 2013).

### **2.2 The Research Problem**

The following table (4) shows the size of the European Union as a market for Peruvian products. Size and GDP make the EU a more than interesting market for anyone trying to increase its trade and exports.

<b>Table 4: ComparisonEU - Peru</b>		
	<b>EU-27</b>	<b>PERU</b>
<b>Population (million)</b>	503,7	30,1
<b>GDP (USD million)</b>	16, 572,827	199,682
<b>GDP per capita (USD)</b>	32,905	6,626
<b>Exports goods, services (% of GDP)</b>	44,7	25,4
<b>Imports goods, services (% of GDP)</b>	42,7	23,8
<b>FDI (USD million)</b>	323,767	12,240

Source: Mincetur, Sunat

However, it is in this chart that we can also appreciate the huge difference existing between the European Union and Peru in terms of economic power. Total GDP of the EU is almost 100 times bigger than the Peruvian GDP: with exports of around 44% of its GDP, the European Union could represent a serious threat for local markets that are not competitive enough or unprepared to deal with high international competition. In these circumstances and considering the previously described points, it is possible to ask: Can Peru -an emerging economy- that has traditional mining and agricultural products as its main exports to the EU actually benefit from trading with such a powerful partner?

According to a study by the Research Center for Economy Policies and Development Solutions of Manchester University, the FTA in question would mean for Peru an increase in its GDP by a maximum of EUR 940 billion (only between 0.2% and 0.7%), while the EU would benefit with at least EUR1000 billion. This study also states that the FDI in Peru would not increase; this contrasts with the expectations of the Peruvian Government that see this FTA as a tool to increase FDI in the country and start infrastructural developments that are urgent to the country (new airport in Cusco, underground in Lima, among others). Besides, this same source forecasts that only export of traditional products would increase, while export of non-traditional products (key to the industrial development of the country) would not increase, and the export offer would not become wider.



There are no studies on the matter. The topic is too recent and definite results are still not available. However, existing data suggests that even if imports from the EU tend to increase, the products that arrive to the country will not be available for the local population / industry, hence limiting the country's development. As mentioned in the introduction, by September 2013, traditional exports to the EU Union had dropped by 11%. However, non-traditional exports had increased by almost 8% (Mincetur, 2013). Even though there is an important difference in the amount of traditional and non-traditional exported products, the fact that the non-traditional exports have increased (even in the current situation where trade in general is still recovering of the last economic crisis) is a clear sign that this FTA can benefit Peru. Moreover, previous experiences with big trading partners show that Peru can achieve wealth within the framework of a Free Trade Agreement, even if there are areas to improve in order to exploit opportunities to the fullest.

### **2.3 Hypothesis**

The Free Trade Agreement between Peru and the European Union is important and positive for Peru in its search to widen and increase its export offer and foreign trade (traditional and non-traditional products) and to develop Peruvian local industries: all these facts will contribute to the country's development and improvement, to make it more attractive and competitive in the international environment.

The following are the objectives of this research that will prove the hypothesis:

- a) Free Trade is positive
- b) Free Trade Agreements are positive for Peru even in its position as a smaller trading partner and emerging economy
- c) Available data to date show the benefits of the FTA in question

- d) Previous experiences of developing economies' FTAs with much larger trading partners support the hypothesis

## **2.4 Limitations of the Research Work**

This work does not aim to assess the impact of the Free Trade Agreement between Peru and the European Union in terms of GDP, using economic models or other. There are not enough figures to make such an evaluation and this is in the end not what is intended here. The purpose of this research is to make an overall statement of whether this FTA is positive or not for Peru, through the analysis of the following points: the theoretical aspect that backs up free trade, the subscription to FTAs and the benefits of those agreements for an emerging economy trading with industrialized countries; results of previous FTAs like the one of Chile with the EU, which became effective on March 1<sup>st</sup> 2005(Mincetur, 2013) and Peru's FTA with the US; opinions of experts on the matter that are closely linked to the subscription of the FTA in question. This statement will be based on previously mentioned aspects. Goal of this work is to identify to what extent it is important for Peru -as an emerging economy- to initiate a free trade with the EU; advantages and risks, and areas to improve in order to exploit opportunities.

## **2.5 Importance of the Research Work**

The importance of this work lies in the fact that up to date there is no information on research at university level that explores this topic, including links between theory and practice. There are only two works about this topic after the enforcement of the Free Trade Agreement between Peru and the European Union: Cantuarias and Stucchi Lopez (2013) use information up to 2012 to evaluate this FTA, giving important focus on

the legal aspect and not evaluating the data from 2014. Leon (2013) briefly mentions this agreement in her summary of Peru's Trade Agreement. In that sense, this work will be current as it explores the trade aspect and the available data up to 2012, which does not show the expected impact. Furthermore, it could provide the basis for the formulation of future works on the matter and accurate evaluation of future figures and identifiable trends.

### **3. Research Methodology and Literature Review**

#### **3.1 Methodology**

The methodology of this research is limited by the availability of literature and data. Theory elaborating on the core of the topic is not wide and the fact that this is a new topic limits the information. In order to be able to define whether the statement in the hypothesis can be real or not, it is necessary to apply a research methodology that can accurately evaluate the available information. This study therefore uses a qualitative methodology that will analyze the information gathered in order to find theoretical conclusions, trends, figures, or assumptions that should support the probability of the thesis. This research will build on the few works that already exist (not exactly about the same topic), forecasts, and opinions of experts in the matter, as well as on previous and similar experiences. An inductive approach will hence be the basis to support the hypothesis: hypothesis will be proven with the information and analysis of the data and this will make it possible to draw a conclusion.

This research started with the collection of secondary sources that were elaborated on the topic: articles, interviews, books discussing (free) trade, among others. All secondary sources were studied and then main ideas were outlined. Opinions and forecasts were contrasted to empirical evidence available on websites and reports. However, before drawing conclusions, the exploration of the topic was deepened by discussing the information in an interview with Director for North America and Europe Ministry of Foreign Trade and Tourism; the Manager Director of the German Peruvian Chamber of Industry and Commerce in Lima and the Manager of Economic Studies at Peruvian Exporter Association –ADEX-; these interviews are the primary sources this researched had access to. They helped widening the view to critically approach the topic, considering as well long term goals of the FTA with the European Union. The overall evaluation of sources helped structuring this dissertation.

## **3.2 Literature Review**

Even though – as mentioned in the previous chapter, there is no work exactly discussing this topic, this literature review will deal with the different sources and data available that should support this thesis and discussion: to what extent is the Free Trade Agreement between Peru and the European Union important and convenient for Peru. The criteria that was followed during the selection of relevant material was availability (in terms of costs and time), relation to the topic (be it theory or actual facts) and validity (renowned authors or authenticity of data). The most recent academic work -and the only one that was found specifically dealing with the topic- that explores this FTA only gives insight to the benefits of the trade agreement in question and points out things to improve, in order to gain maximum benefit. Moreover, this research has also encountered a gap between theoretical benefits of free trade agreements, and possible effects for a South American party that is significantly smaller than its trade partner. That is the reason why this work first focuses on giving a framework for understanding the basic theory that will help the exploration and evaluation of actual facts. Secondly, and aiming to overcome the gap found, this work mentions more recent works that start with the importance of free trade, importance of free trade agreements and gives theoretical reasons that support FTAs between developing and developed economies. In this sense, there is also a discussion on FDI as it is an important aspect of trade agreements and gives rise to local production and investment that affects the trade balance and allows technological exchange.

### **3.2.1 Antecedents about the creation of international trade**

Within the theory, it is necessary to understand what a Free Trade and a Free Trade Agreement is. Cavusgilet *al.* (2008) said that free trade occurs when the constraints to the free flow of goods and capital between countries are relatively absent. According to this source, inhabitants of a country that has implemented free trade benefits from a wider offer of products, more availability, and lower prices for persons and firms operating there. These savings can be invested in better life standards (for natural

persons) or can mean more profit to importing firms, as they save customs fees. Poor countries' prosperity should increase thanks to free trade. From this point on this source explains a theory that is relevant for this work and is said to be the basic thought behind free trade: David Ricardo's Comparative Advantage Principle (Cavusgil *et al.* 2008). Under this concept, every country can benefit from trade. It is not the question whether you produce everything in a more effective way than your trading partner, but how more effective can you produce every product. You should then specialize in the product that you produce the best, and import the rest. Even though you could produce other products as well, the opportunity costs you incur by not concentrating on your strongest asset makes it logical to import goods that you cannot produce that effectively. Being a concept from 1817 that used static simple examples that do not express dynamism, you could say that it is not relevant for trade in the 21<sup>st</sup> century; that is wrong. This is the main idea that leads countries to abolish trade barriers: free flow of goods and capital that replace not effective -or not existing- industries in the local market and give opportunities for development in other areas, while providing the population with a wider variety of goods in terms of quantity and quality. Even if not mentioned explicitly, this is the trigger concept for free trade agreements and -in this case also- for Peru's FTA with the EU. Free Trade is defined then by Cavusgil *et al.* (2008, p.225) as

*A formal arrangement between two countries or more countries to reduce or eliminate tariffs, quotas and barriers to trade in products and services*

This research finds that Mankiw (2009) sums up the ideas presented by the two previous sources having the Ricardian Model as a starting point: for him allowing trade always means that a country will be exporter of what it produces better, and importer of what it cannot produce well enough. To be able to export, the price of the good in the country has to be lower than the world price: this means that opening to trade will increase the price in the local market (it will match the world price) and this will affect local consumers, but producers will benefit from this by increasing income. If the country imports, which would mean that the local price is higher than the world price, opening to trade would lower the price. In this case, consumers would benefit from a lower price, but local producers would struggle. In any case, according to this source, the overall

gains will always be higher than the losses. Even though this source is also in favour of free trade and FTA, it does mention reasons not to do it; not widely discussed, but they provide further ideas that will contribute to the discussion in this work. However, it is mandatory to understand that this research will not base its analysis on the Ricardian Model: the purpose of citing and explaining this model is to understand the principle behind foreign free trade, not to evaluate available data using the model.

The previous chapter described the main objective of this research work; to establish the importance of the recently signed Free Trade Agreement between Peru and the European Union for the South American Country, considering risk and implications due to the size difference of the parties. In this chapter, there will be an exploration of theoretical aspects that sustain the importance of the free trade and convenience for a developing country in subscribing a FTA with a developed economy.

Trade is an instrument that throughout history has led people to wealth. This concept is also applicable to foreign trade. However, when countries are involved trade is not only an instrument to create wealth, but also a tool to control the economy -or players in the economy- with the help of governmental policies, such as subsidies, quotas and non-tariffs trade barriers. Foreign trade nowadays, is vital to a country's economic and political orientations. The trend to liberalize trade between countries started with the General Agreement on Tariffs and Trade (GATT) in 1947 that then became part of the World Trade Organization (WTO) in 1994.(Bandera and Ortega, 2003).It is under the framework of the WTO that several trade agreements have been subscribed, in order to improve openness to trade of the subscribing parties.

For the purpose of this work, the focus on the existing literature about trade will be in the (free) trade part, benefits and risks of openness to trade and the risk of a large size difference between trading partners. It is, however, necessary to consider that some agreements include more aspects (besides the economic one), when entering an economic agreement. Balassa (1961) defined these levels of integration under 5 categories: Free trade area -tariff elimination between members-; Customs Union -elimination of trade barriers for parties and common tariffs against the rest-; Common market -similar to customs union, including free flow of goods and services-; Economic

Union -harmonization of economic policies-; and Complete Regional Integration -monetary union and integration of institutions-. Even though these integration levels are not directly related to the topic, this research considered a brief outline of them necessary.

The first thing needed to understand free trade is to understand the concept behind it: For this purpose, the primary concept we will use is the comparative advantage principle by David Ricardo. Since it was explained before, now the concept will be summarized again and clarified with a simple example.

Cavusgilet *al.* (2009, p.97) explains that this principle is an evolution of Adam Smith's absolute advantage theory that is explained like this:

*...a country benefits by producing only those products in which it has an absolute advantage, or can produce using fewer resources than another country. The country gains by specializing in producing those products, exporting them, and then importing the products it does not have an absolute advantage in producing.*

Table N.5 shows a practical simple example of this principle:

<b>Table 5: Absolute Advantage Example</b>		
	<b>Production Days for One ton of</b>	
	<b>Cloth</b>	<b>Wheat</b>
<b>France</b>	30	40
<b>Germany</b>	100	20
Source: Cavusgilet <i>al.</i> , 2009		

According to this example France can produce one ton of cloth in 30 days; 70 days less than Germany. This gives France an absolute advantage in this case. However, in the production of wheat, Germany produces one ton in 20 days, half the time that



France needs. This gives Germany absolute advantage in the production of wheat. If they specialize in its most effective production, France could produce 1 ton of cloth in 30 days, and exchange it for one ton of wheat from Germany. In this case, France would have one ton of wheat in 30 days, while producing it itself would have required 40 days, and would have taken away resources for the production of cloth. Germany would benefit as well, the other way round. This is a simple example that shows how countries can benefit by trading with each other: not only can they obtain product at a lower cost than the one of local production, but they can also access different products that are necessary or useful to their citizens. It is clear, however, that absolute advantage applies only if a country has total advantage versus another. This would exclude many countries that due to their size (or size of trading partner) do not have absolute advantage in anything. This is the starting point of the comparative advantage theory: this principle states that the importance does not lie in the total cost of production, but in the efficiency with which a country produces certain goods. Even if only one country has an absolute advantage for production of all goods, it will not necessarily have advantage compared to the trading partner. Cavusgil *et al.* explains this concept as follows (2009, p. 98):

*..it can be beneficial for two countries to trade without barriers, as long as one is more efficient at producing goods or services needed by the other. What matters is not the absolute cost of production but rather the relative efficiency with which a country can produce the product (ratio between how the two countries can produce products)*

This chart shows a practical simple example of this principle:

<b>Table 6: Comparative Advantage Example</b>		
	<b>Production Days for One ton of</b>	
	<b>Cloth</b>	<b>Wheat</b>
<b>France</b>	30	40
<b>Germany</b>	10	20
Source: Cavusgil <i>et al.</i> , 2009		

Germany has absolute advantage in the production of cloth and wheat. However, while it can produce cloth three times better than France (1:3) it can only produce wheat 2 times better (1:2). Thus, it should focus its resources on the production of cloth and import wheat from France. Another approach to this chart is the opportunity cost: If Germany produces 1 ton of wheat, it is leaving the chance of producing 2 tons of cloth. If France produces 1 ton of wheat, it is only losing 1.33 tons of cloth: France has here a comparative advantage. This example shows the thought that it is beneficial for a country to specialize in what it does best, or in what its trading partner cannot produce too effectively.

As mentioned before in the research, it is not possible to apply this model in real life, because it only compares one factor that does not change. In real life, there are different factors that can add or deduct comparative advantages to different countries. Level of industrialization and amount of trade can change price or condition of a good. Even if a country does have advantage in some terms, competitors can invest developing infrastructure and overcoming the advantage in time. Current transportation costs, depending on distance and mode of transport can also modify the local advantage: a lack of transport infrastructure reduces the initial price advantage of a good. Mass production of a good is another way to overcome initial price advantage. Government intervention or trade policies can also facilitate or harm trade; not everything is traded for free; and free trade agreements do not necessarily prohibit a government to subsidize the local industry, which in trade is a benefit that a company alone from a different environment cannot imitate. It is also necessary to realize, that foreign trade is driven by companies and not by countries: the latter can only provide a framework for trade, but the action occurs between private entities. Therefore, advantages and risks do not only depend on the environment, but also on how the parties participating in it exploit the resources. There are theories that seek to evolve the concept discussed to enable real life application, but for this research they are not relevant. What this research was aimed to do was to explore the concept that was the trigger for free trade. Now the reasoning is clear, it should be easier to understand why Peru subscribed the FTA with the European Union: What advantages did the country see? Why are the risks -if any- not important enough compared to the benefits?

Development of countries around the world makes it possible to say that the major drivers of the economy are trade and investment. It is under this belief that this work will deepen in FDI in the host country. Hill (2011) summed up the benefits and cost of foreign direct investment for the host country. As discussed in the literature review, the benefits were in resource transfer, employment, balance of payment, and competition and economic growth. FDI usually takes place when a multinational company decides to invest in the host market (as entry or development strategy). The investment brings new funds to the market, which would otherwise not be available. Furthermore, when FDI occurs in a developing country, it usually adds to the country's infrastructure by developing technology in industries, workforce know-how, or providing a more competitive industry than the local one (Hill, 2011). This last point is in the eyes of detractors of free trade not necessarily good. By bringing superior competition than the local industry, FDI (or free trade in general) has a negative impact on the economy: they murder the local companies that are not capable to compete with the new entity due to size and technological differences. In limited markets, this could lead to a monopoly by a foreign company. While people in favour of free trade say that bringing better competition triggers the economy, offers better and wider supply to local consumers and in the worst case scenario eliminates non-effective industries (though coming from Ricardian concept, that a country should not compete at all if they lack effectiveness), detractors argue that the negative impact and job losses are deeper than the positive impact on the host country. Foreign subsidiaries transfer their earning to their parent firm in their own local market, and this is a negative flow of capital for the host country.

### **3.2.2 Free Trade, Trade Agreements and Trade between emerging and developed economies**

In order to relate theory to the importance and convenience of the Free Trade Agreement between Peru and the European Union for the South American country, the following information will be presented as follows:

- 1) Free Trade: Discussions for and against its influence for countries
- 2) Trade Agreements: Advantages and possible problems

- 3) Theoretical reasons that speak in favour of signing FTAs between developing economies and developed economies.

### **3.2.2.1 Considerations for and against free trade**

The FTA between Peru and the EU looks to achieve trade free of tariff and non-tariff barriers. It is therefore necessary to outline reasons that support free trade:

Krugman and Obstfeld (1994) point out that free trade means efficiency. Intervention of the local government takes away efficacy of the economic activities and creates distortions in the market. They say that a tax on an imported good increases the price of the good in the importing country; this gives local producers (that could not produce at the “real price” because they were not effective enough) the chance to compete in the market. As much as this is beneficial for those producers, the fact that they are able to compete is based on tariffs. Therefore, production is an artificial option. Consumers in the local market will suffer from this increased price. If, let us say, a small country applies the tariffs on an imported goods, the author states that this one is a net loss in the economy.

Another aspect to consider is that protected markets (with government intervention) enable bigger profits to local industries and encourage more companies to participate in the market. This participation would be, however, only with low production capacity. The increased price enables inefficient production, without economies of scale. There is no need to improve production processes and in the international market, local products would always remain non-competitive. Free trade encourages competition and subsequently the improvement of production in order to remain competitive in the domestic or international markets. It is, however, necessary to mention that even though free trade helps eliminating non-competitive industries, there is always the need for a certain degree of intervention by the government, especially for products or industries that are for some reason sensitive or that are expected to grow as part of a national development policy. According to the authors, another area to consider is the importance to have free trade without exceptions, not favoring anyone, considering that economic development can create economic forces that could influence the commercial

policies for their own interests, rather than for the interest of the national population, which is in the end the ultimate goal of free trade.

This same source also provides an example of the benefits of applying a tariff in order to improve the exchange relationship: this relationship refers to the idea that a country imports one good (A) and exports another (B). If the price of product B increases, that country will have more money to acquire product A. If the country also produces A, but its partner country applies a tariff on the import of a good, it will have to reduce the price of product A in order to be able to keep on exporting it and not lose the market. Now the country enforcing the tariff would have a better exchange relationship, as the price of the imported good was reduced and it can acquire more of it. Nonetheless, the authors say that the actual use and application of this example is perhaps non-existent.

One more reason against free trade for this source is the argument of the failure of the market. There are cases like malfunctioning of work and capital markets, inability of companies to internalize benefits, or environmental issues (like mining companies polluting the environment) that require government intervention. The efficiency of the market has to consider these aspects. Depending on the situation, companies in the local market may entail an incentive or a tax to limit an activity: in any case, the intervention of the State is required, making this trade not a free trade. However, the authors say that the intervention of the government must not be a commercial one, but in the form of national policies, etc. Besides, it is not possible to define where the failures come from and therefore it is not possible to say that the failures come from the free trade.

### **3.2.2.2 Trade Agreements**

Trade agreements and integration processes allow partners to have a predictable trading field, eliminating also the risk of trade wars (Krugman & Obstfeld, 1994). A trade agreement hence does not provide a scenario in which countries could be selfish and inefficient, as they have to be more effective and cooperate at the same time. Another benefit of a trade agreement is to assure that a country will have a well-defined internal

policy that will not depend on governmental changes, allowing the country to be more consistent in time.

Besides, an aspect of trade agreements was explored by Viner (1950), who said that economic integration could create trade (trade creation), if trade shifted from a high cost supplier of the agreement to a low cost supplier member of the same agreement. Not being part of a trade agreement (in this example, economic integration), could mean trade diversion, where imports are shifted from a low cost non-member country supplier to a high-cost supplier member of the agreement.

In past decades, Latin America looked to achieve welfare by finding substitutes to imported products. Nowadays, this has changed in many countries, which now look to third markets without the need of avoiding imports. In the global context, Lawrence (1997) made a differentiation between Old Regionalism and New Regionalism: the first one was led by governments, with planned allocation of resources; the latter is market driven and is led by private firms. The entry into the New Regionalism concept is one of the keys to the recent trend of developing economies of being more open to trade.

FTA looks for openness to trade with the sureness that the path will not change, in the local or international market. It is necessary to consider that free trade also involves cooperation in different aspects in national and international policies.

### **3.2.3 Theoretical reasons that speak in favour of signing FTAs between developing economies and developed economies.**

In the previous paragraphs it became clear that the free trade and FTAs can help different industries in becoming more competitive, making the best use of the available resources. A tariff would distortion the production by enabling ineffective industries to remain in the market using resources that could be better utilized for different purpose. The only two benefits, in this case, are for the government (more taxes) and for the local producers; consumers will have to pay more for the good, investing more money. In this case it is necessary to mention that if a small trading partner applies tariffs to protect its local industries, the overall effect to the country would be negative: the exporting

country, as a larger economic partner will probably not make any attempt to remain competitive in the local market of the smaller partner. The amount of products will be reduced and the price will be higher than the price in the developed economy. In that sense, it is more convenient for a developing economy / smaller trading partner to be open to free trade.

Production / economies of scale can also take place in developing economies: opening to trade may lead to risks for certain parts of the local industries, but the competitive ones could achieve competitive advantage by exporting to new markets. Actually, free trade agreements give -as mentioned before- a basis and clear field on how trade is going to take place. The smaller country can, with a FTA, avoid changing trading policies by the larger partner, thus avoid trade wars and assure fair trading policies: it is possible to say that the main beneficiary of a FTA will usually be the smaller party.

Snorrason (2012) said that small countries need open trade policies because otherwise they would not be able to gain access to larger markets. According to him, the smaller the country is, *the larger the likely ratio of exports and imports to total outputs*. This means, that external trade is an escape to the disadvantage of being small.

In general, free trade or foreign direct investments have risks and benefits that are related to each country and how it uses or applies it; this means that the reasoning is most likely always the same for every country or region subscribing to FTAs. However, and in order to really evaluate importance and impact in Peru of the discussed FTA, it is necessary to start evaluating real facts.

#### **3.2.4 The Foreign Direct Investment as important element to create and diversify trade**

As foreign direct investment (FDI) is how capital can flow from one place to the other, it is relevant to delve into its consequences for the host country. While Cavusgil *et al.* (2008) analyzes FDI from the perspective of a multinational company, Hill (2011) actually analyzes the host country's benefits and costs. According to the

latter, there are four main benefits coming from FDI for a host country: resource transfer effects, employment effects, balance-of-payments effects and competition and economic growth effects. The first aspect refers to capital that can be brought by foreign multinational companies, which local companies do not have access to. Technology coming from FDI can be incorporated to develop industrial processes or to the productions of personal goods. In any of these cases, it is very important, because many countries do not have enough local technological infrastructures to add value to the local production or industrial chains. Under the employment effects, this source suggests that FDI creates job opportunities that would not exist without it: when a foreign company employs local workforce or when a local supplier increases its number of employees due to the increased amount of money local workers have. The third benefit -balance-of-payments- relates to the trade balance between imports and exports. If FDI comes as a facility that manufactures products locally, the host country's imports would be reduced and the balance could improve; if the foreign company produces locally to export to its subsidiaries or home region, exports of the host country would increase and the trade balance would again benefit. In the fourth aspect, whenever FDI establishes as a new company, competition increases, prices go down and consumers have more choices of products, which at the same time increase in quality. Besides, Hill (2011) explores the costs or risks for the host country: FDI can have a negative effect on competition, if local companies are facing big multinational companies that could take money from operations abroad to eliminate competition (by offering an incredibly low price) and then monopolize the market. This is especially dangerous for countries that do not have big enough local firms. In the balance-of-payments aspect there are two possible risks: first, those earnings of multinational companies are sent to the parent company -thus leaving the local capital market-; secondly when the company imports too many goods, which has a negative impact on the trade balance. The third risk of FDI for the host country is to become economically dependent at some level, since the owner of the subsidiary is the parent company abroad, it does not have any commitment to the host country. Despite the fact that this source does mention possible risk of FDI (and hence FTA) it does not delve in the analysis; it elaborates much more in the benefits. Unlike Cavusgil *et al.* (2008), this



source does mention one or two time implications of free trade for the less developed economic partner, but again it does not go further in the analysis. Nonetheless, and even considering that there is here a gap of analysis of free trade for unequal trading partners, these sources contribute to the research theoretical framework by clarifying terms, idea concepts and discussing benefits of FTAs. As mentioned in Hill (2011), FDI does not necessarily offer a trade surplus and increase of money. Krugman (1996) goes one step further in analyzing this reasoning in his work: he said that an increased foreign direct investment in a country would run a trade deficit because trade balance belongs to payment balance and “*the difference between sales to foreigners and purchases to foreigners must be always 0*”. If there is an imbalance, this should be matched in the capital account. For this work’s objectives this statement is very interesting and relevant because it provides a different point of view than what is seen in the media and official publications about the necessity of FDI. However, Krugman’s work in this case consists of formulations and statements with no real example. For the specific case of Peru, Krugman’s statement cannot be applicable: it is the government's strategy to attract private investment and give it freedom to act within the local market. Even with the trade and payment balance issue, the goal of the strategy is to fill the gap in infrastructure and generate jobs, for instance. As much as Krugman can be making a valid statement, it is a general evaluation of FDI that would have to be revised in detail for each specific case.

### **3.3 Chapter’s conclusions and relationship between literature and hypothesis**

In this part of the work, there is the need of going back to the hypothesis: The Free Trade Agreement between Peru and the European Union is important and positive for Peru in its search to widen and increase its export offer and foreign trade (traditional and non-traditional products) and to develop Peruvian local industries with private investments: all these facts will contribute to the country’s development and

improvement, to make it more attractive and competitive in the international environment. In relation to the hypothesis, the reviewed literature focuses on:

- a) The support to free trade; this part is very important due to the fact that it indeed supports the framework in which free trade agreements take place
- b) Support to free trade in general
- c) Support to the positivity of FTA between developing and developed economies for the less developed party
- d) Positive aspect of FDI as part of trade agreements

In detail, the first part of the research is a theoretical framework that sums up and gives simple example on basic economic theories and reasoning that lead to believe in free trade as a tool to development. This argument is then supported by further academic research that shows how theory always leads to open trade, not without considering some aspects -like failure of the market- that can affect it. It is also mentioned that intervention in the free market causes distortions that more often than not transform into obstacles to the well-being.

About FTAs, they are instruments that give subscribing parties a safe and secure trade framework as it ensures that party economic policies will not change, which in addition supports investments in one of the parties. It is also stated that such agreements are part of an overall strategy towards free market that in the end surpasses the so called “import substitution”, which did not work in Latin America. These agreements are made to speed up openness to trade and economy of the subscribing parties, thus providing opportunities for development.

Regarding the subscription of FTAs by developing economies trading with big and developed economic blocs / parties / economies, the literature shows that interventions in the developing economies such as tariffs-and consequent rejection of FTA and/or free trade- damage those economies as the distortions in the local market turn out to be “higher” than the benefits that local producers and government get. This means that free trade, achieved rapidly through FTAs, is the better option. This links to the previous point, as FTAs do not only provide a secure framework for trade and investments, but

also provide the developing economy with the chance to open to trade, but reduce the risks of disloyal trade policies and negative impact to sensitive local industries, as the free trade comes in the framework of previously negotiated conditions, provided by the subscription to the free trade agreement. It was pointed out in this research, that for a small or developing economy with a small local market and/or difficulties to enter new markets, a FTA becomes a valid alternative as it enables the entry into new and bigger markets that give new trading opportunities and place to grow.

Concerning foreign direct investment, this is an element that cannot be left aside as it is a key to the development of a country; for emerging economies like Peru, this is even more important, because FDI can help changing and improving the export offer -that nowadays consists of mainly raw materials- and provides a sustainable growth in time. Besides, FDI means a source of private capital and technological transfer for investment that would be otherwise unavailable to local industries, companies and the economy as a whole cannot invest in everything that is currently needed. And private capital may not only benefit from the local market, but will be able to reach other markets that Peru has trade agreements with, like the Andean Community (CAN, for its Spanish name), Mercosur, USA, among others.

As the last paragraphs have shown, considering trade and investment aspects, the subscription of a FTA is beneficial for any country, especially for an emerging economy like Peru. The theory relates to the case of Peru; the importance of the FTA between this country and the European Union will be shown in the next chapters as real facts that will back up the theory: the existing theory will be contrasted to the available facts coming from secondary sources like websites and reports: how everything, smooth in theory, is compared to the difficulties of trade in real life, where there is more to consider apart from the trading partners: global economic situations, local policies to exploit opportunities, practical and/or infrastructural problems. Identification of benefits and risks or problems are then held to explore similar situation: Secondary sources provide the research with the chance case studies. FTAs between Peru and USA / Chile and the EU can be seen as examples to the importance of the discussed FTA for Peru. Even though situations are different and sensitive products are not all the same, the overall

impact of trading with a much bigger partner can be observed and discussed. Comparison allows finding trends. Summing up facts and case studies leads to conclusions that are then answers to the hypothesis and research question: comparison includes quantitative and qualitative analysis of the data.

## **4 Free Trade Agreement & Trade between Peru and the European Union**

As the methodology part has shown, any country seeking to develop its industries, infrastructure, wealth and well-being of the population has to open to trade. In this sense, free trade is the fastest way to ensure the flow of goods and capital across national borders. As an unplanned openness to free trade can omit a clear framework in terms of trade policies, legal issues and social aspects, Free Trade Agreements appear as the best way to enter free trade with clear and predictable game rules that allow not only investors to forecast and plan more easily, but also allow parties (countries) to avoid trading risks and accurately evaluate the trade agreement as a whole, in order to protect sensitive local industries or products. These clear game rules are especially important for a country like Peru, which as a developing economy cannot expect to equally compete in free trade with much bigger and developed economies: a FTA provides the chance of free trade in a protected legal, economic and social framework, as a FTA does not mean “every product, industry or investment” and it does not mean “right away”: there is the chance to negotiate products, time periods and conditions. In order to clarify the link between the reviewed theory and ideas and the case this research work is working on, this chapter will clearly state why the European Union is important for Peruvian trade, why the FTA in question is important for Peru and it will summarize the trade between Peru and the European Union in the last 5 years. The results of 2013, which are available up to November of that year, will provide the basis to compare how trade develops before and after the FTA between Peru and the European Union.

In the introductory section it was mentioned that the Free Trade Agreement between Peru and the European Union was subscribed in June 2012. After 9 negotiation rounds that started in 2009 it came into effect on March 1<sup>st</sup> 2013. This FTA includes a wide variety of disciplines, that consider access to markets, customs issues, trade facilitation, obstacles to commerce, commercial defense, capital movement and establishment, among others (Mincetur, 2013). As a consequence of this agreement, 95% of Peruvian

agricultural products and 100% of Peruvian industrial products will benefit from 0 tariffs to enter the European Market. This is a significant improvement compared to the previous benefits Peruvian exports had: Generalized System of Preferences (SGP Plus, for its Spanish name). This is a unilateral tariff preference system conceded by the European Union that Peru has benefited from since July 2005; it offered tariff-free export to the EU at 79.7% of Peruvian tariff Universe (Mincetur, 2013). It is clear that benefits to Peruvian export coming from the FTA exceed those coming from the SGP Plus; not only because of the fact that a bigger amount of Peruvian products will benefit from tariffs preference, but also because the FTA is the result of a multilateral negotiation rather than a unilateral concession: as a benefit subjectively conceded by the EU, the SGP Plus depends on the EU to be taken into force, to be renewed or to be eliminated. The country benefitting from it has no actual bargaining power in terms of duration or universe of products included in it. Moreover, it lacks a long term view and can actually be considered as a transitory short term measurement that cannot be enough incentive for local industries seeking to expand or enter into the market in question, which in turn becomes a lack of incentive to develop export and industrial infrastructure as it would always be unclear whether investment in such areas would pay off in the long term. Besides, during the negotiations for the FTA between Peru and the EU, it was unknown if the SGP Plus possibly applicable up to December 2013 would be lengthened -it is now known that Peru will still have this benefit until 2015, to allow companies enough time to be completely adjust to the benefits provided by the FTA (Andina, 2014). The FTA is hence better, due to the fact that is bilateral negotiation where terms are a mutual agreement; that FTA includes -as mentioned before- not only a larger amount of products benefiting from better tariff conditions, but it also considers a wider variety of aspects that include much more than just export conditions. They aim at achieving the desired level of integration and provide the legal, economic and trade framework that, just as mentioned in the theory section, give Peru the chance to decrease trade risks and protect local industries while still opening to trade. Besides this FTA adds to already existing FTAs that together secure the political stability and make government policies less unpredictable, which has been always the mayor risk in many South American countries, as new governments could completely change economic

policies. This stability, achieved through the contractual aspect of a FTA: in Peruvian law, the Constitution gives international treaties the same level as national laws, as it considers international and national law as part of a same juridical order (García-Corrochano, 2013). This same source considers that having an international treaty and a national law at the same level actually means that the international treaty should have preference above national law in case of a conflict between laws. It is hence shown that the FTA in question is not only a tool for Peru to regulate its international trading conditions with the EU, but it also is one further step to secure internally the way the country in the last 2 decades has been pursuing political stability and therefore also private national and international local investments.

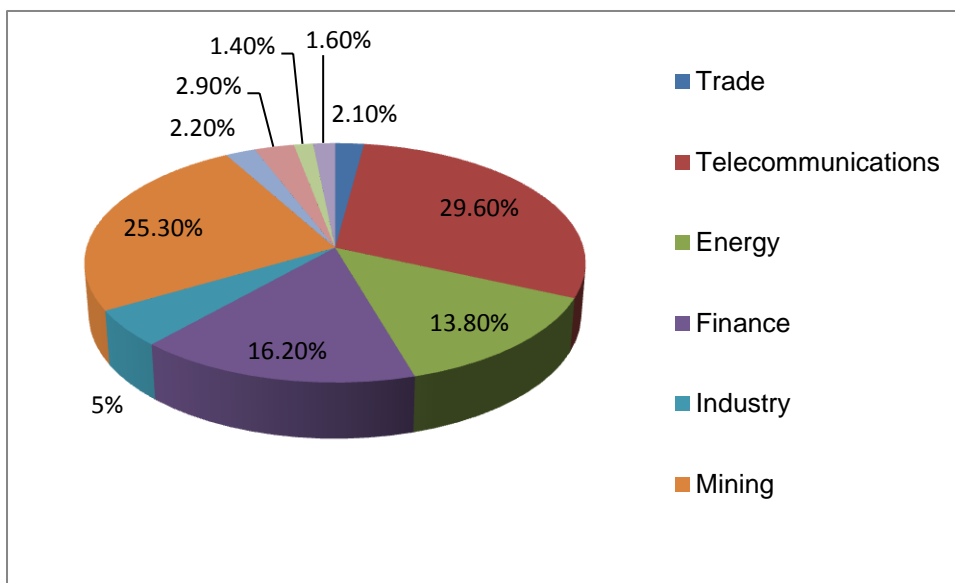
Being a multidisciplinary agreement, the Free Trade Agreement between Peru and the European Union give Peru obligations and conditions in more aspects than just trade. However, for the purpose of this research the focus will be made in trade and investment. The importance of this FTA has already been clarified. However, it was not mentioned why the European Union is important for Peru as a trading partner and what has happened to trade between both parties before and after the agreement.

#### **4.1 Importance of the European Union as trade partner for Peru**

The European Union is a market Peru has not been able to exploit to the fullest of its capacity. The SGP Plus system and the lack of opportunities account for this. However, that economic region is a 500 million people market, with an average per capita income of around USD 30,000 (Leon, 2013). Total imports coming into the EU account for almost 43% of the region's GDP (Mincetur, 2013). In 2012, Peruvian exports to the region exceeded USD 7,700 million, from which 70% were traditional products and 30% were non-traditional ones (Leon, 2013). However, despite the fact that this number was more than 17% of Peruvian total exports (Mincetur, 2013), it accounted for only 0.4% of the region's total imports (European Commission, 2013). This means that Peruvian products have still a lot of place to grow in the EU market. Moreover, it was stated

during the negotiation rounds for the FTA in question that Peruvian and EU market are complementary, which means that there are few sensitive industries that could be affected by this FTA (Stucchi Lopez, 2013), when European companies had more easiness to enter the South American country's local market. Besides, until 2012 51.6% of foreign direct investment in Peru came from EU capitals (Mincetur, 2013). The next graph shows in detail how European FDI in Peru is divided:

**Graph 1: EU FDI in Peru by sectors, 1980-2012**



Source: Mincetur, Proinversion

Graph 1 allows observing that the EU's main investments in Peru are the telecommunications and mining sectors that account for 29.6% and 25.3% of total EU FDI from 1980 to 2012 respectively. Combined with finance, 16.2%, and energy, 13.8%, the four main industries where EU capital plays an important role accounted for 84.90% of total EU FDI in the country until 2012. This graph also shows that even though significant, most of EU FDI in Peru comes from the same countries. As the European Union is an important source of capital, it is important to increase the number of countries investing in the country: It is in this sense that the FTA in question should allow investments from more European countries than the usual ones. Between August



2013 and December 2014 there are 20 new projects (1 in telecommunications, 5 in transport infrastructure, 5 in energy) to award to private investors, that together represent an amount of USD 15,000 million (Carranza, 2013). The fact that in the last 30 years the EU represented more than 51% of total FDI and that more than half of previously mentioned projects belong to the areas EU investment has been historically interested in, leads to the conclusion that the EU should be interested in some of those projects; this in turn becomes another proof of the relevance of the EU as a trading partner for Peru.

The European Union is nowadays Peru's main export market and the third source of imports to the country (Mincetur, 2013). Between 2001 and 2011, trade interchange between Peru and the EU increased by an annual average of 16% (Vice Ministerio de Comercio Exterior y Turismo, 2012). Moreover, as it will be further described in the next sub-chapter, trade with the European Union has left Peru a positive balance in the last 6 years, that accounted for USD 2,746 million in 2012. This adds to the relevance of European direct investment in Peru and the opportunities the European market represents to Peruvian exports, showing therefore the overall importance of the European Union as a trade partner.

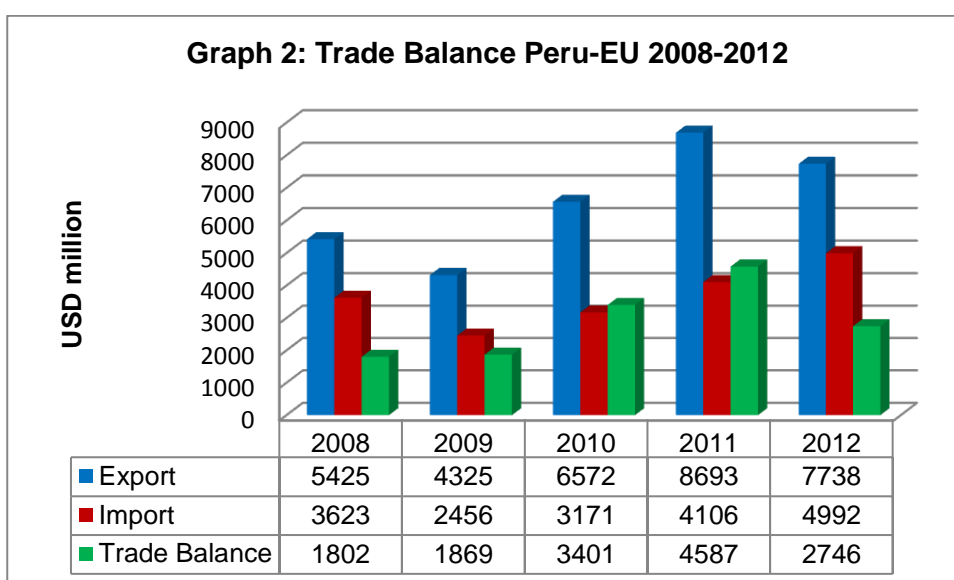
#### **4.2 Trade Peru – European Union 2008 – 2013**

Previous paragraphs have discussed the importance of the European Union as a trade partner for Peru. In order to achieve this goal, they have described why the EU market represents opportunities for Peru and why risks to sensitive industries are low, as both markets are complementary. Furthermore, they have also considered FDI as a point of analysis, as more than half of FDI in the country in the last 30 years belong to EU capital. The following part of this research will delve in the core of the work, as it will compare trade balance between both parties in the last 5 years before an enforcement of the FTA with the preliminary results of trade in 2013.

#### 4.2.1 Trade before Free Trade Agreement

It was previously mentioned that in 2012 the trade balance between Peru and the European Union left the country a positive balance of USD 2,746 million in 2012. In this part of the work, there will be a closer look to the trade results of the last 5 years before the enforcement of the FTA. The main observation is that Peruvian Foreign Trade with the EU has left a positive balance in those years.

With the exception of 2012, the trend has been a positive increase for Peruvian trade balance. The next graph will provide a clear overview of this fact:

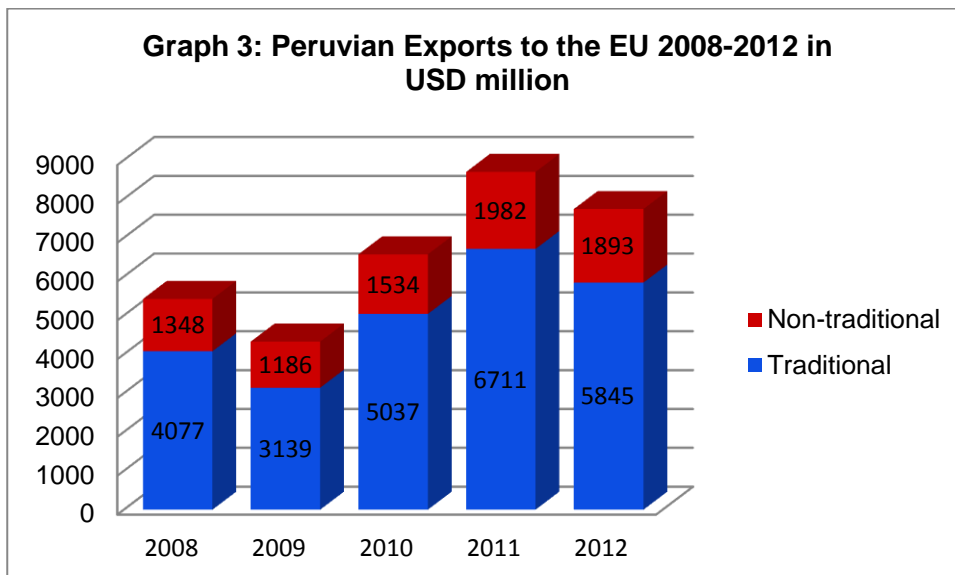


Source: Mincetur, SUNAT

As it is possible to appreciate, between 2008 and 2009 there was a reduction of Peruvian exports to and imports from the European Union. This negative impact is explained by the economic and financial crisis that hit the world in 2009, which had a negative impact for the EU that was reflected in less demand for Peruvian products. However, already in 2010 Peruvian trade with the economic bloc increased, even overcoming the amount of exports achieved in 2008, increasing therefore the trade balance, that recovered by almost USD 700 million compared to the previous year. This trend continued in 2011, where both exports and imports increased. However, export to

the EU grew faster than imports from that economic bloc, so that the trade balance that year grew more than the previous one. In 2012, due to the new financial crisis in the European zone, export to the EU decreased like they had in 2009; however, this time the reduction was not as big as then. Imports -on the contrary- increased by nearly 20%. Thus Peruvian trade balance was lower than 2011 and 2012, but still positive.

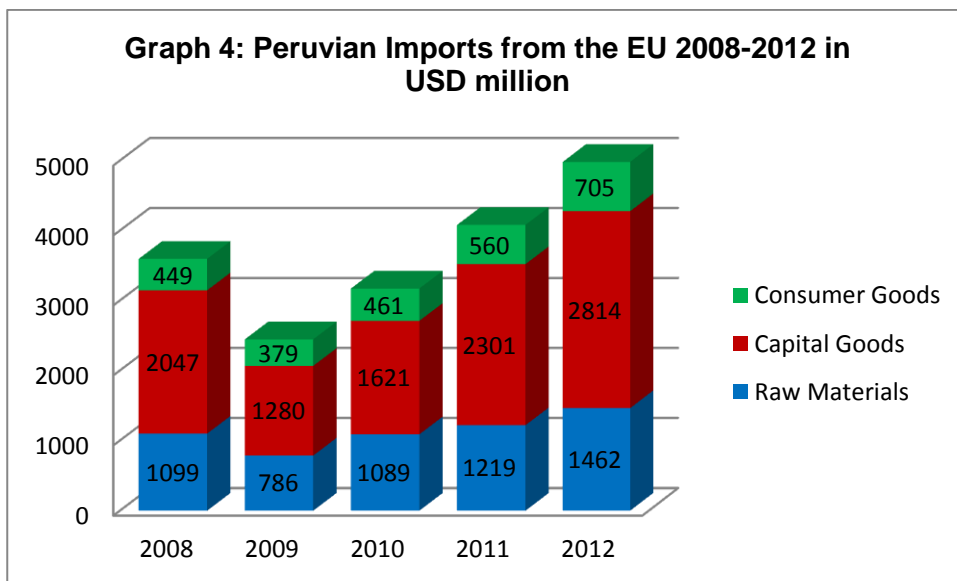
Peruvian export products are traditionally divided in two big sections: traditional and non-traditional products. The first term refers to the products that do not have gained too much added value to change their essence during the production and/or obtaining process; following are examples of products Peru exports to the EU. Traditional agricultural products -cotton, coffee, sugar-, traditional fishing products -fish meal, fish oil-, oil and natural gas, traditional mining products -gold, copper, silver, lead, zinc-, among others (ADEX Data Trade, 2014). The latter considers products that have a more significant added value due to the industrialization process required for manufacturing and/or obtaining process. These include agro industrial products -vegetables, fruits, animal and vegetable oil-, textile products -garments, spinning-, fishing products -fish, mollusk-, among others (ADEX Data Trade, 2014).



Source: Mincetur, Sunat

Graph 3 shows Peruvian exports to the European Union from 2008 to 2012. As it was also shown in the previous graph, the trend between 2008 and 2011 is an increase of total exports and, more importantly, of the amount of non-traditional products. With the exception of 2009, where world economy had to face the impact of the financial crisis, shipping to the EU had increased: traditional products grew from USD 4,077 million to USD 6,711 million, while non-traditional export grew from USD 1,348 million to USD 1,982 million in the same period of time. 2012 means a decrease in export of both traditional and non-traditional products that is understandable due to the “new” crisis the world faced, that continued in 2013 as well and had the European Union as one of the most affected regions. Despite the fact that exports were reduced during 2012, the amount of exports to that region represented more than 17% of Peruvian total exports.

Imports from the EU are capital goods, raw materials and consumer goods. Graph 4 shows how EU imports coming into are divided Peru:



Source: Mincetur, Sunat

After the drop in 2009, imports have been constantly increasing. Main products coming from that region include vehicles -especially for transport of goods-, different kinds of machinery for the mining industry, as well as medicines and vaccines for

human use. The area that experienced the largest growth was the capital goods sector. Here it is necessary to point out that under capital goods, materials for construction are included and Peru has been experiencing a construction boom in the last few years, especially in the capital Lima, as price per m<sup>2</sup> has continuously grown and demand has exceeded supply by far. This is a trend that will continue.

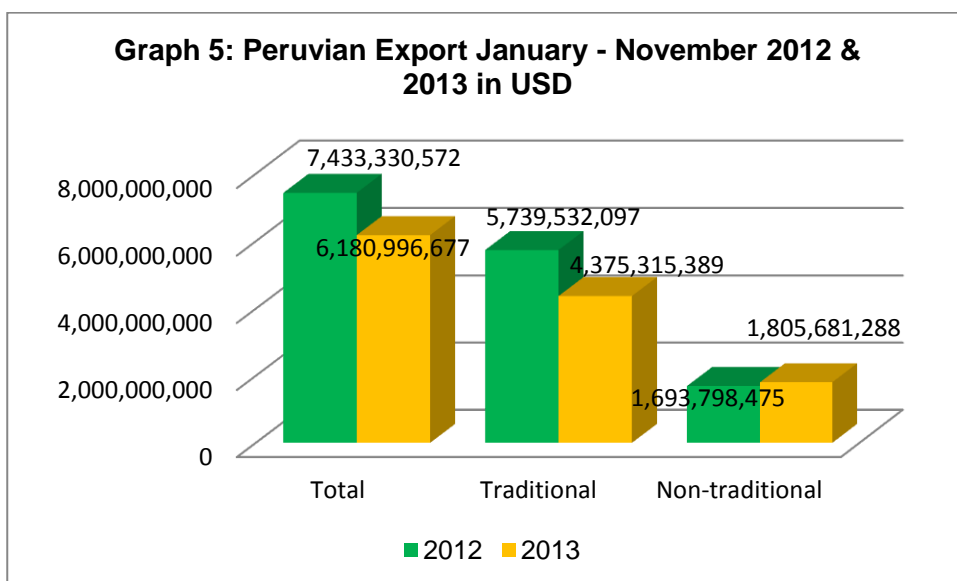
A closer look at the last two graphs show that foreign trade between Peru and the European Union between 2008 and 2012 provide a clear explanation to Graph 2 that showed a decrease of positive trade balance Peru had against the EU. Despite the financial problems the latter faced in 2012, imports into Peru increased, while exports decreased. Even though the balance is less favorable when the amount of imports and exports are contrasted, more import, less total export are not completely negative for Peru. Preliminary results of the FTA in question will provide further explanation.

#### **4.2.2 Trade after Free Trade Agreement**

As the last sub chapter showed, 2012 was a year that brought a reduction of the trade balance for Peru against the EU when compared to the previous two years. It is in this context that the FTA between the country and the European Union finally came into force in March 2013, although negotiations finished successfully before results of 2012 were available.

Despite of the fact that the literature reviewed provide a global comprehension of the importance, benefits and (some) downsides of free trade agreements, there is still a gap in the analysis of the importance of FTAs for developing economies trading with developed economic blocs, like Peru trading with the EU. It was necessary to turn to real facts and similar cases to fill this gap and continue the discussion. A study of Peruvian Ministry for Foreign Trade and Tourism -Mincetur- (2012) sums up macroeconomic indicators in trade between Peru and the EU. Moreover, this study summarizes why Peru -as a developing economy- would benefit from trade with the EU: it emphasizes that size difference is, in this case, an advantage and a big opportunity (as this work mentioned), considering that this region is the main destination of the country's exports and the main provider of FDI. According to this study, the variety of the Peruvian export offer should benefit from the new opportunity to attack new markets

(it was previously explained that Peruvian products had a unilateral benefit given by the EU, the SGP Plus, but this benefit was not applicable to all products and was only transitory), especially non-traditional products, that are products with added value. This study sees the FTA as positive. However, its expectations (increase of FOB value USD 576 million) contrast with the data recently available on the web: according to Mincetur (2013) Peruvian total exports were reduced by 11% and exports to the EU by almost 20% to September 2013. These facts are most important in this thesis discussion, because they lead to think that by the end of the first year, there will be a huge negative breach between expectations and real effects of this FTA for Peru. Nevertheless, and even though available data is not the best, if it focuses on the ratio between exports and imports, the importance of this FTA has more sides than just foreign trade. Moreover, 2013 was a year full of global economic problems like the financial problems in Europe or the slowdown of China's economy (Leon, 2013). These facts had an impact on the process of analysis, as they make 2013 a year that is not comparable to previous years; the reduction of Peruvian export is reflected on trade with Europe, yes, but the trend was the same with almost all trading partners. To November 2013, total exports were reduced by 10.1%, from USD 41,561 million to USD 37,308 million (German-Peruvian Chamber of Commerce and Industry, 2014). The explanation to this reduction lies here: export of traditional products declined by 12.2%, while export of non-traditional products decreased by 3.1% (INEI –Peruvian National Institute of Statistics, for its Spanish name-, 2014). Imports, on the other hand, increased by 3% (INEI, 2014). It is in this context that the Free Trade Agreement between Peru and the European Union entered into force.



Source: Adex Data Trade

Graph 5 compares the development of Peruvian exports to the European Union between January and November 2012 and the same period in 2013. The trend towards declining exports that was observed from 2011 to 2012 in graph 3 continued in 2013, where compared to the period January-November in 2012, the amount of total exports shows a decline of 16.85%. Export of traditional products was reduced by 23.77%, from FOB value USD 5,739,532,097 to USD 4,375,315,389. A different trend is observed in the export of non-traditional products: unlike the traditional ones, these did not continue the downward tendency that was observed in graph 3. On the contrary, graph 5 allows to see that the export of non-traditional products between January and November 2013 increased by 6.61% to USD 1,805,681,288. This amount is higher than the figures for non-traditional exports for the whole year of 2008 and 2010, and is very close to the figure achieved in 2012: it accounts already for more than 96% of the exported value of non-traditional products in that year. A closer look in this area will help pointing out more relevant facts:

<b>Industry</b>	<b>2012</b>	<b>2013</b>	<b>Variation % 2012-2013</b>	<b>Participation% 2013</b>
Agro and Agroindustrial	902,896,573	1,009,055,679	11.76%	16.33%
Textile	50,827,390	59,024,306	16.13%	0.95%
Fishing	239,554,576	251,365,221	4.93%	4.07%
Chemical	139,186,206	153,951,333	10.61%	2.49%

Source: Adex Data Trade

Sub-Chapter 4.2.1 of this research mentioned that three of the main industries exporting non-traditional products to the EU were the agro industrial, the textile and the fishing industry. Table 7 shows how these developed between January and November 2013 compared to the same months in the previous year: the export value of agro industrial products increased by 11.76%; textiles in this case increased by 16.13%; fishing by 4.93%; and the export of chemical non-traditional products grew by 10.61%. It is important to point out that analysis of data in 2013 includes January and February, months where the FTA had not yet been enforced. Nevertheless, the trend of the results was the same, with the exception of non-traditional products, that did show significant increase compared to the first 2 months of the year.

Regarding imports coming into Peru from the EU, the General Office for Economic Studies of Mincetur issued a report on foreign trade between Peru and the EU in October 2013. It shows that up to that month imports increased from CIF value USD 3,752,5 million between January and October 2012 to CIF USD 3973,7 million in the same period in 2013. The trade balance reflected a reduction of more than 50%, but there was still a surplus of USD 982,7 million in that same period (Mincetur, 2013). However, more import does not necessarily mean negative impact: as graph 4 reflects, by 2012 more than 50% of imported goods from the EU were capital goods. These are necessary for production of services or new products. Considering the fact that Peru and companies in the country are looking to improve their respective products or production processes, these turn out to be irreplaceable. ADEX Data Trade (2014) shows that there are products that were not imported in the period 2008-2012, but appear in the information for 2013. These goods are automotive for railways -CIF value



USD 134,105,434-, helicopters of more than 2000kg -CIF value USD 26,437,401-, generators of wind energy -CIF value USD 13,837,859-, barley that is not for sowing -CIF value USD 15,830,101-, among others. Peruvian import offer has started already a slight process of diversification.

Even though the total amount of exports to the EU was reduced after the implementation of the FTA in question -and that is the main reason for the strong decline of the trade balance-, that cannot be considered as a negative impact of that agreement for Peruvian exportations. As it was explained before, this FTA entered into force in a global context of financial problems, uncertainty and slow-down of major economies and economic blocs. This had a strong effect on the price of mining products, which are the main support to Peruvian exportation. Like mentioned in the first chapter of this work, all countries take part in the world economy and the world market. In that context, it is hence understandable why Peruvian exports -and purchasing power of EU, together with other important destinations of Peruvian exports- suffer when the world is facing problems, even if the country grows by more than 5% in that situation (Gestión, 2014). The analysis of the importance and positive impact of this FTA for Peru must therefore focus on more than increase or decrease of trade balances.

Leon (2013) stated that studies show that exporting companies of non-traditional products generate 80 formal jobs for every million US dollar that are exported, because these are the companies that are more intense in the generation of jobs. Due to the fact that Peru is a country where the expansion of informal jobs makes it very hard to estimate the real amount of the informal employment rate, the appearance of formal jobs becomes a more than relevant issue. In this case, if we take this figure and apply it to the surplus of USD 111,882,813 that exists in exports of that kind of products in 2013, one could appreciate the degree of importance of these exports, which increased thanks to the FTA in question, as it provided tariff benefits to them.

Another aspect to consider is the benefit that some products now have due to the FTA and did not have before. According to ADEX (2014) products exported in 2013 that were not exported in the previous years, include palm oil, steel wastes, crustaceans, tellurium, black tobacco, sesame seeds, among others. These are only examples of

Peruvian exports that enter now the European market with 0 tariffs. They support the benefit described in this paragraph, but it is directly related to the FTA in question.

Due to the fact, that results are preliminary in the sense that they do not reflect one year of trade and that 2013 was a year that brought too many difficulties for Peruvian trade because of the price decrease of mining product and financial crisis that faced Peru's main international markets and trade partners like the US, the European Union and China, this research turned to primary research to discuss the importance and positive or negative impact of this FTA to Peru. Primary data of this work consists of 4 interviews with experts on the matter, but from different areas. The first interview was with Mr. Diego Urbina, Director for North America and Europe and Director for North America and Europe at the Ministry of Foreign Trade and Tourism (27<sup>th</sup> June 2013). At the time this interview took place, data to November was still not available, but the trend was already visible. For him, the reduction of export and increase of import was not directly related to the FTA in question, but to the situation of the Euro Zone. He argued that the Peruvian trade as a whole had the same problem that is seen with the EU and that this shows that the reason for the slow-down is the world economy. Like this work, he referred as well to the reduction of mineral and commodity prices, the problems of the US and the deceleration of China. He focused on the non-traditional exportation for his analysis. As this work already showed, he pointed out that an export increase of non-traditional products is an undeniable symptom that the FTA is working -especially in times of global financial problems- because one of Peru's goals with FTAs is the boost of this kind of exportations, due to the fact that they generate more jobs, more technology and are key to overcome the label of exporter of raw materials. Besides, he sees this FTA as a platform toward new markets. As it was pointed out in this part of the work, Peru's main trade partners in the European Union account only for 18% of EU countries. For example, a study of Mincetur (2013) showed that between January and October 2013 non-traditional exports to the main partners in the EU was like this compared to the same period of time in 2012: Holland, 17.3%; Spain, -4.4%; UK, 29.1%, Italy 0.9%; France, 2.6%; Germany 6.2%; Belgium 0.5%. Even though the overall evaluation of numbers is positive, the FTA also offers Peru opportunities to enter a larger market. This is another consideration Mr. Urbina made: for him, the countries

Peru already exports a significant amount of goods to should be used as a platform towards the new markets, like Denmark, Finland or Sweden; this strategy is possible thanks to the FTA, that allows entry to the entire economic bloc under equal conditions with European products, and with same requirements between countries. Regarding FDI, he stated that even though the EU has already a significant amount of FDI in the country the FTA widens the demand as it enables other countries -besides the traditional ones, like Spain- to see Peru as an attractive market. Furthermore, he mentioned that apart from providing advantages to export and imports, the FTA also provides Peru with a better image, internationally speaking, as the subscription of this FTA means that Peru is ready to compete in the global market and continues its policy of opening to free trade, with disregard of the governor in turn (here it is necessary to point out that Peru's actual president who was elected in 2011 belongs to a left party; during his campaign he did suggest revising the FTA between Peru and USA and evaluating the policy of negotiating further trade agreements. However, in more than 3 years he did not revise the agreement with the US; on the contrary he even travelled to Europe to speed up the subscription process of the FTA in question in this work). To finalize, Mr. Urbina believes in the forecasts that see the financial problems of the EU disappearing in the next few years and believes hence that this should not be a concern of Peru.

The second interview was with Mr. Carlos Gonzales (7<sup>th</sup> January 2014), Manager of Economic Studies at ADEX, Peruvian Exporters Association (Asociación de Exportadores, for its Spanish name). ADEX is the one of the main exporter associations in Peru and they actively collaborate with the government making studies, providing forecasts, and working as a link between small, medium and large local exporters and the government, especially concerning decisions such as the subscription of trade agreements. Mr. Gonzales actively participated in the negotiation rounds of the Free Trade Agreement between Peru and the European Union, being part of the experts board that assisted decision making of the government. Regarding the importance of this FTA, he argues that the first thing to consider when analyzing the importance of this FTA to Peru is its history. So far, Peru has signed 18 trade agreements (bilateral or multilateral). Peru has achieved 11 years of sustained growth that coincide with the

country opening to free trade. He explains that until 2000, Peru suffered what is called the trap of low income: only 4 million Peruvians had formal jobs and the wages and salaries were low. As a small market, Peru was not attractive for investment as they would not pay off in time; investments mean growth. Starting with the FTA with US, he says, Peru finds in foreign markets the chance to grow and exports become the engine to grow and develop the country. According to him, the openness to trade also changed the way the country grows: before, growth came from government spending too much money, so that economic growth meant also growth of imports (this is identifiable with a look at the Peruvian exchange rate in the 80's and to some extent in the 90's) and this was of course not possible to support in time. Trade agreements, he says, brought Peru the chance to grow with exports and generate own profit; according to his studies, the country has around USD 65,000 million accumulated: enough for the country to export nothing for 2 years and still be able to handle external commitments. To him exportation and private investment are the mainstays for Peruvian economic growth. He agrees with this research that FTAs, and this in particular, provide the country and private investor with juridical stability and elimination of extreme governmental changes. Mr. Gonzales provided another interesting fact: previous years saw around 300,000 Peruvians leave the country to find work abroad; 2013 saw not only a significant amount of Peruvian people coming back (this was reflected in a law Parliament made that allowed Peruvians coming back home to bring up to USD 30,000 of house goods tax free (Peru21, 2013), but also almost 150,000 foreigners coming into the country to look for job opportunities. When asked about risks to local industries, he agreed with this research's statements that the Peruvian and European Union markets are complementary: apart from the fact that seasons are opposite between South America and Europe, he explained for example that Peruvian exports do not compete in the EU markets with products that are locally subsidized. In Peru, the only sector that according to ADEX studies could be sensible to imports from the EU, is the dairy sector that is anyway not one of the foundations of the Peruvian local industry and is underdeveloped. Furthermore, he explained that other industries that are believed to be sensitive are actually not: Peruvian wheat is important in the local market and it will compete with European wheat -whose import grew by more than 26% between January and

November 2013 and the same period of time in 2012 (ADEX Data Trade, 2014) - on equal condition; however, the one produced in Peru is not useful for the preparation of bread, which turns out is the main destination of EU wheat. Barley produced in the South American Andean countries is also competing now on equal conditions against European barley. Nonetheless, and even if in the period 2008-2012 the European product was not imported into the country and 2013 showed a CIF import value of USD 15,830,101 (ADEX Data Trade, 2014) it does actually not compete with Andean barley, as it is used for the production of beer, a process for which the latter is not usable. In the nature of the agreement, he says the third main reason why this FTA will have a positive impact for Peru: principles of this agreement state that, like goods, EU investors should have the same conditions as a local investor, or international investor of another economic bloc; the FTA allows EU capital to compete on equal terms for investments in the country, with no conditions for hiring local workforce or similar. Combined with the fact that investments in Peru can benefit from the FTAs the country has -and achieve new markets having Peru as a hub for their operations-, this fact contributes to Peru's strategy to become more attractive to private national and most of all international investment, in order to achieve wealth and welfare in terms of jobs, money, infrastructures, among others. And just like that, Peruvian investors will now have the chance to invest in Europe with the same benefits. To Mr. Gonzales, the FTA in question is 100% beneficial for Peru and how foreign trade developed in 2013 should not be an indicator of this agreement performance: The key to the analysis in 2013 lies in the details, and he, like this research, agrees that how non-traditional exports developed is the best indicator of the impact of this FTA (by September 2013 traditional and non-traditional exports to markets with no trade agreements had dropped unlike the case of the EU, China, Mexico, or Singapore where there is always an increase in non-traditional product exportation (Mincetur, 2013)), as Peru should aim to export more products with added value. Besides, Peru's economic integration with trading partners coincides with its development in the last few years. That is the best indicator of the positive impact of an FTA in general, even in Peru's position as a developing economy. So far, there is no national production activity that has been affected by any of the FTAs.

Mr. Jörg Zehnle, Director Manager of the German-Peruvian Chamber of Industry and Commerce in Lima, considers that the FTA in question is positive for Peru, as well as for Germany and Europe (Zehnle Interview, 9<sup>th</sup> January 2014). According to him, the German Chamber of Industry and Commerce expects the foreign trade between Germany and Peru to double within the next two years due to the FTA. The Chamber also expects German FDI in Peru to multiply by 3 within the next 3 years, due to the economic development of both countries; for him the FTA makes Peru a better place for German and European investments, which is in end-effect one of the main goals of Peru for this FTA, and it also gives Germany and the European Union a good market and place to invest in. He mentions the example of the company Heinz Glas -production of glass and decoration- that has production facilities in Peru in order to benefit from Peru's trade agreements to export products to the region; according to Mr. Zehnle, the FTA between Peru and the European Union will bring more facilities of more European companies to use Peru as a production center for trade in the region. However, in this point he issues a warning: infrastructure in the country and the region does not make it possible to have physical distribution -ground transportation- since the road and railway infrastructure is not good. To him, the exploitation of opportunities the FTA in question brings to Peru can only be achieved if the country makes more efforts in that area: to have FTAs is good, but Peru should aim at supporting the legal and economic framework with physical infrastructure. Nonetheless, Mr. Zehnle sees in this lack of infrastructure a good opportunity to exploit this FTA and all others in terms of Foreign Direct Investment. As mentioned before, this FTA considers also aspects regarding investment, technology and intellectual property that contribute to make Peru very attractive for private investors: in this sense, it is not relevant if more than 50% of FDI in Peru already comes from EU capital, as the FTA offers chances to attract investments from other countries that have not typically invested in the country. Besides, FDI helps overcoming possible lack of capitals in Peru for certain investments needed, develops the economy by bringing job opportunities and provides technological transfer, due to the fact that private investment will almost always focus on high tech areas or the development and improvement of processes used in the country they are investing in. Regarding the strong reduction of almost 22% of trade between Germany and Peru -

that reflects trade reduction between Peru and the EU- he explains that most of this reduction comes from price effects due to the drop of mineral prices (this work explained before that the mining products are the ones that have been the main support to the increase of export), rather than quantity effects -quantity has of course decreased, but the main problem were the prices-. All in all, Mr. Zehnle and the German Chamber of Industry and Commerce see this FTA as very positive for Peru and for Germany and Europe. The trust is so big, that they have already collaborated to set up Peruvian trade offices in new cities, like the one that will now open in Hamburg.

Although being experts in the different areas, all three have agreed on the importance of this FTA. They all conclude that the current context is only temporary and that the real overall impact of the trade agreement in question will be noticeable in the future. Nonetheless, and despite having an approach from different angles, they agree with this research statement that the key figure to evaluate the importance of this agreement is the increase of non-traditional exportation, private investment is not negative for Peru, even if more than 50% comes from the same source, and the increase of imports and the FTA in general will not have a negative impact on Peruvian local industries as EU and Peruvian market are complementary.

### **4.3 Chapter's Conclusions**

The purpose of this chapter was to review Peru's decision to start a Free Trade Agreement with the European Union. The importance of the EU for Peru was explained, as well as the trade figures before (2008-2012) and after (January-November 2013) the enforcement of the FTA in question. The statements made during the chapter were supported with statements from three different experts of three different sectors that are closely linked with the agreement.

Even though results are not the expected in the time of the negotiations, the context in which these figures have appeared and the fact that this FTA is new do not allow to evaluate the impact of this FTA by making a review of only trade balance. The focus then has to be on some details of the information. In the export section, the clear

symptom of the positive impact of this FTA was the rise of 6.61% of non-traditional exportations to the EU between January and November 2013 and the same period in 2012, even though Peru's total exports to that region declined by 16.85%. This is important not only because non-traditional products have added value and are the key to development, but also because according to a study, companies exporting those products generate 82 new formal jobs for every USD million of exported products. The fact that imports have increased while exports decreased is not the best situation, but in the specific case of Peru, trading with the EU is not that relevant: as explained in the theory section, an increase in imports is not negative as long as the products acquired add to the welfare of the population and local industries. Graph 4 reflected that until 2012, more than 50% of EU imports were capital goods that are needed for production or service purposes in the local market. Moreover, according to ADEX Data Trade (2014) new products that were imported from the EU into Peru and do not appear in the previous years are automotive for railways and barley among others: products that Peru does not produce locally, but has nonetheless the need for them. In this sense, the FTA facilitates access to better and wider quality of raw materials, products and services. The statements made during the analysis of figures were supported by the information and opinions of the three interviewed experts: Mr. Urbina and Mr. Gonzales agreed that the main indicator of the positive impact of this FTA was the increase of non-traditional export. Like this work, they also consider that 2013 is an atypical year for analysis due to the global financial problems. Both of them also consider that besides the trade side, another important aspect is the secure juridical framework for private national and international investments and for political stability. Mr. Zehnle also sees this FTA as extremely positive for Peru but considers that there is the need for further investments to exploit opportunities to the fullest. However, despite the reduction of overall trade between Peru and Germany/EU, he as Director Manager of the German Chamber of Industry and Commerce in Lima expects the situation to improve, agreeing then that the subscription of this FTA was the logical step Peru had to make towards the overall strategy of attracting investments to generate welfare of the population.

The analysis of available data as well as the considerations and studies of the people interviewed support the statements made in the theory section: free trade is positive and



FTAs with a developed economy is important even to a country like Peru, a developing economy. Peru's development and improvements since its openness to trade is the best example of this. Besides, as the EU is an important trading partner for Peru, it was the only logical step to provide a secure framework for the development of trade and private investment in the country. Moreover, exportation has been the basis of Peruvian economic growth. This last sentence is at the same time supported by the development of non-traditional exportation, which, like it was mentioned before, grew even against the negative economic environment.

The brief summary made in the last paragraphs show how the research has fulfilled the first 3 objectives described in the introductory section. The nature of this FTA, the fact that it is recent and the context, in which it was enforced, however, could take away the truthfulness of the statement supporting the hypothesis until now. That is the reason why this research considers it necessary to find further support to the hypothesis in 2 case studies that are comparable to the research topic: Free Trade Agreement between Peru and USA and Free Trade Agreement between Chile and the European Union.

## **5 Previous Experiences of Free Trade Agreements between developing and developed economies**

Chapter 4 discussed the importance of the Free Trade Agreement between Peru and the European Union for the South American country by analyzing why that region is important as a trade partner for Peru and why the country will benefit from the FTA in question. It summed up and evaluated figures and drew conclusions then supported by interviews. However, as that chapter also mentions, 2013 was an atypical year to make analysis of the FTA. Hence, this research will make 2 brief case studies regarding the first three years of those agreements to support its conclusions: Peru's FTA with the US, and Chile's FTA with the EU.

The case studies selected are considered relevant for this research because the first one is the first FTA Peru subscribed with any country. Moreover, it offers data that supports the statement this thesis that a developing economy will benefit from free trade with larger and more developed trading partners. The latter is relevant as it is also a South American developing economy that decided to enter free trade with the EU. Besides, in many senses Peru's current strategy to open to free trade is to this research a follow up and improvement of Chile's experience, which is considered in the Peruvian trade environment one of the examples to follow.

### **5.1 Free Trade Agreement between Peru and USA**

The Commercial Promotion Agreement -Free Trade Agreement from now on-between Peru and the European Union was subscribed on April 12<sup>th</sup> 2006 and it came into force on February 1<sup>st</sup> 2009 (Leon, 2013). It considers the areas bilateral trade aspects like trade of goods, promotion of investments, intellectual property and it also includes regulations about labour and environmental issues (Mincetur, 2012).

This FTA was the replacement of the ATPDEA (Andean Trade Promotion and Drug Eradication Act that was the replacement of the ATPA or Andean Trade Pact), which

was a system of exclusion of tariff payments for some Peruvian export products that was unilaterally and temporarily awarded by the USA to some countries in the Andean Region (Mincetur, 2012). Unlike that system, the FTA with the US brought Peruvian export clear and permanent benefits, as the negotiation of a FTA succeeds as both parties equally and mutually agree on concessions, obligations and conditions that make the FTA bilateral and in that sense more positive than an arbitrary unilateral concession. When the government announced negotiations of this FTA the public opinion was divided: there were the ones who considered this a big step towards an economic integration with the world, on the other hand, there were the people that saw in this trade agreement a major risk to Peruvian local industries and were reluctant to believe the benefits several studies forecast for this FTA. In the end after the election campaign in 2006 Mr. Garcia -Peru's former President between 1985 and 1990, when the country had the biggest financial crisis in its history expressed his support to the FTA and the importance it would have in the country's future development, even though in the campaign he was reluctant not express himself in favour of the agreement.

After the three first years of enforcing this agreement, the results have been positive, regardless of the negative trade balance up to 2012: the first aspect to consider is its contractual framework, as explained with another example in previous chapters, which puts this agreement as a mandatory condition to Peru and in the end leads to political and juridical stability, as results become positive. The uninterrupted strategy the last three governments have had in terms of economic behavior are the best example of this, as Peru has traditionally been a country where a change of government could imply a change of everything. This stability is the first and main step to attract private investments.

On the one hand, this FTA provided relief to 99.5% of all Peruvian export products in a period of time between 0 to 17 years, including all products that benefited from the ATPDEA-with the exception of 17 tariffs sub-headings-(Mincetur, 2012). To the main products Peru exports to the US belong sugar, coffee, gold, asparagus, cotton T-shirts, among others (Leon, 2013). On the other hand, Peru conceded immediate elimination of tariffs to 76% of US products; the rest would access tariff elimination in a period of 2 to 17 years (Mincetur, 2012). To the most important import products coming from USA to

Peru belong yellow corns, vehicles, vaccines for human use among others (Leon, 2013).

After the first three years of enforcement of this FTA the overall balance is positive: Peruvian exported value reached USD 16,938 million, that is an accumulated increase of 190% compared to the exported value in 2008 (Leon, 2013). There are 508 new exported products to the US since the enforcement of this FTA; 96% of them are non-traditional products (Leon, 2013). Between 2009 and 2012 traditional exportation increased by 21%; for instance, export of products like sugar, coffee or gold grew by 209%, 50% and 40% respectively (Mincetur, 2012). Non-traditional exportation in the same period expanded by 21% compared to 2008: iron and steel sector by 190%, the chemical sector by 90%, non-metal mining products by 67% (Mincetur, 2012). Only in the third year, exportation of asparagus and T-shirts grew by 17% and 0.1% respectively. Thanks to the tariff elimination, Peruvian exports benefit from in this FTA, the amount of tariffs payment was USD 14,4 million; 98% less than the amount Peruvian exports would have paid without this FTA: USD 637 million (Mincetur, 2012).

Peruvian imports from the US have grown by 218% during the first three years compared to the amount in 2008 (Leon, 2013); in this period, 61% of imports were raw materials, and capital goods and construction materials accounted for 32%. Due to the benefits of this FTA, Peruvian importers paid a total of USD 162,2 million in tariffs; without those benefits, the amount would have been 35% higher or USD 251 million (Leon, 2013).

As the USA has historically been the main trading partner for Latin America, it was only logical to ensure a clear trading framework between parties. As this work has previously explained, it is necessary to open to trade, especially for developing economies seeking to grow; and in that sense, it is necessary to provide a clear and safe framework. Even though the balance was 2012 is not the expected one, the importance and positive impact of this FTA for Peru is easily substantial. Traditional exportation grew in that year (BCRP Banco Central de Reserva del Perú – Peruvian Central Bank-, 2013) and again that is the key to analysis in terms of foreign trade. The growth of exports and expansion of imports combines with the fact that Peru gains, with this agreement, juridical framework for trade in the country, but also political and

investments stability. The FTA with the US represented for Peru the biggest challenge to date, as it was the first international experience in that sense and Peru has not even had two decades since it started looking at the global market. Despite original rejections, the FTA turned out to be really positive because leaving aside the results in increase of foreign trade, it was the first step towards Peru's goal of becoming attractive to private investments and achieving sustainable economic growth. Even when nowadays there is still room for improvement, it is not possible to deny that being a developing economy implies for Peru many challenges when trading with larger economies, but the benefits will always overcome the negative aspects and impacts. There is a lot to say about this FTA as in many ways it changed the country's future, but for the purposes of this research that discussion is not relevant. However, the facts shown and the statements made in this brief case study should be enough to understand the positive impact of this FTA to Peru.

## **5.2 Free Trade Agreement between Chile and the European Union**

On November 18<sup>th</sup> 2002 Chile and the European Union signed an Association Agreement -from now on Free Trade Agreement- after more than three decades of Openness to Trade by Chile and the subscription of many other free trade agreements (Blanc, 2005). Like the FTA between Peru and the European Union, this agreement included more aspects than just the trading parts. Even though it completely entered into force on March 1<sup>st</sup> 2005, the trade part of the agreement was enforced already since February 2003.

The first effect of this agreement was the increased trade between both parties: Chile's exportation to the EU grew by 17% only after the first year of enforcement of the trade part of the agreement (Blanc, 2005). Products not related to copper -that is the main exportation product of Chile, that accounted at that time for 44% of external market- had augmented by more than 24% (Blanc, 2005). Besides, exports to EU members like Finland, Greece or Portugal, that were not the traditional markets for Chile -Italy, Holland, France, Germany, UK or Spain- increased by 60% (Blanc, 2005).

Regarding imports coming to Chile from the EU they grew by 12.4%, vehicles, medicine for human use and machinery being the principal products imported (Blanc, 2005). Chile's strategy of attracting private international investment has also benefited by this agreement: EU FDI in that country grew 58%, achieving USD 2,982 million.

Results show that this agreement had a positive impact on Chile; not only talking about export, import and FDI development, but also in terms of trade stability: the EU was at that time the first market for Chile's exportation and it was also the main source of FDI in a country. An agreement that improved and enlarged the framework of previous agreement was here again the logical step towards the goal of integrating into global economy in a secure framework. It also provided Chile with the chance to decrease its dependence on the export of primary products, as it gave a global benefit and hence incentive to Chile's industrial exports. Moreover, being trade partner -and not benefice of some unilateral regime- Chile started having more chances to gain attention of local EU consumers due to more presence in the region. According to Blanc (2005) these agreement benefited the FDI by a reactivation of EU investments in the country, benefited export offer due to a bigger and wider Chilean exportation and benefited local industries and consumers, as it gave the chance to acquire more and more developed products. In the context of the agreement, between 2003 and 2011 bilateral commerce between Chile and the EU had increased by 135%: Chilean exports have grown at an average rate of 11%; imports have grown by an average of 13% in the same period (Moreno, 2013). Moreover, the EU is still the main source of FDI in Chile -almost 30%- and the accumulated surplus for Chile from 2003 to 2012 accounts for more than EUR 42,000 million (European Commission, 2012).

### **5.3 Conclusions and application of examples to the research topic**

Similarities between the research topic and the two examples presented in the previous section are what make these useful to support the hypothesis and statements presented during this work.

The first example provided had Peru as one of the trading partners; it was a different situation for the country but it was the same country: the export offer supported by mining products, developing economy and need of private investment. Nonetheless, the political situation and uncertainty due to the fact that that FTA was the first for Peru provided an unstable, unpredictable and risky framework. Results in the end were so positive, that even though political parties and population sectors have different opinions on wide variety of topics, there was an overall consensus in one: the key to growth is exportation and openness to new and bigger markets and economic sectors; two governments with left side orientations have already agreed to this. Like the EU, USA conceded Peruvian exports a temporary and unilateral benefit. As the US is a main market for Peru, it was necessary to secure the development of exports and imports. This FTA was also the first piece of Peru's overall explained strategy and it now adds to the total export offer and import variety that have supported the country's development. Moreover, it is a key part to the political stability that has helped making new FTAs and it is a clear sign that Peru is evolving and is prepared and looking for more political integration.

The second example is also applicable due to similarities: Chile and Peru are both South American developing countries and just like Peru, Chile's economy and exportation is supported by the mining sector. The EU is the main source of FDI in both countries and the EU is the main market for both countries exportations. They both look to attract more international private investment, increase the exportation of non-traditional products and they also aim at "non-traditional" European markets. Results of Chile's example are clear: trade, overall exportation and exportation of products with added value and FDI increased. Besides, the agreement reinforced trade relationships between both parties and provided Chile with a better position. The country has been able to gain more attention from the markets and it has accumulated a positive trade balance. As Peru and Chile are similar, those are results that can be similarly expected for Peru's FTA with the EU, after the economy finally recovers from the crisis. It is, however, also necessary to consider here some differences: while Chile's development occurred in decades, Peru's boom has occurred within less than 10 years. In 2005 Peru's GDP per capita was the same as in 1975; nowadays it is almost USD 11,000

(Vargas, 2013). This is the result of an aggressive strategy that has benefited from commodity prices and the global situation. In 2013, Peru's GDP has now surpassed Chile's (Vargas, 2013). Despite that, there is a strong difference in terms of education and physical infrastructure, where Chile is clearly more developed. Peru has to aim to overcome this gap to achieve real sustainable growth and distribution of wealth.

The application of results support the hypothesis of this work: the analysis of this kind of FTA goes further than the trade balance. In that sense, both examples provide a clear view to how developing economies react to free trade with a developed and much bigger economic partner. The revised examples resulted beneficial and positive for both Chile and Peru and the facts presented support this research's ideas and hypothesis. Peru has to overcome, however, an educational gap that it has not been able to correct. Nonetheless, it has now more tools than Chile: the growth comes at a time where technological and trade development allows the country to benefit from its delay and achieve an overall development in a way that should enable welfare for the population if the future governments decide to act as is necessary.



## **6 Summary, Conclusions and Recommendations**

### **6.1 Summary and Conclusions**

As the final statement of previous chapter expressed, Peru has now tools to exploit its Free Trade Agreement with the European Union that countries like Chile did not have. The global situation and framework that made its explosive growth of the last decade possible as well as a continuous political stability and economic and governmental measures account for this. However, there is still a lot to do if the country wants to achieve the main goal of sustainable development with appropriate distribution of wealth and welfare of the population. As referred in the introduction, it is undeniable that trade is the key towards the overall development of a country, but the question was to what extent this specific FTA is relevant and positive for this goal, considering the development of foreign trade after the enforcement of the agreement and Peru's position as a developing economy entering into free trade with a much bigger and developed economic bloc. Because of the fact that the FTA in question is new and results cannot be conclusive, this research opted to provide a theory framework that supports free trade from the position of a developing economy and then support it with real facts of the FTA in question, different experts points of view and similar examples.

The hypothesis of this work was that The Free Trade Agreement between Peru and the European Union is important and positive for Peru in its search to widen and increase its export offer and foreign trade (traditional and non-traditional products) and to develop Peruvian local industries: all these facts will contribute to the country's development and improvement, to make it more attractive and competitive in the international environment. To achieve this goal, this researched determined following objectives: show that Free Trade is positive and that Free Trade Agreements are positive for Peru even in its position as a smaller trading partner and emerging economy; find available data to date showing the benefits of the FTA in question and refer to previous experiences of developing economies' FTAs with much larger trading partners that would also support the hypothesis.

The conclusions of this work succeeded in supporting the hypothesis and achieving the objectives:

- 1) In the theory part, this work succeeded in supporting that openness to trade is the main tool towards the desired development. Start was the comparative advantage principle by David Ricardo that provided the main idea behind foreign free trade: exchange of goods seeking to earn the most and provide the best to the local population. With that basis, this research reviewed different sources that supported free trade and showed that the benefits outweigh the downsides, especially in terms of foreign trade and foreign direct investment. In that part, the most important ideas this work rescues are the trade war concept by Krugman and Obstfeld (1994), which considered FTAs necessary to secure loyal trade relationships and Snorrason's (2012) statements that foreign trade is the escape to the disadvantage of being small, or, in this case, still a developing economy. It is in that sense that the theory part concludes the size difference and importance of the European Union for Peru made the FTA in question the logical step towards a clear and safe trade and investment framework, especially considering that Peru -as a developing economy- cannot avoid free trade for development, but anyway has to enter it as safe as possible to avoid risks.
- 2) The subscription of the FTA between Peru and the European Union is then supported by the theory; 95% of Peruvian agricultural products and 100% of Peruvian industrial products benefit from 0 tariffs since March 1<sup>st</sup> 2013 and the agreement provides a clear framework for Peruvian importers and exporters. Besides, imports coming from the EU also gained tariffs benefit, that allow local importers to save money and this translates into a price reduction to final consumers.
- 3) The trade results after the enforcement of the FTA are not the expected by previous studies. Graph 5 in Sub-chapter 4.2.2 showed that Peruvian exports to the EU in the period January-November in 2013 were reduced by 16.85%, compared to the figure corresponding the same period in 2012: export of traditional products was reduced by 23.77%, from FOB value USD 5,739,532,097 to USD 4,375,315,389. A simplistic look at these figures would lead to the

conclusion that Peru was wrong in making this trade agreement with the European Union, as it will not have a positive impact for the country. Such a statement would support the study made by the Research Center for Economy Policies and Development Solutions of Manchester University that considered this FTA not important for Peru as it states that neither in FDI, nor in exports or import Peru would benefit from results: that study concluded that export of non-traditional products, key in Peru's strategy for the country's development and transformation from a raw material exporter to a more developed economy, would not increase. A closer view at the figures, however, allows seeing that the overall negative conclusion of that study is not supported by facts: it is true and hence irrefutable that Peruvian exports to the EU decreased and imports coming from that bloc into the country increased, reducing therefore the trade balance that is nevertheless still positive for Peru. However, as the interviewees by this research helped to clarify, 2013 was an atypical year to analyze Peruvian foreign trade with its partners; the EU still had not recovered from the crisis and faced new problems during the year, the US had its well-known debt and financial problems. Together with China's deceleration, those facts contributed to an overall negative year for world's economy and trade. Peru, even though having still grown by more than 5%, cannot be alien to the globe's situation and was of course affected. The analysis of this FTA had to be more detailed.

- 4) A closer view to the available data showed that a different trend was observed in the export of non-traditional products; graph 5 reflected that export of non-traditional products between January and November 2013 increased by 6.61% to USD 1,805,681,288. This amount is higher than the figures for the non-traditional export of the whole year of 2008 and 2010, and is very close to the total figure achieved in 2012. To this research's point of view, supported by the interviewees' opinions, this is the best and clearest signal of the real impact of this FTA for Peru: even in a framework where Peruvian trade is suffering from the low prices of commodities and contraction of markets, that will most likely mean a deficit in the trade balance for 2013, the non-traditional exportation to the EU increased; a trend that, as explained before, is observed in almost every non-traditional

exportation figures trade partners Peru has a trade agreement with. This work has already explained the importance of this kind of exportation. Peru should aim at having these exports account for almost half of the country's total exports (Leon, 2013). In this sense, the importance and positive impact of this FTA to Peru is undeniable.

- 5) Imports from the EU grew from CIF value USD 3752,5 million between January and September 2012 to CIF USD 3973,7 million in the same period in 2013. As was explained in the theory framework, more imports do not necessarily mean a negative impact: to 2012 more than 50% of imported goods from the EU were capital goods, necessary for production of services or new products. ADEX data trade figures (2014) showed that there are products that came into Peru from the EU in 2013, but were not imported in the period 2008-2012: automotive for railways, helicopters of more than 2000kg, generators for eolian energy, barley that is not for sowing, among others. These are products that Peru does not produce but needs for its population and development of national infrastructure.
- 6) Previous experiences between developing economies also support the hypothesis made in this work, and helped overcoming the fact that as the analyzed topic is recent, hypothesis and statements in this research could not be considered fully supported by the discussion. The Free Trade Agreement between Peru and the US shows a positive impact after three years of enforcement. In those years traditional exportation increased by 21%; and non-traditional exportation in the same period expanded by 21% compared to 2008, last year without trade benefits. Peruvian imports from grew by 218% during these three years compared to the figure in 2008. The case of Chile also supports the statement that developing economies can benefit from free trade with bigger and more developed economic partners: between 2003 and 2011 commerce between Chile and the EU had increased by 135% and the country had an accumulated surplus of EUR 42,000 million to 2012. Chilean exports have grown at an average rate of 11%; imports have grown by an average of 13% in the same period.

To this point, it is clear that this research has achieved the objectives that support the hypothesis: it has shown that free trade is positive, free trade agreements are not only important and positive but also necessary for developing economies, the figures up to date reflect the desired development -at least in the main aspect, non-traditional exportation- and previous experiences support the statements. This work, however, sees in this FTA a wider and bigger impact. This research finds, it is unquestionable that the subscription of the FTA in question was necessary and logical in Peru's strategy. Besides, country's former experiences support this decision: according to Leon (2013) Peru's FTA with Canada accumulated an export increase of 456% after the first three years of this agreement, compared to the last year without tariffs benefits; the exporter value of non-traditional products grew by around 30%; 98% of new exported products to Canada were non-traditional and 495 new exporting companies were created, 69% of which were PYMES -small and micro companies-. Imports grew by an accumulated of 287% and most goods were raw materials for industry and agriculture. The trade balance in 2012 was positive for Peru: USD 2,857 million. Leon (2013) also summarizes the general figures of Peru's FTA with China: Peruvian export to that country grew by USD 12,897 million -or 216%- between 2009 and 2012; 2013 new products were exported, 96% of them were non-traditional products. Imports from China to Peru grew by 24% between the first and second year of this FTA; most of imports were capital goods for industry. The trade balance with China in 2012 was positive, USD 46 million. The FTA between Peru and South Korea meant for Peru an increase in the exportation of non-traditional products of 19%; 82 new exporting companies were created and shipped together a total value of USD 18.9 million; 42% of these companies were MYPES (Leon, 2013). Imports from South Korea were mainly consumer goods, like vehicles, or televisions, and construction materials: they grew by 23% after the first year of this FTA. Trade balance with that country for Peru was negative in 2010, USD -146 million, in 2012 it is USD-103 million. These figures and facts show that Peru is a country that is prepared for the FTA with the European Union. Peru has demonstrated that the subscription of the FTA in question came in the framework of a clear long term strategy and that decision is hence, as said before, unquestionable. These figures have shown the importance of FTA to the exportation of non-traditional products –whose

importance has already been explained- and also to the creation of the so-called PYMES: according to COMEX -Peruvian Society of Foreign Trade, (Sociedad de Comercio Exterior del Perú for its Spanish name)- PYMES contribute with 77% to employment and 42.1% to country's GDP. FTAs are one of the most important sources for the creation of PYMES and hence the importance of any FTA -including the one in question- to Peru's development.

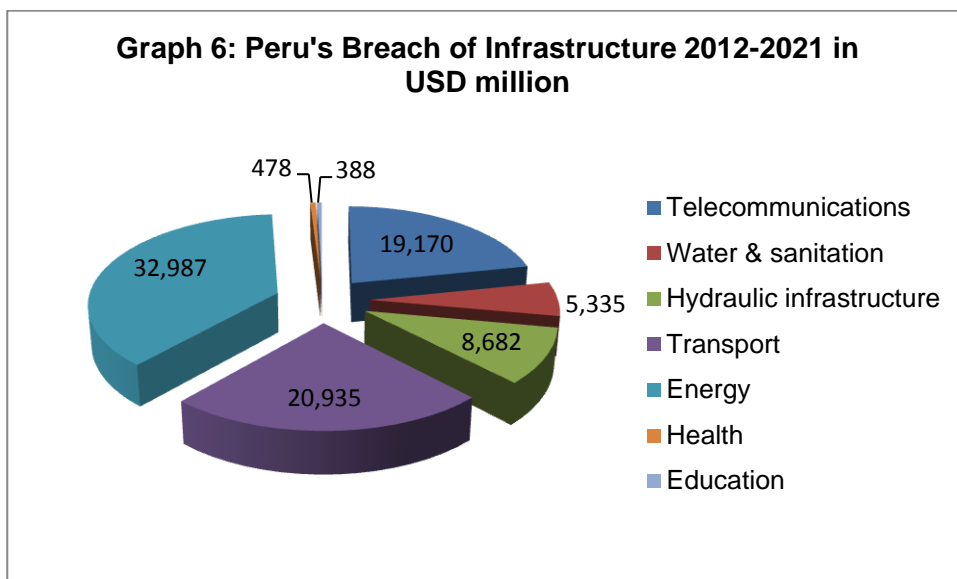
It is not possible to doubt that trade and investments are of utmost importance to Peru's development. In that sense, non-traditional products and the exportation of them is of primordial importance. The FTA between Peru and the European Union provides Peruvian exportation with the chance to compete on equal terms with any product in the EU local market, as they benefit from tariff elimination. Moreover, the complementarity of both markets reduces competition and risks, allowing more chance to grow combined with the fact that most of the EU market is not known to Peruvian exporters. The import of EU products does not present risk to Peruvian local producers; however, the government has, according to the agreement, the chance of a safeguard. In terms of investment, now EU capitals have more to invest in projects in Peru.

This research concludes that the analysis of figures available to date already shows that this FTA has a positive impact on Peru is undeniably important, as it was a necessary step towards Peru's strategy to attract investment and sustainable growth. The evolution from SGP Plus to this FTA gives predictable and clear ground to investments and export and import. Openness to trade is the key to the development of the country; FTAs with the most important economic blocs are necessary. In 12 years, Peruvian exportation has grown from USD 6,955 million to USD 46,268 million, 565% growth and 26% of the country's GDP (Leon, 2013) and this is the clearest symptom of the importance of any FTA. This FTA in particular, contributes to attract investment that will increase the well-being of the population, as it adds to the obligations of the government, making changes more difficult and hence providing more stability for investors, a fact of utmost importance for a country that has not shown political or social stability in the past, as the brief review of Peruvian history showed. This FTA will show more benefits in terms of foreign trade when the global economic environment improves its current situation; the way to recovery is probably going to start in 2014 (Carranza,

2013). However, the main importance and positive impact of this FTA lies in the fact that it adds to the previous ones: this research considers, that to a country like Peru, it is the combination of FTAs that provide juridical and political stability in order to achieve any of the country's goal. Even the analysis of Peru's first FTA -the one with the US- is not possible without analyzing the trend it started; for the FTA researched, the conclusion is the same: its importance and positive impact reflects of course in figures, but it is the trend it contributes to, the fact that it is the one more -and very important- proof in national and international eyes that Peru is following a clear national strategy and has no intentions of changing it any time soon; the fact that Peru improves its positions from receiver of unilateral benefits to party of an agreement that involves free trade as well as other aspects relating to economic integration and social and policy stability, like labour rights or environmental issues; the fact that Peru is on the road to development in more sense than purely economic growth. In order to achieve real sustainable growth there is the need for internal structural reforms that contribute to balanced economic growth. A growth based on export is good, growth based on non-traditional exportation is better; it has been demonstrated how this FTA affects the export offer. Nonetheless, it is not negative to grow on the basis of primary mining products. The question is, what the country can and will do to exploit the wealth generated by them. Trade in general generates wealth and job and this FTA will contribute to this, but this increase must be reflected in the reduction of poverty, improvement of education, and other aspects that, sometimes, seem to be forgotten when analyzing Peru's situation.

## **6.2 Recommendations**

Last sub-chapter mentioned the gap between Peru's economic growth and its government's real action with regard to aspects like education or infrastructure. Bonifaz *et al.* (2012) made a study on the breach of infrastructure Peru will have for the period 2012-2021, that accounted for a total of USD 87,975 million.



Source: AFIN 2012

Graph 6 shows that Peru needs a huge amount of investment for the development of basic services for the population such as water, energy or transport. It is a good step to keep on signing FTAs, but the country needs to exploit its benefits. It is no surprise that one of the current President's main statements to win votes in the election campaign was that he was not in favour of FTAs for Peru -especially the one with the US-. Even though he ended up accepting the undeniable benefits, the way wealth is distributed leads to many inhabitants in Peru not feeling the positive impact that government and media talk about. For them, this is invisible. To avoid this, it is necessary to have more regulation like law Nr. 30056, which should eliminate bureaucratic barriers to facilitate investments and boost productive development (Carranza, 2013). Moreover, it is necessary to modify regional governments that usually do not use all capital they have – especially mining regions- and do not provide the region's population with basic required services.

Graph 6 also helps to understand the lack of competitiveness Peru has in terms of infrastructure: barriers like lack of/poor road conditions do not contribute to the competitiveness of exportation. Moreover, even if entities like the port are concession, there is still a problem with the labour force: last PISA evaluation (Program for International Student Assessment) placed Peru last among 65. Competitiveness is only achieved with adequately prepared labour force that has to be educated. It is necessary



then to exploit better relationships coming from international agreement: EU Erasmus program for postgraduate scholarships is an example. Another aspect to consider is the need of specialized labour force, focusing on one special area. Peru has an institute - SENATI- that prepares its student in areas like IT or auto-mechanics, but the gap between supply of and demand for technical professionals is still high. Here Peru should exploit relationships to imitate systems like the German one that has as one of its pillar the dual apprenticeship program, where students can prepare in a wide variety of fields from bakery to foreign trade; this system combines classes tan institute with pre-professional working experiences at a company. This enables the preparation of skilled labour force that will respond to the specific requirements of the demand. To this goal, it is necessary that government and all members of the political dome understand that education is an investment and not expenditure.

In the FTA researched as well as in all others, a preliminary revision showed that Peru has 4,215 products it manufactures but does not export to the trading partners (Gonzales Interview, 2014). There is the need of information to producers and possible exporters so that these unexploited opportunities are taken advantage of. The FTA in question opens opportunities that local producers could exploit. This would ease the entry to new markets and would at the same time open new opportunities to more products. Peru should follow Chile's strategy for its FTA with the European Union-it is not surprising that many countries in Europe do not know that Chilean Pisco is actually Peruvian-. Peru should be aggressive and organize delegations to organize fairs in Europe that show the demand there the wide variety of Peruvian products available for exportation. Focus here should be made on non-traditional products.

The country should promote investment in R&D (Gestion, 2014). This will increase chances of exploiting the benefits this FTA and the others bring. FTA with the EU gives Peru the chance to attract more private investments, not necessarily from Europe. The strategy should be to concentrate on increasing chances of exploitation of opportunities and not only signing more FTAs. It is not coherent to have a transversal strategy that gives opportunities to all economic sectors, but without making significant efforts to create more developed industries.

Peru and Peruvian companies should aim at joint ventures with their European partners. In relevant investments for national interests, the State should aim at creating a private-public association.

Peru should be aggressive to show internationally the benefits private investors can have here due to stability and many FTAs. For example, the country should use this FTA to generate more aggressive investments from Europe in areas such as mining, where China is investing continuously to assure access to raw materials. Peru has many areas where it needs improvement and investment is the only way to heal the infrastructure deficit.

It is known to many that theory says that the pursuit of individual interests would lead society to welfare. Not few companies in Peru act blindly towards achieving their own success and do not incorporate all stakeholders in their view. It is necessary to continue and improve campaigns towards growth for everybody and not just a few.

This research showed the importance of the EU for non-traditional exportation; hence Peru and national companies should seek to develop this export offer. Peru has a lot of needs and areas to improve, but it is this that gives Peru the chance to grow and develop in all needed aspects. The tools are there.

## 7. Reference List

ADEX Data Trade (2014) ADEX Data Trade.[Software] Lima.

Andina (2014). Perú renueva SGP Plus con la Unión Europea hasta el 2015 [online]. Lima: Andina. Available from: <http://www.andina.com.pe/english/noticia-peru-renueva-sgp-plus-con-union-europea-hasta-2015-489255.aspx> [Accessed 6th January 2014].

APM Terminals (2013) *APM Terminals en Callao* [online]. Lima: APM Terminals. Available from: [http://www.apmterminals.com/americas/callao\\_es-pe/default.aspx](http://www.apmterminals.com/americas/callao_es-pe/default.aspx) [Accessed 30th December 2013].

Balassa, B. (1961) *The Theory of Economic Integration*. London: George Allen and Unwin.

Banco Central de Reserva del Perú. (2013) *Notas de Estudios del BCRP: Balanza Comercial Diciembre 2012* [online]. Lima: Peruvian Central Bank. Available from: <http://www.bcrp.gob.pe/docs/Publicaciones/Notas-Estudios/2013/nota-de-estudios-08-2013.pdf> [Accessed 23rd December 2013].

Bander, A. & Ortega, V. (2003) *El comercio internacional y la agudización de las contradicciones del capitalismo contemporáneo* [online]. La Habana: Filial Universitaria Jesús Montané Oropesa. Available from: [http://www.nodo50.org/cubasi gloXXI/congreso/bandera\\_10abr03.pdf](http://www.nodo50.org/cubasi gloXXI/congreso/bandera_10abr03.pdf) [Accessed 25th December 2013].

BlackRock Investment Institute (2014) *BSRI Quarterly Update*. [online]. United States: BlackRock Investment Institute. Available from: <http://www.blackrock.com/corporate/en-ip/literature/whitepaper/bii-welcome-to-the-club-bsri-q4-2013-international.pdf> [Accessed 19th January 2014].

Blanc, A. (2005) *Los tres Pilares del Acuerdo de Asociación Chile-Unión Europea: Diálogo Político, Cooperación y Comercio* Santiago de Chile: Estudios Internacionales Vol. 38, N.151.

Bonifaz et al. (2012) *Plan Nacional de Infraestructura 2012-2021*[online]. Lima: AFIN: Asociación para el Fomento de la Infraestructura Nacional. Available from: [http://www.afin.org.pe/images/publicaciones/estudios/plan\\_nacional\\_de\\_infraestructura\\_2012\\_2021.pdf](http://www.afin.org.pe/images/publicaciones/estudios/plan_nacional_de_infraestructura_2012_2021.pdf)[Accessed 10th January 2014].

Cámara Nacional de Comercio, Producción y Servicios. (2011) *Perú: Oferta Exportable por Regiones* [online]. Lima: Cámara Nacional de Comercio, Producción y Servicios. Available from: <http://www.peruembassy.se/docs/OfertaExportable.pdf> [Accessed 6th January 2014].

Cámara Peruano-Alemana de Comercio e Industria (2014) *Comercio Exterior Enero-Noviembre 2013*. Lima: German-Peruvian Chamber of Commerce and Industry.

Cantuarias, F. & Stucchi López, P. (2013) *Acuerdo Comercial entre Perú, Colombia y la Unión Europea: Contenido, Análisis, Aplicación*. 1st ed. Lima: Universidad del Pacífico.

Capuñay Miguel A. (2013) *Bienvenido TLC Perú-Unión Europea* [online]. Lima: Peruvian Official Newspaper El Peruano. Available from: <http://www.elperuano.com.pe/edicion/noticia-bienvenido-tlc-peruunion-europea-2587.aspx#.UuQYghDv7IU> [Accessed 20th October 2013].

Carranza, L. (2013) *Situación Económica y Perspectivas* In: *Presentación ante la Comisión de Economía, Banca, Finanzas e Inteligencia Financiera del Congreso de la República: proceedings of a conference*, Lima, 2013. Lima: Congreso de la República.

Cavusgil, S. T. et al (2008) *International Business: Strategy, Management, and the New Realities*. International Edition. New Jersey: Pearson .

Comex (2010) *PYME: Que su tamaño no te engañe*[online]. Lima: Comex. Available from: [http://www.comexperu.org.pe/archivos%5Crevista%5Csetiembre09%5Cactualidad\\_145.pdf](http://www.comexperu.org.pe/archivos%5Crevista%5Csetiembre09%5Cactualidad_145.pdf) [Accessed 6th January 2014].

Contreras, C. & Cueto, M. (2013) *Historia del Perú Contemporáneo*. Lima: Pontificia Universidad Católica del Perú

Crabtree, J. (2005) *Alan García en el Poder*. Lima: Peisa

Dirección General de Negociaciones Multilaterales y Regionales de Mexico (2012) *Foro de Cooperación Económica Asia-Pacífico (APEC)*. [online]. Mexico D.F. Secretaría de Economía. Available from: [http://www.economia.gob.mx/files/transparencia/informe\\_APF/memorias/12\\_md\\_apec\\_sce.pdf](http://www.economia.gob.mx/files/transparencia/informe_APF/memorias/12_md_apec_sce.pdf) [Accessed 15th December 2013].

Dominguez, R. (2007) *NAFTA: Will it ever have an EU Profile* [online]. Miami: Jean Monnet/Robert Schuman Paper Series. Available from: [http://aei.pitt.edu/8181/1/Dominguez\\_NAFTA\\_WillitEver\\_long07.pdf](http://aei.pitt.edu/8181/1/Dominguez_NAFTA_WillitEver_long07.pdf) [Accessed 24th December 2013].

DP World (2013) *Sobre Nosotros* [online]. Lima: DP World. Available from: [http://www.dpworldcallao.com.pe/faces/home;jsessionid=cR18Sk4YwMLnPZh01xFvWwmyYJcGSPx8zC7v1n210X4ZnmJcm4H!-210155471?\\_afLoop=5422883819610734&\\_afWindowMode=0&\\_afWindowId=null#%2Foracle%2Fwebcenter%2Fportalapp%2Fpages%2Fnosotros%2Fnosotros.jspx%40%3Fadf.ctrl-state%3Djnk66muaf\\_4](http://www.dpworldcallao.com.pe/faces/home;jsessionid=cR18Sk4YwMLnPZh01xFvWwmyYJcGSPx8zC7v1n210X4ZnmJcm4H!-210155471?_afLoop=5422883819610734&_afWindowMode=0&_afWindowId=null#%2Foracle%2Fwebcenter%2Fportalapp%2Fpages%2Fnosotros%2Fnosotros.jspx%40%3Fadf.ctrl-state%3Djnk66muaf_4) [Accessed 30th December 2013].

El Comercio (2013) *Lima tiene 8'500.842 habitantes: ¿Hay más hombres o más mujeres?*[online]. Lima: El Comercio Newspaper. Available from: <http://elcomercio.pe/lima/sucesos/lima-tiene-8500842-habitantes-hay-mas-hombres-mas-mujeres-noticia-1524307> [Accessed 1st January 2014].

European Commission (2012) Peru [online].European Commission. Available from: [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_111556.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111556.pdf) [Accessed 16th November 2013].

European Commission. (2012) *Unión Europea y Chile: Comercio e Inversión*[online]. Luxembourg: European Commission. Available from: [http://eeas.europa.eu/delegations/chile/documents/press\\_corner/folleto\\_dg\\_trade.es.pdf](http://eeas.europa.eu/delegations/chile/documents/press_corner/folleto_dg_trade.es.pdf) [Accessed 3rd January 2014].

García-Corrochano, L. (2013) El Tratado de Libre Comercio entre el Perú y Colombia con la Unión Europea desde la perspectiva del derecho internacional público. In: Cantuarias, F. and Stucchi López, P. (eds.) *Acuerdo Comercial entre Perú, Colombia y la Unión Europea: Contenido, Análisis y Aplicación*. Lima: Universidad del Pacífico. pp. 41-61.

Gestión (2014) *Perú crecería 5.7% este 2014, proyectó Banco Santander* [online]. Lima: Gestión Business Newspaper. Available from: <http://gestion.pe/economia/peru-economia-peruana-creceria-57-2014-proyecto-banco-santander-2085147> [Accessed 2nd January 2014].

Hill, Charles (2011) *International Business: Competing in the Global Marketplace*. 8<sup>th</sup> ed. New York: McGraw-Hill.

INEI: Instituto Nacional de Estadística e Informática (2014) Evolución de las Exportaciones e Importaciones – Noviembre 2013. [online]. Lima: Peruvian National Institute of Statistics and Informatics. Available from: <http://www.inei.gob.pe/media/MenuRecursivo/boletines/export-import-noviembre-2013.pdf>[Accessed 11th January 2014].

Krugman, P. & Obstfeld, M. (1994) *Economía Internacional, Teoría y Política*. ed. in Spanish. Madrid: McGraw-Hill / Interamericana de España S.A.

Krugman, P. (1996) A Country is not a Company [online]. Cambridge. Harvard Business Review. Available from: <http://www.afi.es/EO/Paul%20Krugman%20A%20country%20is%20not%20a%20company.pdf> [Accessed 12th November 2013].

Lawrence, Robert (1997) *Preferential Trading Arrangements: The traditional and the new*. Center for Economic Policy Research (CEPR) and the Egyptian Center for Economic Studies (ECES).

Leon, L. (2013) *Acuerdos Comerciales del Perú*. Lima: Congreso de la República.

Mankiw, N. (2009) *Principles of Economics*. 5<sup>th</sup>ed . Mason: Cengage Learning.

Ministerio de Comercio Exterior y Turismo. (2013) *Acuerdos Comerciales del Perú: Acuerdo Comercial entre Perú y la Unión Europea* [online]. Lima: Peruvian Ministry of Foreign Trade and Tourism. Available from:

[http://www.acuerdoscomerciales.gob.pe/index.php?option=com\\_content&view=category&layout=blog&id=50&Itemid=73](http://www.acuerdoscomerciales.gob.pe/index.php?option=com_content&view=category&layout=blog&id=50&Itemid=73) [Accessed 18th October 2013].

Ministerio de Comercio Exterior y Turismo. (2013) *Acuerdos Comerciales del Perú: Acuerdo Comercial entre Perú y la Unión Europea - Antecedentes* [online]. Lima: Peruvian Ministry of Foreign Trade and Tourism. Available from: [http://www.acuerdoscomerciales.gob.pe/index.php?option=com\\_content&view=category&layout=blog&id=51&Itemid=74](http://www.acuerdoscomerciales.gob.pe/index.php?option=com_content&view=category&layout=blog&id=51&Itemid=74) [Accessed 18th October 2013].

Ministerio de Comercio Exterior y Turismo. (2013) *Exportaciones a Septiembre* [online]. Lima: Peruvian Ministry of Foreign Trade and Tourism. Available from: [http://www.mincetur.gob.pe/newweb/portals/0/prensa/2013/noticia\\_174\\_2013.html](http://www.mincetur.gob.pe/newweb/portals/0/prensa/2013/noticia_174_2013.html) [Accessed 18th October 2013].

National Geographic (2004) *Atlas: America II*. Edition in Spanish. Lima: RBA Coleccionables S.A.

Nelson, R. (2008) Poor Logistics hindering Latin American Economy. Lloyd's List n.k.

Oficina General de Estudios Económicos del Ministerio de Comercio Exterior y Turismo. (2013) *Reporte de Comercio Bilateral Perú-Unión Europea (UE-28) III Trim-2013* [online]. Lima: Peruvian Ministry of Foreign Trade and Tourism. Available from: [http://www.acuerdoscomerciales.gob.pe/images/stories/Reporte\\_bilateral/europa/union\\_europea\\_UE\\_28\\_iii.pdf](http://www.acuerdoscomerciales.gob.pe/images/stories/Reporte_bilateral/europa/union_europea_UE_28_iii.pdf) [Accessed 10th November 2013].

Oficina General de Estudios Económicos del Ministerio de Comercio Exterior y Turismo. (2013) *Reporte de Comercio Bilateral Perú-Unión Europea (UE-27) I Trim-2013*. Lima: Peruvian Ministry of Foreign Trade and Tourism.

Oficina General de Estudios Económicos del Ministerio de Comercio Exterior y Turismo. (2012) *Estudio de Aprovechamiento del TLC Perú – EEUU: Tercer Año de Vigencia del TLC* [online]. Lima: Peruvian Ministry of Foreign Trade and Tourism. Available from: [http://www.acuerdoscomerciales.gob.pe/images/stories/eeuu/docs/estudio\\_aprovechamiento\\_tlc\\_eeuu\\_3\\_ano\\_ogee\\_oe\\_mayo\\_2012.pdf](http://www.acuerdoscomerciales.gob.pe/images/stories/eeuu/docs/estudio_aprovechamiento_tlc_eeuu_3_ano_ogee_oe_mayo_2012.pdf) [Accessed 24th December 2013].

Oficina General de Estudios Económicos. (2013) *Evolución de las Exportaciones 2013* [online]. Lima: Peruvian Ministry of Foreign Trade and Tourism. Available from: [http://www.mincetur.gob.pe/newweb/Portals/0/documentos/comercio/RM\\_Expo\\_Octubre\\_2013.pdf](http://www.mincetur.gob.pe/newweb/Portals/0/documentos/comercio/RM_Expo_Octubre_2013.pdf) [Accessed 12th January 2013].

Parker, Javier (2013) *Cuando se dispone de excedentes, el conocimiento hace la diferencia* [online]. Lima: Gestión Business Newspaper. Available from: <http://gestion.pe/tu-dinero/cuando-se-dispone-excedentes-conocimiento-hace-diferencia-2077153> [Accessed 20th December 2013].

Pease, H. & Romero, G. (2013) *La Política en el Perú del Siglo XX*. Lima: Pontificia Universidad Católica del Perú

Perú21. (2013) *Entró en vigencia la ley del retorno* [online]. Lima: Perú21 Newspaper. Available from: <http://peru21.pe/economia/entro-vigencia-ley-retorno-2144875> [Accessed 18th December 2013].

Rugman, A. & Collinson, S. (2009) *International Business*. 5<sup>th</sup> ed. : Prentice Hall

Snorrason, S.T. (2012) *Asymmetric Economic Integration Size Characteristics of Economies, Trade Costs and Welfare*. Berlin: Physica- Verlag a Springer Company.

Stucchi López, P. (2013) La liberación comercial y las medidas de defensa comercial. In: Cantuarias, F. and Stucchi López, P. (eds.) *Acuerdo Comercial entre Perú, Colombia y la Unión Europea: Contenido, Análisis y Aplicación*. Lima: Universidad del Pacífico. pp. 193-239.



Tamayo, J. (2010) *Nuevo Compendio de Historia del Perú*. ed. 2010. Lima: Wari S.A.C.

Vargas, H. (2013) *Las razones del “milagro peruano” que amenaza el liderazgo económico de Chile*[online].Santiago de Chile: La Segunda online. Available from: <http://www.lasegunda.com/Noticias/Economia/2013/09/881789/las-razones-del-milagro-peruano-que-amenaza-el-liderazgo-economico-de-chile> [Accessed 5th January2014].

Vice Ministerio de Comercio Exterior y Turismo.(2012) *Informe de Beneficios del Acuerdo Comercial entre la Unión Europea y Perú-Colombia*.Lima: Peruvian Ministry of Foreign Trade and Tourism.

Viner, J. (1950) *The Customs Union Issue*. New York: Carnegie Endowment for International Peace.

## 8. Bibliography

ADEX: Asociación de Exportadores (2014) *Productos con valor agregado no impiden caída de exportaciones a la UE* [online]. Lima: ADEX Peruvian Exporters Association. Available from: [http://www.adexperu.org.pe/notas/notastxt.htm#PRODUCTOS\\_CON\\_VALOR\\_AGREGADO\\_NO\\_IMPIDEN\\_CAÍDA\\_DE\\_EXPORTACIONES\\_A\\_LA\\_UE](http://www.adexperu.org.pe/notas/notastxt.htm#PRODUCTOS_CON_VALOR_AGREGADO_NO_IMPIDEN_CAÍDA_DE_EXPORTACIONES_A_LA_UE) [Accessed 14<sup>th</sup> January 2014].

Cruz, D. (2013) *¿Qué obras hacen falta para mejorar el acceso al puerto del Callao?*[online]. Lima: El Comercio Newspaper. Available from: <http://elcomercio.pe/economia/1653996/noticia-que-obras-hacen-falta-modernizacion-puerto-callao> [Accessed 12<sup>th</sup> December 2013].

Durand, F. (1982) *La Década Frustrada, Los Industriales y el Poder*. Lima: Desco.

El Peruano Newspaper (2013) *TLC, Escudos para exportar*[online]. Lima: El Peruano – Peruvian Government Official Newspaper. Available from: <http://www.elperuano.pe/edicion/noticia-tlc-escudos-para-exportar-12059.aspx#.Ut2IXRDv7IW> [Accessed 8<sup>th</sup> October 2013].

European Commission – Directorate General for Trade.(2012) *Evaluación del Impacto Económico del Pilar Comercial del Acuerdo de Asociación UE-Chile* [online]. Paris: European Commission. Available from: [http://trade.ec.europa.eu/doclib/docs/2012/september/tradoc\\_149945.pdf](http://trade.ec.europa.eu/doclib/docs/2012/september/tradoc_149945.pdf) [Accessed 11h January2014].

Gestión (2013) *El editorial de Gestión: “El peso de las exportaciones”*[online]. Lima: Gestión Business Newspaper. Available from: <http://gestion.pe/economia/editorial-gestion-peso-exportaciones-2079162> [Accessed 7<sup>th</sup> November 2013].

Gomez, R. (n.k.) *Agricultura Comercial Moderna en el Perú: El Caso de la Exportación No Tradicional (1995-2007)*. Lima: SEPIA XII.

La República (2012) *TLC con la Unión Europea también tiene impactos negativos para el Perú*[online]. Lima: La República Newspaper. Available from: <http://www.larepublica.pe/17-12-2012/tlc-con-la-union-europea-tambien-tiene-impactos-negativos-para-el-peru>[Accessed 15<sup>th</sup> October 2013].

Ministerio de Economía y Finanzas (2012) *Agenda de Competitividad 2012-2013* [online]. Lima: Peruvian Ministry of Economics and Finance. Available from: [http://www.mef.gob.pe/contenidos/competitiv/documentos/Agenda Competitividad 2012 2013.pdf](http://www.mef.gob.pe/contenidos/competitiv/documentos/Agenda%20Competitividad%2012%202013.pdf) [Accessed 1st November 2013].

Ministerio de Relaciones Exteriores (2012) *El Desarrollo Sostenible del Perú: Un Panorama General de las Instituciones, Mecanismos, Políticas y Objetivos*[online]. Lima: Peruvian Ministry of Foreign Affairs. Available from: [http://www.acuerdoscomerciales.gob.pe/images/stories/union\\_europea/peru\\_desarrollo\\_sostenible.pdf](http://www.acuerdoscomerciales.gob.pe/images/stories/union_europea/peru_desarrollo_sostenible.pdf) [Accessed 13<sup>th</sup> December 2013].

Morón, E. (2005) *Evaluación del Impacto del TLC en la Economía Peruana*. Lima: Universidad del Pacífico.

Oppenheimer, A. (2006) *Cuentos Chinos: El engaño de Washington, la mentira populista y la esperanza de América Latina*. 9th ed. Buenos Aires: Editorial Sudamericana

Parodi, C. (2013) *Perú: Crecimiento Económico y otras cifras*. 8 March 2013. *Economía para todos*. [online]. Available from: <http://blogs.gestion.pe/economiaparatodos/2013/03/peru-crecimiento-economico-y-o.html> [Accessed 1<sup>st</sup> October 2013].

Standard & Poor's (2013) *Colombia y Perú: Su ruta hacia alzas de calificación*[online]. New York: Standard & Poor's Rating Services. Available from: [http://www.standardandpoors.com/servlet/BlobServer?blobheadername3=MDT-Type&blobcol=urldata&blobtable=MungoBlobs&blobheadervalue2=inline%3B+filena me%3D13.03.11\\_ColombiaPeruUpgradesPath.pdf&blobheadername2=Content-Disposition&blobheadervalue1=application%2Fpdf&blobkey=id&blobheadername1=content-type&blobwhere=1244258092850&blobheadervalue3=UTF-8](http://www.standardandpoors.com/servlet/BlobServer?blobheadername3=MDT-Type&blobcol=urldata&blobtable=MungoBlobs&blobheadervalue2=inline%3B+filena me%3D13.03.11_ColombiaPeruUpgradesPath.pdf&blobheadername2=Content-Disposition&blobheadervalue1=application%2Fpdf&blobkey=id&blobheadername1=content-type&blobwhere=1244258092850&blobheadervalue3=UTF-8) [Accessed 1<sup>st</sup> January 2014].

Standard & Poor's (2013) *Top 20 Financial Institutions in Peru* [online]. New York: Standard & Poor's Rating Services. Available from: [http://www.standardandpoors.com/servlet/BlobServer?blobheadername3=MDT-Type&blobcol=urldata&blobtable=MungoBlobs&blobheadervalue2=inline%3B+filena me%3D13.10.21\\_Top20PeruFinancialInsitutions.pdf&blobheadername2=Content-Disposition&blobheadervalue1=application%2Fpdf&blobkey=id&blobheadername1=content-type&blobwhere=1244335954605&blobheadervalue3=UTF-8](http://www.standardandpoors.com/servlet/BlobServer?blobheadername3=MDT-Type&blobcol=urldata&blobtable=MungoBlobs&blobheadervalue2=inline%3B+filena me%3D13.10.21_Top20PeruFinancialInsitutions.pdf&blobheadername2=Content-Disposition&blobheadervalue1=application%2Fpdf&blobkey=id&blobheadername1=content-type&blobwhere=1244335954605&blobheadervalue3=UTF-8) [Accessed 1<sup>st</sup> January 2014].

Winkelried, D. & Saldarriaga, M. (2012) *Socios Comerciales y Crecimiento Económico* [online]. Lima: Banco Central de Reserva del Perú. Available from: <http://www.bcrp.gob.pe/docs/Publicaciones/Revista-Moneda/moneda-152/moneda-152-08.pdf> [Accessed 31st December 2013].

## 9 Appendices

The original text of the agreement could not be included due the length of the same. It is available on the web in Peruvian Government's official web pages of trade agreements<sup>1</sup>. The following Interviews took place when the researcher travelled from Hamburg to Lima: June 2013 and January 2014. The recorded interviews consisted of a conversation with the basis of the questions made by the researcher; interviews were not answers to questionnaires. Due to this fact, this research presents here a summary of the interviews, organized as question and answer by the researcher after the interviews took place. Interviews with Mr. Urbina and Mr. Gonzales were made in Spanish, while Interview with Mr. Zehnle was made in German.

### 9.1 Summary: Interview with Mr. Urbina, Director for North America and Europe at the Peruvian Ministry of Foreign Trade and Tourism (June 27<sup>th</sup> 2013)

**Researcher (R):***Mincetur Studies from 2012 expected an increase in export and trade balance for Peru after the enforcement of the FTA with the EU. It seems, however, that exports have decreased and even trade balance is showing a reduction. Is then the FTA negative and not important for Peru?*

**Mr. Urbina (U):**The reduction of export and increase of import was not directly related to the FTA in question, but to the situation of the Euro Zone. If you look at figures of Peruvian trade in general, you will see that this is not a good years for us. Nevertheless, this also shows that what is happening with EU trade is not a consequence of the FTA from March. Besides, the EU situation combines with US

---

<sup>1</sup> [http://www.acuerdoscomerciales.gob.pe/index.php?option=com\\_content&view=category&layout=blog&id=52&Itemid=75](http://www.acuerdoscomerciales.gob.pe/index.php?option=com_content&view=category&layout=blog&id=52&Itemid=75)

financial problems and China's slow-down. Combine problems in 3 of our main markets with the reduction in the prices of mining products and you will have the answer to the situation we are facing. There is no way to say that this FTA is going to have a negative impact or will be not important for Peru.

*R: However, the figures I have to date do not show any positive effect.*

**U:** That is not completely right. A report that is not available right now shows that the exportation of non-traditional products has increased. As a Peruvian, you understand why this is of utmost importance. We are traditionally a country that exports raw materials, but the non-traditional products have added value; they have a transformation process and have an important level of industrialization for Peruvian standards.

*R: And are there any other positive effects for Peru?*

**U:** You have already seen that EU FDI in Peru and Peruvian exportation to the EU have always the same EU countries. This FTA gives Peru the chance to compete in new markets and find new consumers, like Denmark or Sweden, as Peru will have a benefit that will last in time and also make it possible to start marketing in those regions. There is now no disadvantage for Peruvian products competing in the EU and this makes it possible to develop from our traditional markets to new ones. Traditional markets can be used as platforms towards the new ones. The SGP Plus provide Peru with an unilateral benefit that did not enable long term planning, as Peru had no right to decide if we will continue benefiting from it or not. The FTA is a multilateral agreement where Peru is one the parties. It was negotiated considering all needs of Peruvian exporters, importers and local industries.

*R: This means that it is important for us to attract more EU investment, even when to 2012 more than 50% of FDI here was from the EU?*

**U:** Yes, it is. Peru needs investment and technology transfer to develop local industries and infrastructure. Hence, if EU capital comes it is welcome. Moreover, private international investments provide a better image of the country that in

combination with this FTA and the others will make Peru more attractive to more international investments. Peru needs FTAs and private investments as they are the only way to achieve the desired development. There are projects like the subway in Lima or the airport in Cusco and it is always good to widen the possibilities of investors; the FTA with the EU makes Peru attractive for other EU investors besides the traditional ones.

*R: Then, to you opinion and to the Ministry, this FTA is not only good, but also necessary?*

**U:** Of course, all we have talked about shows this. Besides, when the financial problems stop, the results of this FTA will be clearer. Even this year, you will be able to see the development of non-traditional exportation.

## 9.2 Summary: Interview with Mr. Gonzales, Manager of Economic Studies at ADEX, Peruvian Exporters Association (January 7<sup>th</sup> 2014)

***Researcher (R):** What is your opinion as a member of ADEX regarding the FTA in question? Do you believe it will be positive or negative for Peru, especially as it is a developing economy trading with a developed and much bigger economic bloc?*

**Mr. Gonzales (G):** The first thing you have to consider is Peruvian History. Peru has for the first time achieved 11 years of sustainable growth, and they coincide the Peru opening to trade. Besides, there is a variety of studies that support the subscription of this FTA. You have mentioned that results are not the expected ones, but Peru's decision of making this FTA is not questionable. We suffered before the trap of low income: only 4 million Peruvians had formal jobs and the wages and salaries were low. As a small market, Peru was not attractive for investment as they would not pay off in time; and you know investments mean growth. You remember how many people were reluctant about the FTA with the US, but now it is undeniable that Peru finds in foreign markets the chance to grow. The

FTA with the US started Peruvian openness to trade. The experiences support Peru's decision: The US is as important as the EU and Peru has not had any problems. Moreover, you cannot question a decision that is made by a government or a country that is following a continuous strategy. Even if this year figures are not the best, you have to consider that there is a team of experts in economic, political and many other aspects that support the FTA. We are well aware that we are a developing economy, but rejecting trade and FTAs is not the solution. On the contrary, with the FTA we can gain a sustainable and clear framework for business that is really important for any country, especially a developing one that has to open to trade to grow. To me that Peru is a developing country is an important aspect to consider, but not an argument to discuss if this FTA is positive for Peru.

*R: This means that you do not see any risk in this FTA for Peruvian industries?*

*What about the subsidies the EU makes to some agricultural products?*

**G:** Peruvian and European Union markets are complementary and Peruvian exports do not compete in the EU markets with products that are locally subsidized. ADEX studies show that dairy sector could be considered sensitive, but that is not really relevant to Peruvian industry. There are other industries that many people have said can be or will be problems: Peruvian wheat is important in the local market and it will compete with European wheat on equal conditions; but the one produced in Peru is not useful for the preparation of bread, which is the main destination of EU wheat. You have also the case of Barley that is produced in the South American Andean countries is also competing now against European barley. But it does actually not compete with Andean barley, because it is used for the production of beer, a process for which the latter is not usable. These are examples that show what I am saying. I have participated in the board that assisted the subscription with this FTA and I was active in the negotiation rounds and therefore I can say with no doubt that there is not a sensitive industry important for Peru that will suffer because of this FTA.



*R: I want to come back to the figures available to date: how would you analyze the results until now?*

**G:** Before FTAs, growth came from government spending too much money, and this meant more imports, which in turn will have an effect on the exchange rate. You did not exist in the 80s and suppose were a baby in the beginning of the 90s but I am sure you have taken a look at the exchange rate in that period. Trade agreements gave us the chance to grow with exports and generate own profit; according ADEX studies from my area, we have around USD 65,000 million accumulated: enough to export nothing for 2 years and still be able to handle external commitments. As I have said, exportation and private investment are the mainstays for our economic growth. The non-traditional exportation with the EU have grown even in this atypical year. This is the key to our development and growth and this figure should be your best argument to support that this FTA is already having a positive impact, even if general balance does not reflect this. You have to look at the details. Besides, our economic integration with trading partners due to the 18 Trade agreements coincides with our development in the last few years. That is another indicator of the positive impact of an FTA in general, even in Peru's position as a developing economy. So far, there is no national production activity that has been affected by any of the FTAS

*R: Then, the importance of this FTA lies in the export offer?*

**G:** Exportation and investment. This FTA has shown its importance with the non-traditional products and their export, but it also gives the country and private investor with juridical stability and elimination of extreme governmental changes that had traditionally been a risk in Latin America. Besides, EU investors can benefit from Peru's trade agreements and will besides have same conditions than local investors: this makes us more attractive towards private investment in general. I say that this FTA is 100% positive and important for Peru. It is now time for us to improve local workforce and infrastructure to exploit the opportunities. We have wealth from mining products and we should use it to improve and develop our export offer.

9.3 Summary: Interview with Mr. Zehnle, Director Manager of the German-Peruvian Chamber of Industry and Commerce in Lima (January 9<sup>th</sup> 2014)

**Researcher (R):** *What would you say about the figures? They show a reduction of trade and Peruvian exports.*

**Mr. Zehnle (Z):** The main part of that reduction comes from price effects due to the drop of mineral prices. The exported quantity has obviously decreased but the main problems were the prices. Nonetheless the German Chamber of Industry and Commerce expects foreign trade between Germany and Peru to double within the next two years due to this FTA. We also expect German FDI in Peru to multiply by 3 within the next 3 years, due to the economic development of both countries. I think you want me to say whether this FTA is positive for Peru. I say this to you; Germany or Europe will not negotiate a trade agreement if they do not see a positive impact for both parties. Besides, that Peru is now able to negotiate a trade agreement in equal terms with us is very relevant as the importance of Peru as a trading partner is being recognized.

**R:** *What are the risks for Peru in terms of FDI?*

**Z:** Peru needs investment for its infrastructure and industries. It is today really hard possible to have physical distribution -ground transportation- in Peru, since the road and railway infrastructure is not good. Peru should aim at supporting the legal and economic framework and security that investors in the country has thanks to this FTA and the other ones with physical infrastructure: Peru has here the opportunity to exploit this FTA and all others in terms of Foreign Direct Investment. Even if more than 50% of FDI in Peru already comes from EU capital, as the FTA offers chances to attract investments from other countries that have not typically invested in the country. Besides, FDI helps overcoming possible lack of capitals in Peru for certain investments needed, it develops the economy by bringing job opportunities and provides technological transfer, due to the fact that private investment will almost always focus on high tech areas or the development and improvement of processes used in the country they are investing in. I do not see a risk here. On the contrary, it

would be nice for Peru to have more companies like Heinz Glass, which has Peru as the center for its production in the region.

*R: Then can I say that to you and the Chamber the FTA is important and positive for both, Peru and the EU?*

**Z:** Yes. I already told you about what we expect for foreign trade. We have even collaborated to set up Peruvian trade offices in new cities, like Hamburg; you know Peru had no trade office there even though Hamburg is the second most important port. It is only important to point out that Peru has to improve its infrastructure and workforce. I see as very positive that you are subscribing many trade agreements, but I have to say that that should be reflected in more improvements than tariffs elimination.

