BILATERAL INVESTMENT FLOWS BETWEEN CHILE & PERU[1][2]

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INTRODUCTION

Although there is no agreement on a definition of foreign direct investment (FDI), it tends to be associated with "one that comes from a natural or legal person from abroad, whose capital is invested in a country with the intention of having a direct long-term influence on the business' development. This investment can be fulfilled through participation in other established companies or through the establishment of a subsidiary of the investor company" (Ramírez, Florez, 2006). Particularly, it is sought to differentiate FDI from portfolio investment, which is carried out by the stock market in search of short-term returns. This variety of definitions comes not only from academia, but also from governments and international organizations, many of which have developed their own definitions of FDI, depending on their approach to the subject. Since there are multiple approaches, with minimum thresholds to qualify as FDI or criteria for including non-monetary contributions, statistics may vary between sources. These definitions do not differ essentially, however they do have an impact on the investment accounting and make it difficult to compare between countries and over time.

The Organization for Economic Cooperation and Development (OECD) defines FDI as cross-border flow rate by a resident of an economy – direct investor- with the objective of establishing a lasting interest on a resident company in an economy other than that of its nationality (2008).

Around the concept of FDI are several classifications. The present study examines the one that explains the phenomenon considering the potential of the receiver economy as a determining factor on the flow. On that basis, the investor allocates its resources on the target market. Thus, four categories are suggested: a) Natural resource-seeking: the investor is basically oriented to the extraction of natural resources and, therefore, interested in the export of commodities, b) Market-seeking: the investor is interested in the potential related to the industry and agents market, c) Efficiency-seeking: in this case, the investor determines its target market by focusing on higher added value activities, d) Strategic asset-seeking (innovation-seeking): a recent category which suggests that the investor is focused on sectors where more intensive use of high technology is needed (Dunnig, 1994).

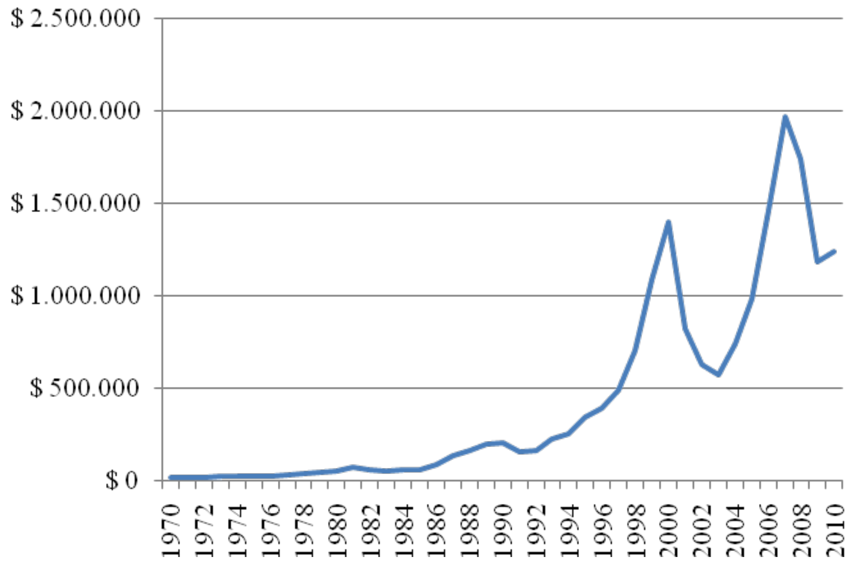
This classification allows us to understand the type of FDI that operates in Latin America, its nature and opportunities. Categories a) and b), the most common in the region, have been benefiting certain sectors for a long time, to the point of becoming key industries for local economies. In the case of categories c) and d), compared with the first two, have become the most desired investment by receiver States, as their industrial development involves processes that generate higher value added and require intermediate goods and services that demand the intensive use of technology, which is desirable for developing countries as it not only creates value in one specific sector, but also generates positive externalities to the rest of the economy.

Finally, the entry forms to a new market of a company are basically performed through three mechanisms: greenfield, brownfield and joint venture. Greenfield FDI is the FDI that starts from scratch, building the company and accomplishing all conditions and requirements to operate in a third market. By contrast, brownfield FDI is one that buys an asset from another company to start or expand operations. This may be done through acquisitions or mergers. The joint venture responds to the need for local expertise to market penetration. This need can arise from legal (minimum property), cultural (knowledge of the market and consumer habits) or other obligations.

The evolution of FDI in the world and Latin America

FDI has experienced exponential growth since the late eighties (Figure 1). Unlike other international flows (such as trade in goods and services), FDI is much more sensitive to international recessions, highlighting the falls post Asian (2000-2003) and financial (2009 -?) crisis. This sensitivity can be observed both in times of depression and expansion, as after the Asian crisis of the late nineties, FDI only took a couple of years to return to pre-crisis levels, and in the current recession, there is a return to the growth path. However, events in Europe and the general uncertainty about the real magnitude of fiscal imbalances and public debt haves stopped this new growth cycle.

Figure 1: FDI Evolution in the world (million of USD)

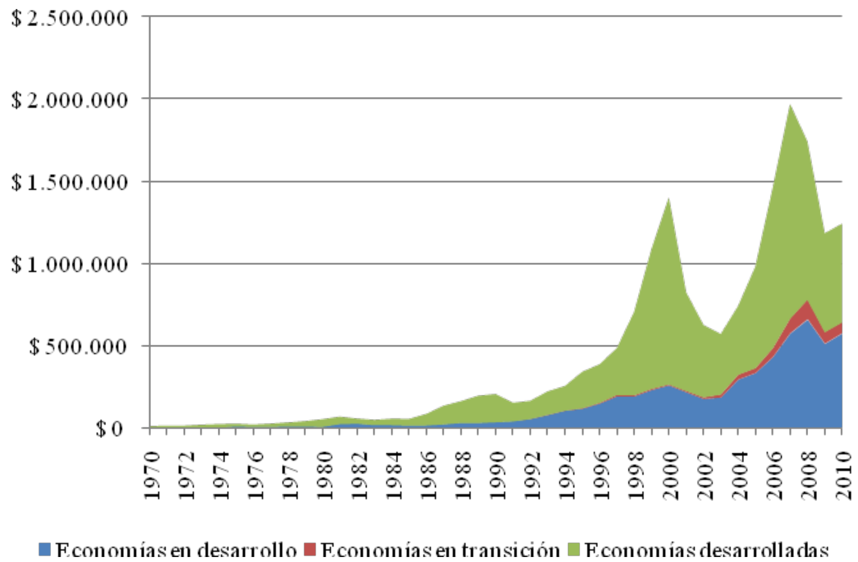


Source: Own illustration on UNCTAD data, 2012.

Along with the general analysis of FDI, it is interesting to review the composition of the investments' issuers and receivers, particularly due to the increasing flow of capitals from the developing world. Figure 2 shows a growing tendency of developing countries to receive capital. While still major investments are currently carried out in developed countries, both stocks and flows, the growth of FDI from developing countries can anticipate a future scenario where capital to "developing" countries or economies outweighs the "developed" ones, creating a new power relationships and interdependence.

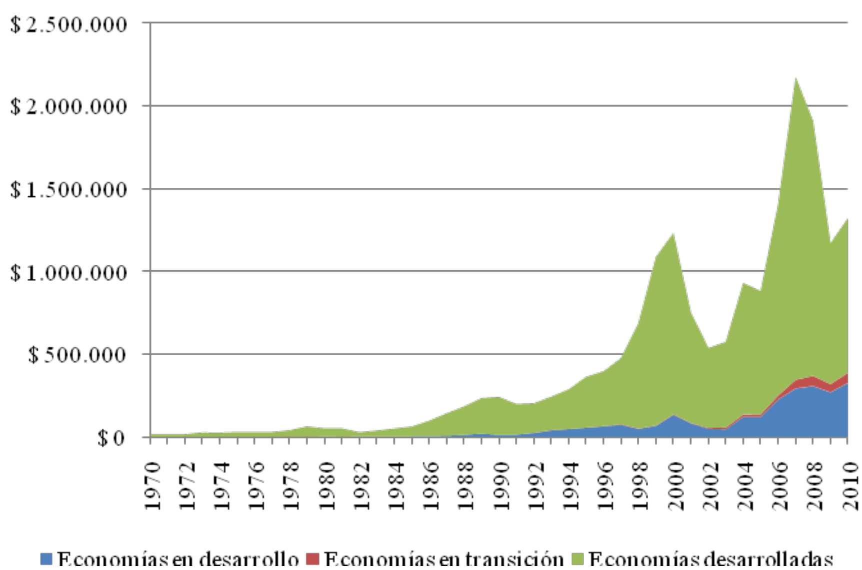
Similarly, Figure 3 shows the situation regarding the issue of FDI. In this case, the emergence of capital from "developing countries" has been smaller than the reception. However, the developing world begins to appear on the radar of FDI, and as companies mature and achieve progress in their internationalization processes begin to be significant in official statistics.

Figure 2: FDI Evolution in the world, according to receiver country (million of USD)



Source: Own illustration on UNCTAD data, 2012.

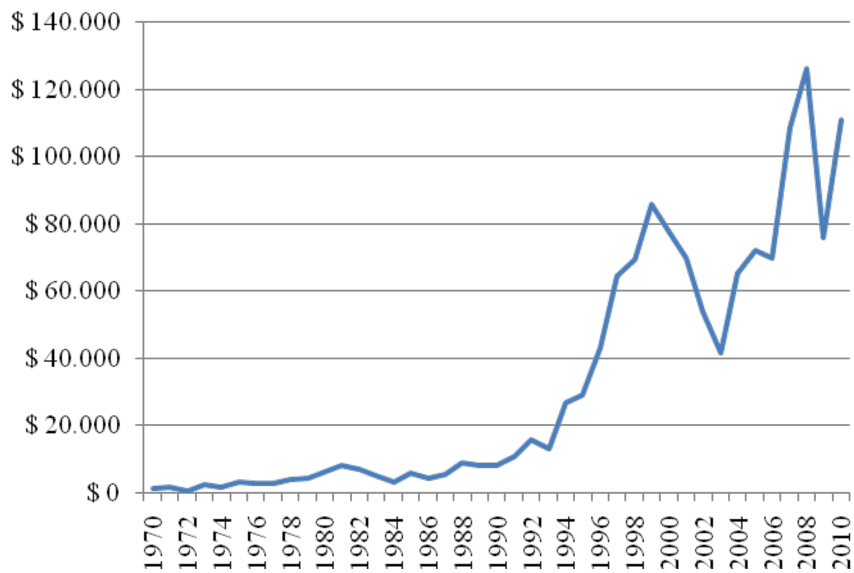
Figure 3: FDI Evolution in the world, according to issuer country (million of USD)



Source: Own illustration on UNCTAD data, 2012.

Latin American FDI has shown a greater dynamic and positioning as global receptor on the last decade (Figure 4), particularly after the financial crisis of 2008 (ECLAC, 2011).

Figure 4: FDI evolution in Latin America (million is USD)



Source: Own illustration on UNCTAD data, 2012.

FDI: Chile and Peru

Chile and Peru have followed very active international economic integration processes, establishing a wide network of trade and investment agreements, which leads them to face common challenges and opportunities for the future of their international economic relations.

The strong growth of trade and capital flows between both countries in recent years has created opportunities for cooperation and mutual benefits. Likewise, the signing of various legal instruments that promote and give certainty to this relationship has strengthened the bilateral interactions in trade and investment. The future of Chilean-Peruvian trade and investment relations should allow both countries to create positive working agendas to achieve higher goals. Possibly, one of the more positive spaces for bilateral relations between Chile and Peru is the economic area. To this end, the present research is organized in six chapters. Chapter 2 contains a brief explanation of the Chile's and Peru's regulatory frameworks. Chapter 3 explains the investment and trade – related clauses included in the Peru – Chile Free Trade Agreement, in force since 2009. In Chapter 4, FDI flows and stocks of both countries are presented. Chapter

5 contains an analysis of the perceptions about the current bilateral investment relation. Finally, concluding remarks and comments are contained in the Chapter 6.

Legal frameworks and policies for FDI

Chile

Over the past years, the Chilean economic and industrial policy has distinguished itself by providing for a position of neutrality and non-discrimination, in a broad sense of application. In general terms, regarding FDI, Chile grants non-discriminatory treatment to foreign investors. This arises from the Constitution of the Republic. In Article 22°, the Constitution guarantees "a non-discriminatory treatment arbitrarily imposed, to be granted by the State and its bodies in economic matters" (Chile, República de, 2005). Likewise, the Constitution guarantees the rights of private property an economic freedom. Such constitutional guarantees have been highlighted regarding Chile's success in attracting investment (Rodas, 2005).

This non-discriminatory and economic freedom policy has implied that the State has no major interference in the capital inflows to Chile. In this sense, FDI is directed by two entry mechanisms, Chapter XIV of the Compendium of Foreign Exchange Regulations of Central Bank of Chile (Chapter XIV) and the Decree Law 600 - Foreign Investment Statute (DL 600), which will be review in the next section.

Entry mechanisms and Investment Promotion

Chapter XIV of the Compendium of Foreign Exchange Regulations of Central Bank of Chile

"Chapter XIV of the Compendium of Foreign Exchange Regulations of Central Bank of Chile establishes the applicable standards to foreign exchange transactions relating to credits, deposits, investments and capital contributions from abroad. This regime enacts free access of foreign capital to Chile's formal exchange market" (Servicio de Impuestos Internos, 2012). Basically, Chapter XIV is a form of registration for international operations that are traded on the Chilean Formal Exchange Market (FEM)[3].

Every operation in the FEM that surpasses USD 10,000 (or its equivalent in other currencies) should be notified to the Central Bank for approval. This procedure has been characterized as nimble and simple, since investors just need to fill in an application form to the Central Bank, to

[3] The Chilean Formal Exchange Market (FEM) consists of the Banks and Money Exchange operating throughout the country.

access the formal market. This proceeding can be fulfilled through any Bank or Money Exchange, who take charge for handling and settling the amount. It is noteworthy that this procedure must be carried out prior to the liquidation of the respective currency. The verification and approval by the Central Bank is fulfilled within two days, offering the investor the advantage to dispose of the investment capital from minute making the request.

Within a year of liquidated the investment, the investor may re-export the invested capital. Such re-export should also be done by changing the currency. The payments or currency remittances must be reported to the Central Bank directly through the FEM entity. There are no restrictions on repatriation. The cost varies on the commission of the FEM and the duration of the procedure is approximately one week. It must be said that this mechanism does not lead to the signing of any contract with the State.

Decree Law 600 (DL 600) – Foreign Investment Statute

The first statute that regulated FDI in Chile dates from 1954, with the Decree with the Force of Law (DFL) 437, which was only applicable to those investments that were intended to iniciate, expand or promote activities that tended to stimulate industrial development or promote activities that improve the exploitation of mineral, agricultural or forestal wealth, and to improve or increase transportation means. This boundary to specific economic sectors, which were desired to stimulate, was broadened by the DFL 258 in 1960 which included fishing (Zabala, 1987). In this sense, the introduction of the Decree Law 600 (DL 600) in 1974 represents a substantive change, since it stopped favoring a specific sector, which did happened with the previous legislation. “In 1974, the new Chilean authorities decided to take a turn on the economic development strategy. They gave up on the one that had prevailed since the Great Depression, based on a combination of import substitution industrialization, critical view of the market and increased government intervention in all national economic facets, particularly in productive activities” (Hachette, 1998). Since then, the DL 600 constitutes the main framework regulating the FDI in Chile, followed by the Heading I of Chapter XIV of the Compendium of Foreign Exchange Regulations of the Central Bank.

The Decree Law 600 – Foreign Investment Statute was enacted in 1974, during the military government and subsequently “its revised, coordinated and systematized text was published in the Official Gazette on September 3rd, 1993” with the restoration of democratic governments

(Rodas, 2005). In order to promote the flow of FDI to Chile, it was created a new regulatory body related to FDI, which also impressed the beginning of a new economic policy based on openness.

The DL 600's main purpose is to provide a framework of stability and certainty for foreign investors, through tax stability regime. Just like Chapter XIV, "it is a transfer of capital mechanism towards Chile. Under this voluntary regime, foreign investors bringing capital, physical assets or other forms of investment, request to sign a foreign investment contract with the State of Chile" (Foreign Investment Committee, 2012). This contract with the state of Chile es managed by the Foreign Investment Committee (FIC), which is a public legal person, who relates to the President of the Republic through the Ministers of Economy, Development and Tourism (who presides it), Treasury, Foreign Affairs, Social Development and the president of the Central Bank. Its administration is headed by an Executive Vicepresident, appointed by the President of the Republic. The FIC is the only organism in charge, representing the State of Chile, to accept the entry of foreign capital under the DL 600 and to establish the terms and conditions of the respective contracts.

It is notable that the DL 600 does not provide a definition of FDI, although in its Article 1° it supplies the elements under which the concept of foreign investment is understood: "The foreign natural and legal persons, and Chileans residents and domiciled abroad, who transfer foreign capital to Chile and enter a foreign investment contract, will be conducted by the provisions of this Statute" (Chile, República de, 1993). In like manner, the Decree points out the requirements that the investment must meet in order to establish itself as such:

- Subjects, Foreign natural and legal persons, and Chileans residents and domiciled abroad.
- Transfer of foreign capital into Chile, which must be conducted through the Formal Market. Since 2003, the minimum amount for a new investment project comprising foreign currency and credits associated is USD 5.000.000. When the investment consists of physical assets, technology and capitalization of profits or credits, the minimum amount is USD 2.500.000. (López, Muñoz, 2011)
- Foreign Direct Investment contract with the State of Chile.

The main guarantees and benefits under DL 600 to potential foreign investors are:

- 42% flat tax.
- Remittance of Profits: It has no deadline. The capitalized earnings are considered income for this purpose, for there is no length of stay and can be remitted at any time.
- Possibility of unilateral modification by the investor.
- Exempt restrictions in case of adverse macroeconomic conditions that may be imposed by the Central Bank on the FEM.

The minimum investment amounts required in foreign currencies to be registered through the DL 600 have changed since its inception, being in 1978 of USD 10.000 to USD 5.000.000 since 2003, for investments comprising foreign currency and associated credits. In the case of an investment that consists of physical goods, technology and capitalization of profits or credits, the minimum amount is USD 2.500.000 (Figure 5).

Figure 5: Evolution of the Minimum Entry Amount of Foreign Investment by DL 600, according to input mode

	1974	1978	1986	1997	2003	2005
Foreign Exchange	10.000	100.000	25.000	1.000.000	5.000.000	5.000.000
Another Mode	--	--	--	25.000	250.000	2.500.000

Source: FIC, 2012

The repatriation of invested capital is exempted from any contribution, tax or assessment up to the amount of the materialized investment, including any fortuitous restriction to outflows. That in adverse macroeconomic conditions could be imposed by the Central Bank on the FEM, making a substantial difference compared to those capitals admitted through Chapter XIV (Figure 6).

Likewise, the DL 600 provides tax options that allow the investor to benefit from the tax regime prevailing at the time of investment. This possibility to benefit from the Special Regime of Flat Tax at 42% has been evaluated as obsolete against current tax rates, where Chilean companies must pay corporate tax equal to 20% and profits 35% additional tax, in respect of which, the corporate tax is a credit to the investor.

On the invariability of indirect taxes, the DL 600 states that foreign investment entering the country in the form of physical goods must accept the general rules of Value Added Tax (VAT), as well as domestic customs regulations. The foreign investors have benefits when importing technology (VAT exemption). There is a special régime for big projects. The investments on new industrial or extractive activities, including mining, are subject to additional tax benefits, as long as their value is not less than USD 50 million, which means, in practice, that these benefits have as main target, major projects.

Figure 6: Comparison of Chapter XIV and DL 600

Chapter XIV	DL 600
• Applies to any option over USD 10,000. • There is no contract. • Access to the FEM is ruled by existing regulations at the time of operation. • There is no minimum term for remittance. • Common tax régime.	• It is voluntary for operations over USD 5,000,000. • There is a contract between the State of Chile and the investor. • Guarantees the access to FEM. • Capital remittances may be made after the expiry of one year from the date of their respective revenues. Profit remittances are not subject to term. • Special tax régime.

Source: López, Muñoz (2007)

International Agreements

At the same time, the foreign investor in Chile can benefit from several international agreements. Amongst these are the Investment Promotion and Protection Agreements and the investment chapters are contained in the Free Trade Agreements (FTA) signed by the country.

The importance of Investment Promotion and Protection Agreements, also known Bilateral Investment Treaty or BIT, and the investment chapters that some FTAs include, is the protection they give to the investor. The certainty of a non-discriminatory treatment and a stable legal framework, with clear rules and the possibility to access to a dispute settlement mechanism, constitute them as an effective device for the investment protection. At this point, the subscription of the States to the ICSID (International Centre for Settlement of Investment Disputes) becomes relevant, since this is the organism in charge of arbitrating investor-state differences.

In the case of BITs, they constitute the larger number of agreements, being mostly signed with European countries (20). This happens because the European Union (EU) Association Agreement with Chile does not include an investment chapter, remaining in force previously signed BITs with each country. In the same way and unlike what happens in trade, each country of the EU is individually present in ICSID (Figure 7).

Figure 7: Geographical distribution of international agreements signed by Chile relevant for FDI

	BIT	FTA	ICSID	Double Taxation
North America	--	3	1	2
Central America	6	6	6	--
Caribbean	1	--	1	--
South America	6	4	6	6
Europe	20	--	21	13
Middle East	--	--	3	--
Asia	3	2	8	3
Oceania	--	1	1	1
Total	36	16	47	25

Source: Own illustration on information based on the FIC, SICEX, World Bank and SII.

Other relevant agreements for the promotion of FDI are the Double Taxation Agreements, whose objective is to open the country's economy to new markets through the reduction of tax rates. Furthermore, the existence of Conventions makes foreign investors more interested in Chile (SII, 2012); and the Social Security Agreements, to facilitate the movement of persons.

In like manner, Chile is member of different international investment organizations and has ratified a number of instruments that strengthen legal, economic and political model certainty and respect of the foreign investor, being the most recent its incorporation to OECD and the adhering to its recommendations. In other areas, Chile is a member of the Multilateral Investment Guarantee Agency (MIGA), the ICSID and Overseas Private Investment Corporation (OPIC). Chile has also ratified the Inter-American Convention on International Commercial Arbitration, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the Convention on arrangements of Investment Disputes between States and Nationals of other States. On September 29th, 2004, the Official Gazzette published Law No. 19.971 on International Commercial Arbitration in Chile. The publication of this law was considered a fundamental step to position Chile as an international center for international trade and investment in the region, thanks to the possibility of using this modern and efficient mechanism for resolving international conflicts (López, Muñoz, 2007).

Figure 8: Restrictions to FDI

Generally speaking, following the main guidelines conducting FDI in Chile, such as the DL 600, there are no restrictions for investment, with some exceptions. Among these, stand out those related with "exploitation of existing fields in maritime waters under national jurisdiction or located in areas designated by law as of importance to national security, the production of nuclear energy for peaceful purposes and the right of first refusal thorium and uranium" (Foreign Investment Committee, 2012). For practical purposes, these restrictions apply to two cases: oil and gas hydrocarbons, and lithium, the latter for reasons of national security, with the exception of mining concessions previously established (Article 3, Law Nº18.097, Constitutional Act of Mining).

However, despite these restrictions, the participation of foreign capital is allowed in very narrow cases. In the case of liquid hydrocarbons, it is allowed under a modality called Petroleum Operation Special Contracts (CEOP for its name in Spanish), which consists in the association of a company with the National Oil Company (ENAP for its name in Spanish), state-owned. Since the implementation of this method in 1975, 25 CEOP have been established, always with the participation of the state firm, in a record spanning to 2009 (Agostini, Saavedra, 2009).

In the case of lithium, its operation is basically performed by the Chemistry and Mining Society of Chile (SOQUIMICH for its name in Spanish), which had concessions prior to the enactment of Law No. 18.097, allowing it, by 2010, to be the world's largest producer of the mineral. However, from May, 2012, the exploitation of lithium is allowed to foreign companies under special contracts, awarded under the bidding by the Ministry of Mines, which establishes a restriction of three years for the investor to make withdrawals or further operation of the concession sales, after authorization by the Secretary of State (Article 9, Decree Nº16, Ministry of Mines).

Peru

General Framework

The legal framework relating specifically to foreign investment dates back to the nineties. As part of the structural reform implemented at the beginning of 1990, Peruvian government enacted legal provision with the objective to attract foreign investment, which even have constitutional status. In this sense, the current Political Constitution of Peru, approved in 1993, includes a series of provisions that guarantees a favorable juridical framework to promote the development of private investment.

These main principles are:

- free private initiative exercised in a market-based social economy
- free competition and prohibition of restrictive practices and the abuse of dominant or monopolistic positions
- freedom to hire workers
- special powers to the State to sign contract laws that establish guarantees
- national treatment
- the possibility to submit investor-State controversies to national or international
- arbitration
- freedom to hold and dispose foreign currency
- inviolability of property and establishment of conditions for exceptional causes that empowers expropriation, specifically, in-advance cash payment of a fair-value; equal treatment on taxation matters; and the express acknowledgement that no tax may have confiscating effects.

Other laws that were also enacted following the main principles abovementioned are the Foreign Investment Law (Legislative Decree No. 662) and the Framework Law for the Growth of Private Investment (Legislative Decree No. 757).

In this sense, Peru's legal investment framework is based on the national treatment principle. Under this principles, foreign investors are allowed without restrictions and previous authorization in most of the economic activities. However, there are activities were private investment, whether national or foreign, face limitations, which include the development of protected nature reserves, although the regulated development and use of such areas may be permitted subject to regulation under the applicable laws.

There are also some restrictions impose only to foreign investors. In terms of ownership, the restrictions are mostly related to the possibility of foreign individuals or corporate bodies to own mines, lands, forest lands, waters, fuels and energy sources, within 50 kilometers from the borders. In these situations, authorizations are granted for cases of public necessity and an approval by the Ministry Council is required.

No selection mechanisms or performance requirements are applied or required to foreign investors. All legal provisions that conditions domestic production to the use of domestic inputs or the exportation of a percentage of domestic productions have been repealed, in compliance with multilateral, regional and bilateral trade commitments. Moreover, no intervention in production processes of companies over the type of economic activity, installed capacity, or any other similar economic factor is allowed. Exceptions are made for legal provisions over hygiene and industrial security, environment and health.

Finally, foreign investment policy falls within the purview of the Ministry of Economy and Finance (MEF). It is the responsibility of the Private Investment Promotion Agency (PROINVERSIÓN) to propose and implement national policies for the promotion of private investment in accordance with the general policy guidelines established by the MEF. PROINVERSIÓN also oversees investors' compliance with the investment commitments they have assumed in cases where this task has not been assigned to any other regulatory agency.

Legal Stability Agreements

One of the mechanisms used since the nineties to attract foreign investments is the legal stability agreements. In these case, the State guarantees legal stability to the foreign investor through the signing of an agreement with law-contract status, which is subject to the general provisions on contracts established in Peru's Civil Code.

More specifically, Peruvian government guarantees foreign investors:
a) national treatment;
b) stability of the Income Tax System, applicable to the investor, in force when the agreement is signed; and
c) free availability of foreign currency and remittance of profits, dividends and royalties.

Also, the State grants stability to the enterprise receiving the investment on:
a) labor engagement system in force when the agreement is signed;
b) export promotion system in force when the agreement is signed; and
c) Income Tax System.

Any investor or enterprise receiving the investment can sign legal stability agreements. However, to sign this kind of agreement, investors from privatization or concession processes and the enterprises involved need to fulfill the following commitments:
a) to make in a two year term capital contributions for an amount not below US$ 5 million in any economic activity (except mining and hydrocarbon sectors, where the amounts must be not below US$ 10 million);
b) to acquire more than 50% of shares of an enterprise participating in the privatization process;
c) to make capital contributions to the enterprise included in the concession contract, fulfilling the investment requirements established in this contract.

In the case of the enterprises receiving the investments flows, it is required that:
a) one of its shareholders signs the corresponding Legal Stability Agreement;
b) in case tax stability is requested, contributions shall account for a 50% increase in relation to the total amount of capital and reserves and shall be destined to expand production capacity or contribute to the company's technological development;
c) the privatized enterprise transfers more than 50% of its shares;
d) the enterprise benefits from the concession contract.

Legal stability agreements are usually valid for 10 years. In the case of concessions, its period of validity may be extended in accordance with the time set in the concession contract. Under these agreements, any dispute is derived to arbitration tribunals. After the legal stability agreement expires, this cannot be renewed. To sign a new agreement, the investor needs to commit to new investment contributions and the State guarantees the stability of the regulations in force by the date the new agreement is signed.

Other incentives to investors

Peru's investment laws also provide some specific incentives to investors:

- Anticipated Recovery Regime: Individuals or corporate bodies engaged in the production of goods or services for export can get a refund of the Value-Added Tax paid on imports or domestic acquisitions of capital goods.

- Incentives to agriculture: Individuals or corporate bodies involved in agriculture or the agribusiness sector are favored with lower Income Tax rates, accelerated depreciation, tax refunds and access to hire workers under more favorable labor and social security systems.

- Incentives to aquaculture: Individuals or corporate bodies involved in agriculture or the agribusiness sector are favored with lower Income Tax rates and access to hire workers under more favorable labor and social security systems.

- Amazon Region Law: Special tax conditions have been created to favor private investment in this Region if engaged in the following activities: agro-farming, aquaculture, fishing, tourism, forestry extraction and manufacturing activities related to the processing, transformation and commercialization of primary goods from the aforementioned activities.

Special Zones

a) Tacna Duty Free Zone (ZOFRATACNA)

Industrial, agribusiness, assembly and service activities can be carried out in the Tacna Duty Free Zone. These activities include the storage, distribution, disassembly, packaging, marking, labeling, division, exhibition and classification of merchandise, among others. In addition, the repairing, reconditioning and maintenance of machinery and equipment used in mining is allowed in the Tacna Duty Free Zone. Companies settled in ZOFRATACNA in relation to the aforementioned activities are tax exempted.

b) Puno Special Economic Zone (ZEEDEPUNO)

Currently, the Peruvian Government is implementing a Special Economic Zone in the Department of Puno. The activities to be carried out in ZEEDEPUNO are going to be similar to the ones allowed in ZOFRATACNA[65]. In the same way, the companies to be settled in ZEEDEPUNO to participate in these activities will be tax exempted as well.

International Investment Agreement

In the last years, Peru has embarked on an extensive negotiations path with the objective to facilitate trade and attract investment. At the bilateral level, Peru has taken a very ambitious and comprehensive approach in order to facilitate transactions and increase trade and investment flows with other countries. This process started in the nineties when Peru began to negotiate and implement bilateral investment treaties (BIT), especially with developed countries. During that time, BITs with various European countries were put in place such as United Kingdom, France, Spain, Belgium, among others.

By the end of that decade, Peru initiated the process of negotiating trade agreements, which, in the beginning, did not include investment-related provision. Thus, Peru joined into the Andean Free Trade Zone, which was in effect since 1993. Peru negotiated a gradual integration into this zone with the rest of the Andean Community members and completed its full incorporation in December 31st, 2005. After the incorporation to the Andean Free Trade Zone, Peru negotiated a Free Trade Agreement in goods with Chile, which entered into force in 1998. Moreover, Peru signed a Free Trade Agreement with MERCOSUR in 2005, which only covers trade in goods. Apart from these agreements, under the framework of the Latin American Integration Association (ALADI) Treaty of Montevideo, Peru has negotiated and put into force Partial Agreements in goods with Mexico and Cuba.

In 2003, Peru entered in negotiations with the United States to conclude a free trade agreement that included provisions related not only to goods, but also to services and investment. This was the first trade agreement negotiated by Peru that included investment provisions. After this agreement, most FTA negotiated by Peru have included an investment chapter or provisions that are aimed to regulate, protect and promote investment flows.

Currently, Peru has 26 BIT in force with the following countries: Argentina, Australia, Bolivia, Colombia, Cuba, Czech Republic, Denmark, Ecuador, El Salvador, Thailand, United Kingdom, Venezuela, among others. It is worthy to mention that as a consequence of the FTA negotiations some BIT have been incorporated or replace of the Investment Chapter include in the FTA, such is the case of agreement with: Canada, Chile, Singapore, Japan and South Korea.

Regarding Double Taxation Agreement, Peru has only concluded four agreements. Although, as will be described in following sections, most enterprises take into account the existence of a Double Taxation Agreement to invest in a country, Peru has only implemented two Double Taxation Agreement, with countries such as Chile, Brazil and Canada. Nowadays, negotiations to conclude more agreements have been conducted by the Ministry of Economy and Finance, however the approval process of this agreement may be one of the reasons of the reduce number of agreements in place.

Figure 9: Geographical distribution of international agreements signed by Peru relevant for FDI.

	BIT	FTA	Double Taxation
North America	--	3	1
Central America	1	1	--
Caribbean	1	--	--
South America	6	1	2
Europe	15	2	--
Asia	2	4	--
Oceania	1	0	--
Total	26	11	3

Source: Proinversion

Bilateral Agreements Related to Investment between Chile and Peru

Free Trade Agreement

In 1998, under the framework of the Treaty of Montevideo, the governments of Peru and Chile agreed to negotiate an Economic Complementation Agreement with the aim of establishing an economic space between the countries to allow free movement of goods. The agreement, called the Economic Complementation Agreement No. 38 (ACE 38), has allowed that currently more than 95% of good traded by both countries are duty free.[4]

It is important to note that the ACE 38 was intended only for the free trade of goods between Peru and Chile. For this reason, the agreement only contain provisions on Market Access of Goods, Technical Barriers to Trade, Sanitary and Phytosanitary Measures, Safeguard Clause , Rules of Origin and the Dispute Settlement Mechanism.

Notwithstanding, bilateral trade increased substantially since the implementation, in 2005, during the celebration of the V Meeting of the Administrative Committee of ACE 38, representatives of the Peruvian and Chilean Government decided to improve the legal framework for trade relations between the two countries and strengthen international relations between the two countries. In this sense, in August 2005, negotiations were launched with the objective of expanding the scope of ACE 38, by improving the legal framework related to trade in goods and by incorporating disciplines regarding services and investment. Thus, the negotiation process were focused on issues such as: Technical Barriers to Trade; Dispute Settlement; Sanitary and Phytosanitary Measures, Rules of Origin, Competition Policy, Trade Remedies, Customs Procedures, Services and Investment.

With respect to the Investment Chapter, the investment-related provisions of the FTA apply to all investors and their investments at all levels of government, both existing and future, except:

- Investors and their investments in financial institutions (this is due to the commitment to negotiate a financial services chapter, which has not been finished);
- Government procurement, and
- Any act or fact which took place or any situation arising before the date of entry into force of the Agreement.

[4] The signing of ACE 38 also intensified the economic and trade relations between the two countries, and led to coordinated action in international economic forums, aimed at improving the access of products from the two countries in world markets.

Regarding this last point, it is important to mention that Chile and Peru had in force a Bilateral Investment Treaty entitled "Agreement between the Government of the Republic of Chile and the Government of the Republic of Peru for the Promotion and Reciprocal Protection of Investment ", signed in Lima on February 2, 2002. In this sense, the investment chapter of the FTA included a specific Annex ending the BIT, from the entry into force of the Agreement (since it is replaced by the Investment Chapter), which provides that any investment made under the BIT before the entry into force of the Agreement shall be governed by the rules of the BIT and not by the Investment Chapter. The new ACE 38 entered into force in March 2009.

The main agreements reached in this chapter are:

- As for the definition of investment, it includes the entire investment cycle, from pre-establishment stage (include a footnote defining the pre-establishment stage as one in which the investor intends to materialize the investment by performing essential acts such as the channeling of resources to the constitution of a company's capital, obtaining permits or licenses, among others).

- As for the standard treatment of investors, the Investment Chapter incorporates the disciplines of national treatment (equal treatment for domestic and foreign investors), most favored nation (equal treatment for foreign investors), minimum standard of treatment (covering fair and equitable treatment and full protection and security), performance requirements, senior executives and directories, investment and environment, special formalities and information requirements, denial of benefits, among others.

- With regard to the regulation of expropriations, the Chapter regulates in detail the assumptions of indirect expropriation, describing the criteria to be taken into account in determining whether a measure is considered indirect expropriation and safeguarding the possibility that the signing States may design and apply nondiscriminatory regulatory actions to protect legitimate public welfare objectives, such as public health, safety and the environment, by expressly providing that such acts will not be considered as indirect expropriation. Thus, the Investment Chapter incorporates criteria for determining what can be understood as "indirect expropriation". This determination is made on a case by case basis, considering the following factors: (i) the economic impact on the investor acts (expressly provides that the acts of a State to have adverse effects on the economic value of an investment for themselves not necessarily constitute an indirect expropriation), (ii) the extent to which government actions interfere with distinct, reasonable expectations of investment and (iii) the character of the governmental action. Additionally, the Chapter establish that do not constitute indirect expropriations nondiscriminatory any regulatory action that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment.

- Regarding the Chilean Decree Law 600 (Legal stability voluntary framework similar to arrangements in Peru's Legislative Decree 662, which regulates the Legal Stability Agreements, which can be accessed when the investment amount is greater than U.S. $ 5 million), it has been included a provision that allows Peruvian investors to sue for breach of the obligations of national treatment, most favored nation and expropriation by local courts while not in compliance with the obligations by Chile in terms of investments under this Decree Law.

- Regarding the dispute settlement mechanism provided for in Investor-State Investment Chapter, the detailed procedure incorporates a set of rules that provides greater strength and efficiency to the process, incorporating standards of transparency and third party participation anticipating who might be affected by matter of controversy (amicus curiae). It also provides that hearings be public, unless the parties request confidentiality of certain actions. In this regard, it is noteworthy that the State in any form loses its sovereignty stipulate when settlement mechanism investor-state dispute. The mechanism regulated by Chapter (international arbitration) can be activated in case any of the States (Peru and Chile) violates any obligation and / or commitment in Chapter ensuring rights to investors.

Double Taxation Agreement

The double or multiple taxation occurs when two or more countries consider that have the right to tax a particular income. In these cases, the same gain can be taxed by more than one State. This situation is usually problematic for firms, because their benefits are reduced when they operate in different countries and their revenues might double or triple taxed.

Peru-Chile Doubled Taxation Agreement is in place from 2004. In general terms, the agreement provides for the taxing of revenues in the country where the revenues have been generated. Thus, one of the countries declines its right to tax firms' revenues when they have been produced in the other country part of the agreement. As it will be mentioned below, most investors take account of the existence of a double taxation agreement to decide whether invest or not in a country.

FDI evolution

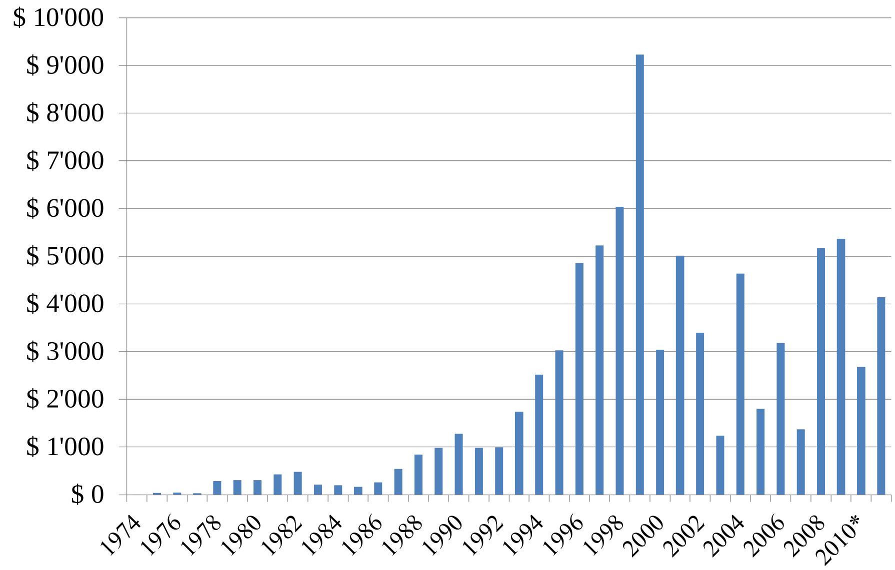
Chile's Inward and Outward Foreign Direct Investment (FDI)

Main Trends of FDI in Chile

Chile has become one of the most important destinations for foreign investment in Latin America. Despite not having a domestic market with the volume of other countries in the region (Argentina, Brazil, Mexico), features such as the availability of natural resources (minerals, forests, fisheries), the politic and macroeconomic stability, trade liberalization and the privatization of public services have allowed that the stock of materialized FDI through DL 600 exceeds the USD 82,000 million (FIC, 2012).

As we can appreciate on Figure 10, during the first years of operation of the DL 600, investment flows to Chile were relatively low. The economic and political conditions at the time (the late seventies and early eighties) did not favor the minimum requirements to attract investment in Latin America and Chile particularly (dictatorial governments and debt crisis). The investment flow increases considerably after the return to democracy in 1990. This responds to the political and economic stabilization in Chile's first post-dictatorship years, as well as to the beginning process of privatization of major public utility companies. In this respect, the year 1999 marks the major milestone in FDI with the Spanish capital inflows to the energy and sanitary sectors. "After this, one can observe a gradual decrease of entered capital through DL 600 and an increase of those who do by Chapter XIV. This change in the preferences of foreign investors might respond to a failure to update the DL 600, which would no longer be providing incentives for its use" (López, Muñoz, 2007). Likewise, a sharp drop in FDI flows is observable in line with international markets, highlighting the falls post Asian crisis (2000) and financial crisis (2010). In recent years, with preliminary figures for 2011 and projections for 2012, a recovery in FDI flows is noticeable.

Figure 10: Materialized FDI Flow in Chile according to DL 600, 1974 – 2011 (USD million)

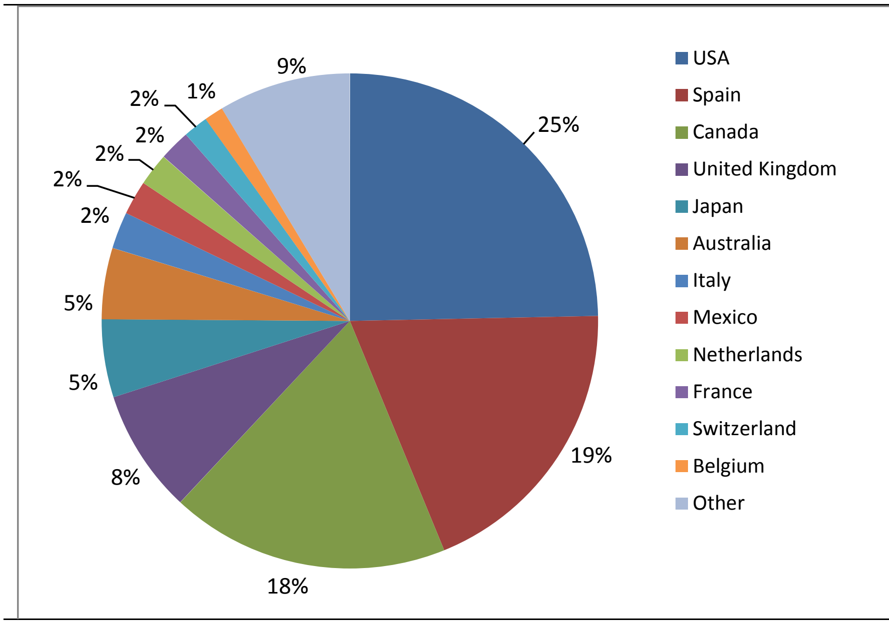


Source: Own illustration with FIC data (2012)

Analyzing the origin country of capital coming to Chile, one can observe a clear dependence on flows from developed countries. USA, Spain y Canada concentrate together over 70% of the investment (Figure 11).

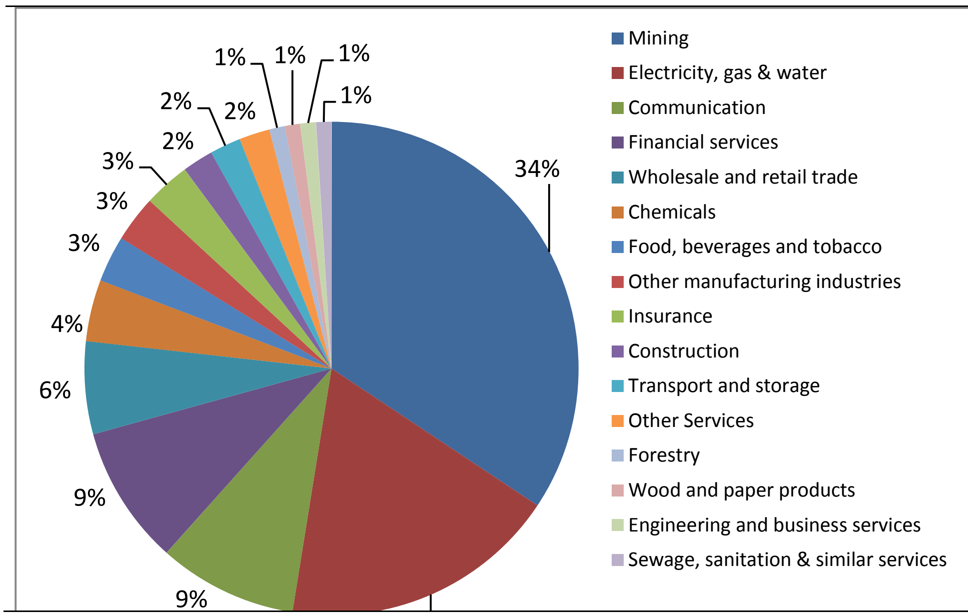
The only developing country that appears among Chile's main investors is Mexico, due mainly by the investment of the Slim Group. This concentration of origin is consistent with the sector concentration of investment. The largest sector is mining and quarrying, where the presence of capital from the USA, Canada, Japan, UK and Australia stands out. In second and third place are service sectors-electricity, water and gas and financial-, where the Spanish and Mexican capital are prominent (Figure 12).

Figure 11: Origin of materialized FDI in Chile through DL 600, 1974-2011



Source: Own illustration with FIC data (2012)

Figure 12: Destination of materialized FDI in Chile through DL 600, 1974 to 2011



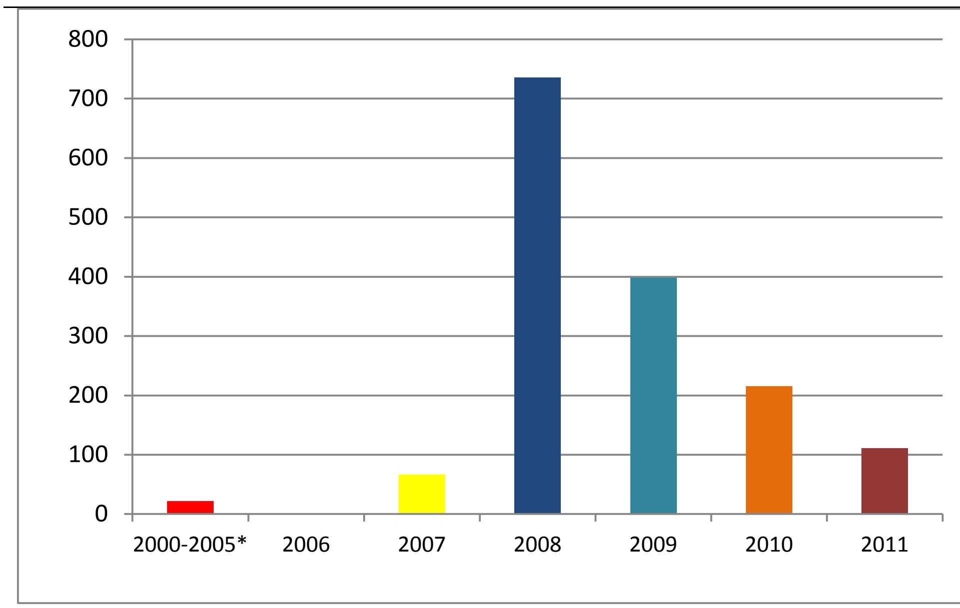
Source: Own illustration with FIC data (2012)

The Peruvian FDI in the world

Peru is a country that has recently joined as an issuer of FDI in the Latin American context. It is not identified as a major source of FDI, except in certain years, like 2008 and 2009, where it has represented a significant percentage of the total net, 2.0% and 3.8%, respectively. When analyzing the Peruvian investment abroad, its main destination are those geographically closer countries, such as Ecuador, Colombia, Bolivia and Chile. It is important to mention that there are not Peruvian official statistics about the capital flows abroad, so figures are estimated from information gathered from third States or international organizations.

During the first half of the 2000s, the average Peruvian foreign investment was USD 22 million, showing a significant increase from 2007, reaching a peak of USD 736 million in 2008 (Figure 13). This investment is materialized almost entirely in Latin America. While that figure has decreased, it has remained at levels above 2007 (ECLAC, 2011).

Figure 13: Peruvian FDI in Latin America, 2000-2011
(USD Million).



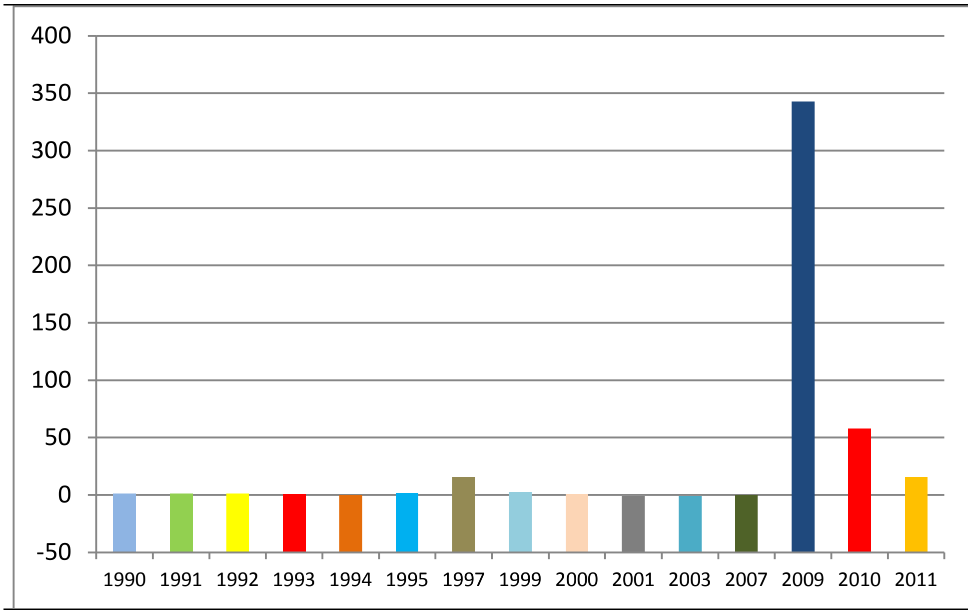
Source: (ECLAC, 2011)

The Peruvian direct investment in Chile

In the case of investment headed to Chile, the factors that have been identified to select it as a destination are generally the size of the economy, macroeconomic stability, transparency and clear rules.

The large Peruvian business groups have developed a minor relative presence in Chile, unlike what has happened with Chilean capital flows. Peru is the main destination for Chilean firms' materialized FDI abroad in recent years, especially in the case of the retail industry (Pérez, 2011). The PDI in Chile is incipient both in value and number of projects, as we can see on Figure 14, there is no trend with respect to the PDI, but rather a series of seemingly unrelated events, that stamp breaks in the flow from the neighboring country.

Figure 14. Peruvian Foreign Direct Investment in Chile, 1990-2011 (USD million)



Source: Own illustration with FIC data (2012)

Unlike what happens with the total FDI in Chile, in the specific case of the Peruvian capital, they do not concentrate on mining, utilities or financial services (Figure 16). However, this fact must be blended by the deed that just a single case practically explains most of the PDI in Chile, the entry of the Breca Group (Figure 15). In 2009, this major conglomerate purchased Melon S.A., through American Mining and Breca Investment and a final disbursement of USD 300 and USD 100 million, respectively, accounting, alone, 81.2% of the total PDI in Chile between 1990 and 2010. The acquisition was carried out at the French company Lafarge S.A. in 2009, and subsequently re-registered as Melon S.A. by the Breca Group (Melón S.A., 2012). The group currently controls 99.5% ownership of the company, through Inversiones Cordillera del Sur Ltda (SVS, 2012).

From this acquisition on, the Brescia Group has remained the main source of PDI. On December 30th, 2011 the Superintendency of Securities and Insurance (SVS for its name in Spanish) was reported on the purchase, by an essential fact: the company Tricolor S.A. was acquired entirely by the Breca Group, through Pinturas del Sur, in a transaction valued at USD 96 million (SVS, 2012).

Figure 15: Breca Case

The Breca Group is one of the main economic groups in Peru, ranking second after the Romero Group, with revenues of USD 3,500 million during 2010 (Peru: The Top 10, 2012) and an estimated fortune of USD 8,200 million to February, 2010. This is a highly diversified conglomerate, with investments in various industrial areas, financial services, mining operations and services in Peru and abroad. In like manner, it is involved in agribusiness, explosives, paints, chemicals and construction, as well as having a presence in the field of health and other services.

The first ties of the Breca Group with Chile initiated through the company Sigdo Koppers (hereafter SK), industrial conglomerate founded in Chile that is dedicated to provide services and products to the mining and industry, with presence in Peru since 1998 (SK, 2012). Thus, between the two clusters has been a long business relationship linked mainly to mining sector. In 2008 Enaex, belonging to the SK Group and the Breca Group, agreed to partner on a project of ammonia and ammonium nitrate in Peru (Enaex, 2011). In 2009 this relationship was brought into conformity through the creation of Nitrates of Peru, investment of some USD 650 million, with the purpose of serving that market, controlled by the Brescia with a 51%, and the remainder in the hands of Enaex.

During the same year, the Breca Group took its first steps in the Chilean market with the acquisition of Cementos Melon. Then, in 2011 acquired all Tricolor Paintings by Public Offering of Shares (OPA for its name in Spanish) for a total of USD 96,170,000. This operation did not only continued to expand its position in the domestic market, but also managed to become the largest player of this area in Peru and one of the largest companies in Latin America (Estrátegica, 2012), as Tricolor had presence in Peru since

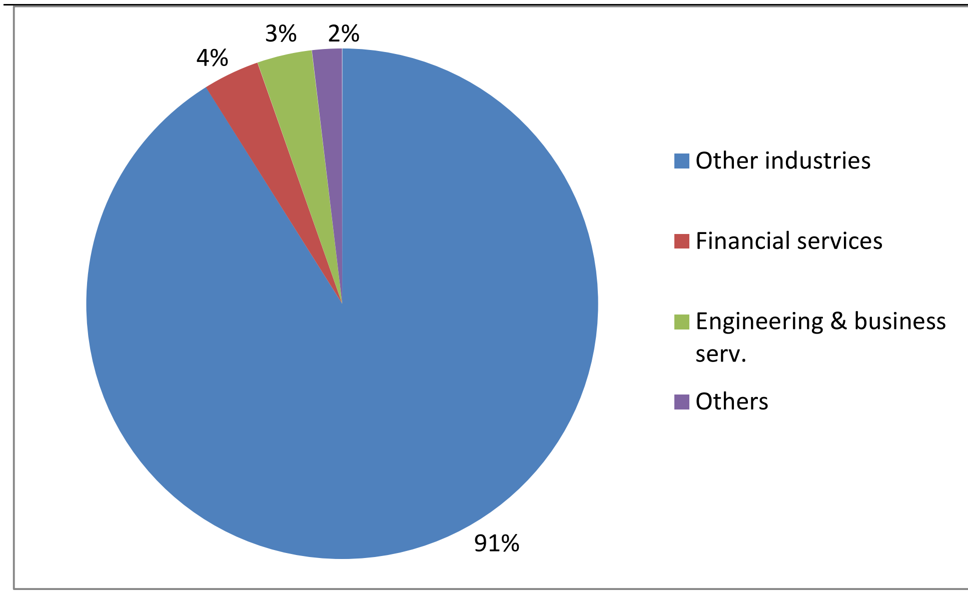
1993, when Tricolor Peru Industry was created, propietary at the same time of Tintas Gráficas Vencedor S.A. Perú e Industrias Vencedor (FitchRatings, 2006).

During the present year, these companies have acquired two-thirds, in equal parts, of the largest civil explosive company (40% of this market). (Diario Financiero, 2012).

As we can see, once analyzed the chronology and the actors involved in this case, it is possible to make evident that in addition to the existence of a business opportunity, there is also present a strategic factor in its expansion. It is clear that Breca continues in Chile with the pattern used in Peru, strongly positioned in the construction industry and paints. From this it is also important to mention that, besides the obvious interest in the Chilean market, the group has used the purchase of Tricolor Paintings to position itself as the largest actor in this segment in Peru and one of the largest in Latin America.

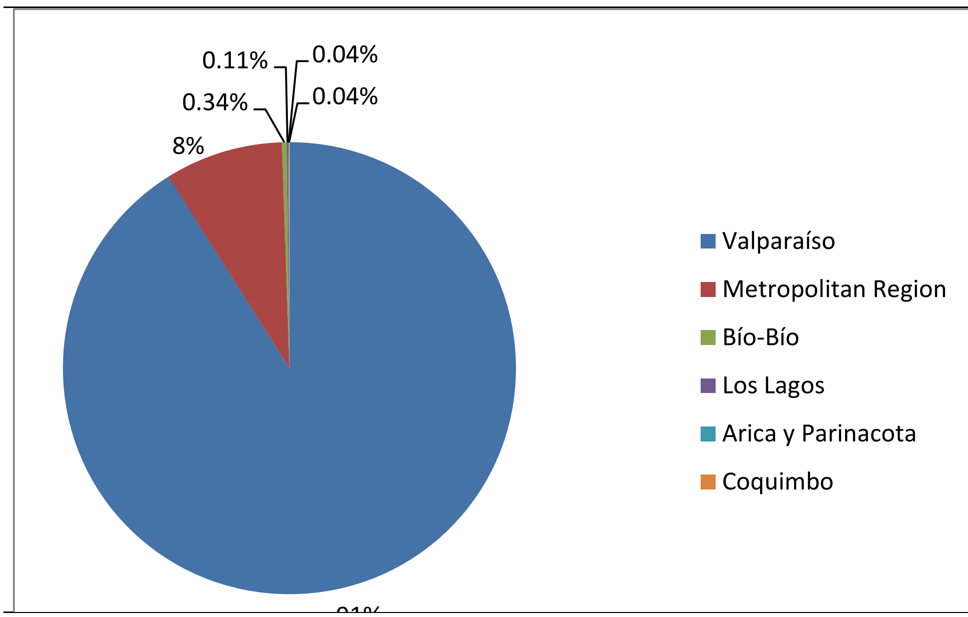
In like manner, in the year 2011, an investment of USD 15.2 million is registered in CAM Holding Ltda., in the field of business' services by Grana y Montero, located in the Metropolitan Region. In terms of geographical distribution of PDI in Chile, it is concentrated in the Valparaíso Region, as it is there where Melon S.A. operates, and, as we have seen, this operation is almost all of the PDIs in Chile (Figure 17).

Figure 16: Peruvian Foreign Direct Investment in Chile, 1974-2011.
By Sectors (percent)



Source: Own illustration with FIC data (2012)

Figure 17: Peruvian Foreign Direct Investment in Chile, 1974-2010. By region of destination (percent)



Source: Own illustration with FIC data (2012)

Figure 18: Main Peruvian Investments in Chile, 1974-2010

Investor	Recipient Company	Figure in thousands	Economic Area

		of USD	
Minera Latinoamericana S.A.C./ Inversiones Breca S.A.	Inversiones Cordillera del Sur Limitada e Inv. Cordillera del Sur II Limitada	400.000	Nonmetallic mining products
Banco de Crédito del Perú	Inversiones BCP Limitada	15.480	Banks
Unión de Cervecerías Peruanas Backus y Johnston S.A.	Agroinversiones S.A.	1000	Beverage industry
C. Alvarado and others	Inversiones Alfil S.A.	847	Construction
M Rubini and others	Salmones Plata Ltda	500	Fish farming
E. Mayser and others	Sociedad Comercial e Industrial Santa Rosa Limitada	398	Trade
B. Arrué	Sociedad Inmobiliaria San Isidro Ltda	317	Construction
J. Sansour	Jisa Plásticos Ltda	198	Chemical industry
A. Martorell and other	Embotelladora Carnaval S.A.	180	Beverage insdustry
J. Rassmuss*	Pegasus Minera de Chile Limitada	155	Minning
S. Trosso	Coremaq S.A.	155	Trade
N. Arditto	Promotora de Belleza S.A.	8.774	Chemical industry
Other 36 investors	--	4.254	--
Total	--	423.618	--

* Corresponds to the Peruvian investor participation in joint projects with companies from other countries.

Source: FIC, 2012.

With regard to the collection of data on PDI in Chile, there is an underestimation, as the only available records are made by the FIC, which are limited to investments benefiting from the DL 600 and for an amount exceeding the USD 5 million. It is highly likely that there is a significant amount of investment that enters through Chapter XIV and therefore, is not being registered as an unbundled basis to analyze target sectors or its impact. This would explain the differences between the estimated investment figures from other sources, which place it in 5 or 6 times the figure given by FIC. In October 2009, the then Minister of Foreign Trade of Peru, Martín Pérez, estimated the Peruvian Investment in Chile around USD 2,500 million (Perú 21, 2009), while in 2012, an estimate by the private sector agents was around USD 3,000 million (Que Pasa, 2012).

A complementary source on collecting data on PDI, is constituted by press records and information available in institutions such as SVS, which carries out a record limited to actions taken by issuers of publicly offered values.

While using the SVS records can significantly complement the available information, it is an instrument that presents objections to draw conclusions. The great difficulty is that it does not record the origin of the property or the form of FDI. The main example that accounts for this situation is the case of Cencosud. Although part of the property belongs to the Peruvian Group Wong, this corresponds to a purchase transaction conducted in Peru in 2007 which involved the exchange of shares between the two groups (SVS, 2012), in which case does not correspond to consider it as FDI.

Likewise, there is a number of relatively smaller investment, particularly in gastronomic and hotel services that has not been captured by the FIC and that represent not only a significant penetration of capital but also of customs and Peruvian labor into the country.

In addition to the Brescia Group, already mentioned, the presence of large economic Peruvian groups in Chile began in the 90s (Que Pasa, 2012), with an investment of Banco de Crédito del Perú (BCP) in 1997, belonging to the Romero Group, in the financial sector by USD 15,480,000, materialized in the Metropolitan Region. This initial investment is understood in the context of an agreement between that institution and the Banco de Crédito e Inversiones (BCI), where the BCP directly owns 3.6% of the property (BCI, 2012). This 1995 agreement between both institutions, provides that both presidents will be part of the respective boards. His latest investment in the financial sector corresponds to the purchase of 60.6% stake in the brokerage IM Trust by BCP (SVS, 2012).

In the case of the Rodríguez-Pastor Group, it has harmonized its investment in the entertainment industry in film distribution chains, with the entry of Cineplanet Perú market under the Movieland Brand in 2005 in the Chilean, and adopted the chain name, Cineplanet, in 2012 (Que Pasa, 2012). Other remarkable cases are the entry, in May 2011, to Cement Polpaico property of Peruvian miner Volcan, plus Belmont Group investments in the area of cosmetics and Industrial Intradevco, owner of Klenzo cleaning products brand (Perú Económico, 2012).

Figure 19: Record of Peruvian Investment Projects in Chile, 2009-2012. Sources other than FIC

	Receiver	Year	Category	Figure in million of USD
Inversiones Breca S.A.	Tricolor S.A.	2012	Industry	96
Grupo Intradevco	Klenzo	2010	Manufactoring	16
Tiendas KUNA Michelle Belau	Apertura Local	2009	Comercio	1
Banco de Crédito del Perú	Corredora IM Trust-Chile	2012	Financial Intermediation	n/i
	Foodlinks (Holding Invertec)	2012	Financial Intermediation	n/i
Belcorp	Ebel		Cosmetics	
Tiendas KUNA	Apertura Local	2009	Trade	n/i
Platerías El Pulpa		2009	Manufactoring	n/i
Cineplanet	Movieland	2005	Services	

Source: SVS, Press records, Foreign Investment Department, International Economic Relations Division, Ministry of Foreign Affairs, Chile

Special mention concerns the gastronomic area, with a number between 120 and 150 restaurants owned by Peruvian nationals, with an estimated investment of USD 200 million

(Que Pasa, 2012), which is mainly concentrated in the Metropolitan Region. This figure should be analyzed in detail, as most of these investments do not necessarily operate under the traditional mechanisms of the FDI, but take different forms, ranging from the franchise, such as "Astrid y Gastón", brand property of chef Gastón Acurio to entrepreneurs initiated by Peruvian immigrants in Chile with prior residence.

Finally, an interesting aspect is the increasing visibility of the PDI in Chile, as well as the identification of the product’s origin and the presence of Peruvian investors in corporate boards.

Peruvian mining company Volcán, which holds a stake in the ownership of the cement Polpaico, is present in the board of the firm, through the presence of directors to the president of the Peruvian company, José Picasso and José Ignacio de Romagna. In the case of the Romero Group, they are present in both the BCI and in the Port of Arica, being Dionisio Romero a member of its board. In the case of Peruvian Group WONG, the presence of Erasmo Wong in the CENCSOUD board in Chile, lies on the purchase made by the Chilean retailer of the Peruvian firm in late 2007, which sought, among other things, that the Wong family would have a percentage of shares of the Chilean group, becoming one of the three largest individual shareholders stake in the company, integrating in this way the Cencosud board (Figure 20). An interesting case is that of Peruvian investor Juan Rassmuss Echecopar, who until the arrival of Breca Group, owned the main Peruvian investment in Chile, but despite its importance, it is not registered as FDI. The aforementioned is the holder of 39% of INVERCAP S.A., which holds 31.2% of mostly major economic groups, such as the CAP Group S.A.

Figure 20: Board of main Peruvian investments in Chile

Company	Category	President	Vicepresident	Board
Melón S.A.	Cement	Pedro Brescia C.	Mario Brescia C.	5 directors
Cencosud S.A.	Retail	-	-	Erasmo Wong
Polpaico S.A.	Cement	-	-	José Picasso José Ignacio de Romaña
Terminal Puerto Arica	Port	-	-	Dionisio Romero

BCI	Financial	-	-	Dionisio Romero
Invercap	Steel/ Mining	-	-	Juan Rassmuss

Source: Memorias Empresas y SVS.

Crossborder business associations and chambers

Finally, private partnerships that bring together businessmen from both countries and the role they play in the arrival of PDI are observable. Basically, these are two: the Binational Chambers and the Business Council respectively. In the first case, it is noticeably larger the Peruvian-Chilean Chamber than the reversed one. The Peruvian- Chilean Chamber of Commerce has 89 partners, compared with 44 of its Chilean counterpart. This is probably explained due to the higher presence of Chilean capital in Peru, both in terms of the amount invested as in the years that it has remained in that country. At the same time, it should be noted that in the Peruvian case, they are affilieted to the main Chilean investors, such as Ripley, Falabella or LAN, with the notable exception of Cencosud, which is indirectly represented through the Wong group. This situation does not occur in the case of Chile, where the main sources of PDI are not affiliated with this instance.

In the second case, the Business Council consists of two chapters, the Chilean one, chaired by Juan Eduardo Errazuriz, and the Peruvian one, chaired by Juan Francisco Raffo. It is an entity that brings together leading businessmen of both countries, and despite having no known address, it has gained significant visibility, manifested in meetings and seminars with business and political authorities of both countries, being its promotional activities more visible in the case of Chilean FDI in Peru (Fundación Imagen País, 2012).

Peru’s Inward and Outward Foreign Direct Investment

Overall Inward and Outward FDI

In the nineties, most foreign investment was related to the privatization of some public enterprises such as the Public Telephone Enterprise. However, as a consequence of the positive economic growth experienced by Peru in the 2000, investment flows have increased significantly in the last decade reaching US$ 63,448 million in 2012. Between 2007 and 2012, FDI stock in Peru grew at an average rate of 21.0%, which is above of the average growth rate of Latin America Countries.

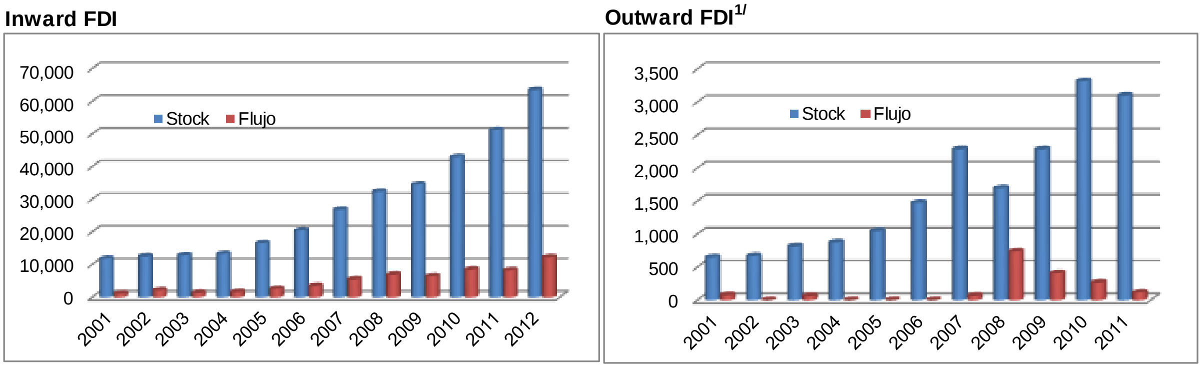
In terms of Peru's inward FDI flows, these have been doubled in the last five years. In 2012, FDI flows reached the highest level in the last 15 years, US$ 12,240 million. Although, FDI outflows were registered in 2009 and 2011, most probably because of the financial crisis that began in 2008, the average growth rate between 2007 and 2012 was 25.8%.

With regard to the outward FDI stock, Peruvian investment abroad has begun to grow substantially. In 2011, Peruvian companies invested approximately US$ 3,099 million outside the country, which showed a growth of 20.5% (average 2007-2011). Figure 21 provides the latest Peru's data for inward and outward FDI.

Figure 21: Peru's Inward and Outward FDI

(US$ millions)

Inward FDI **Outward FDI[1/]**



Source: Peru's Central Bank, UNCTAD.

1/ Not information is available for 2012.

With respect to the inward FDI, it is important to mention that foreign investment information presented below are based on the Statistics of Balance of Payments carried out by the Central Bank of Peru. The main drawback with this statistics is that no information by sector and country of origin is available. For this reason, the statistics of PROINVERSION are helpful because, pursuant to the provisions of Article 19° of Legislative Decree No. 662, companies and investor have the obligation of registering all foreign investment. Although, the information provided by PROINVERSION allows to make sectoral and country of origin analysis, it is underestimated because Article 19° does not set strict time limit or penalty on anyone who does not comply with this registration of the foreign investment.

The difference between the statistics reported by the Central Bank and those registered in PROINVERSIÓN are explained by the fact that the Central Bank's FDI statistics also consider the contributions of capital and buyout capital (transfer of shares between residents and non-residents), the reinvestment of profits (the difference between the profits generated in the period less dividends paid to foreign investors in the same period) and net lending to the parent (received less paid) between the investor and its affiliate.

On the other hand, the methodology used by PROINVERSION refers to different types of contribution to capital (including share reductions and transfers) in companies established in the country (investment actually made). Unlike the information disseminated by other sources, these information does not include flows on loans, or the valuation of goods or other assets that are not destined to the capital of the local company.

Taking into account the above considerations, although PROINVERSION statistics are underestimated, they are a good proxy of the sectoral and country of origin distribution. In this sense, according to PROINVERSION, Spain, England and the United States were the main foreign investors in Peru, in 2012, followed by the Netherlands and Chile with shares of 20.5%, 19.8%, 13.8%, 6.8% and 6.1% respectively.

At the sectoral level, inward FDI in Peru is highly concentrated in mining, financial and communications. The mining sector had a share of 23.9% in 2012, with Southern, Xtrata, Gold Fields, Cerro Verde and Yanacocha acting as the country's main foreign investors in the sector. On the other hand, foreign investment in the financial sector is also relevant with a share of 18.5%, during 2012. The most important foreign companies in this sector are, Scotiabank, BBVA, and other insurance companies such as Sura and ING. In the communications sector, the telecommunication sector continues to be dominated by Telefonica, alongside Nextel International and America Movil.[5]

[5] Despite the increasing participation of more enterprises in the Telecom sector, Telefónica maintains an important position in the market. As in most countries, Telecom enterprises were of public ownership in Peru until 1990's. In 1994, the privatization process began and Telefónica bought Peru's Telecom public enterprise (Entel Peru) and enjoyed of a monopoly until 1999 (according to the privatization contract). After this period, the liberalization process in the telecommunications sector began in 1999, under the supervision of OSIPTEL. After more than ten years of liberalization process, Telefónica's share has reduced from 99.6% in 2001 to 74.1% in 2012, maintaining its dominated position in the market.

Figure 22: Peru's Inward FDI by Country of Origin

Country	2011 share (%)	2012 share (%)	Growth Rate (%)
Spain	20.15	20.53	3.62
United Kingdom	19.81	19.81	1.71
United States	14.21	13.97	0.00
Netherlands	6.88	6.76	0.00
Chile	6.20	6.13	0.59
Brazil	5.12	5.04	0.00
Colombia	4.74	4.82	3.41
Panama	4.20	4.13	0.11
Canada	3.79	3.73	0.00
Mexico	2.09	2.05	0.00
Switzerland	1.96	2.01	4.22
Singapore	1.64	1.61	0.00
Luxemburgo	1.22	1.20	0.00
Japan	1.05	1.05	1.71
Others	6.94	7.17	5.04
Total	100.00	100.00	1.72

Source: Proinversion - Peru

Figure 23: Peru's Inward FDI by Sector

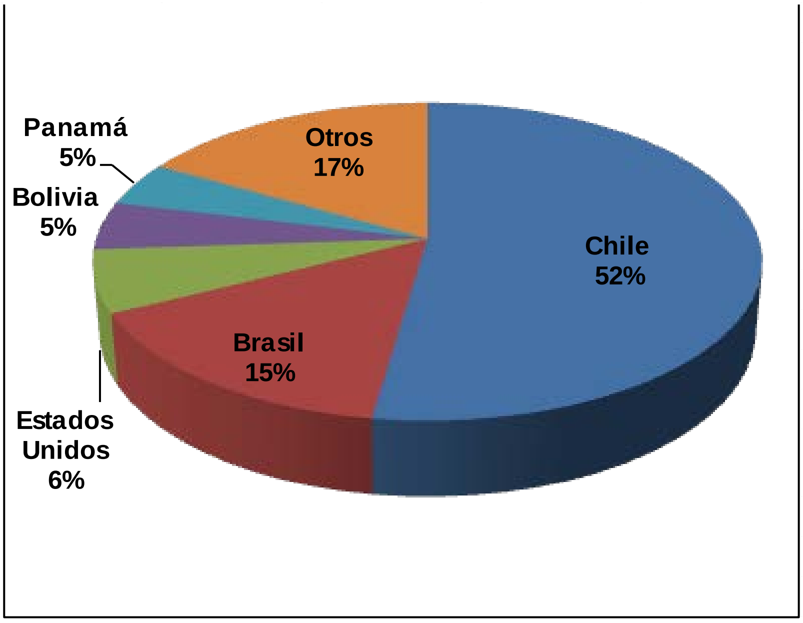
Sector	2011 share (%)	2012 share (%)	Growth Rate (%)
Mining	24.19	23.89	0.48
Financial Services	18.30	18.46	2.58
Communications	17.08	17.33	3.19
Industry	13.94	13.72	0.07
Energy	13.18	13.50	4.16
Commerce	3.56	3.51	0.16
Oil	2.81	2.76	0.00
Other Services	2.51	2.47	0.00
Transport	1.51	1.49	0.00
Construction	1.48	1.47	1.55
Fishing	0.73	0.72	0.00
Tourism	0.34	0.34	0.00
Agriculture	0.20	0.20	0.00
Housing	0.15	0.14	0.00
Forestry	0.01	0.01	0.00
Total	100.00	100.00	1.72

Source: Proinversion - Peru

Regarding the outward FDI of Peru, although, Peru is an important receptor of FDI in Latin America, it is also becoming a relative significant investor in the region. As shown in Figure 24, Peruvian investment abroad is heavily concentrated on Latin American countries, with the exception of the US. The main Peru's investment destinations in Latin America are Chile, Brasil and Bolivia. As it may be expected given the boom of Peruvian cuisine and tourism in the last years, many restaurants are expanding their operations abroad by opening direct-related restaurants or by selling their franchises to entrepreneurs in the destination country.

It is important to mention that, in Peru, there are no precise statistics, at sectoral or firm level, about Peru's FDI outward. In that sense, based on the information from the Peruvian Chamber of Franchises and the National Commission of Values, Figure 25 shows a sample of Peruvian firms that have invested abroad.

Figure 24: Peru's Outward FDI by Receiving Country, 2010



Source: Peru's Central Bank, IMF

Figure 25: Peruvian Enterprises Investing Abroad

Enterprises	Sector	Destination
Yobel SCM	Customs Agency	Bolivia, Chile, Ecuador, Honduras, El Salvador and Guatemala
Transporte Transaltina Chile Limitada (CERVESUR)	Land Transport	Chile
Banco de Credito de Bolivia S.A.	Financial Sector	Bolivia
Banco Interbank	Financial Sector	China, Brazil* and Panama*
Credibolsa S.A.	Financial Sector	Bolivia
Credicorp Securities INC	Brokerage	United States, Panama
Credifondo SAFI S.A.	Financial Sector	Bolivia
Inversiones BCP Ltda.	Financial Sector	Chile
Soluciones en Procesamiento S.A. Servicorp	Flower shop	Bolivia
Rosatel	Flower shop	Chile, Colombia, United States and Mexico
Heladeria 4D	Restaurants	n.a.
La Caravana	Restaurants	United States
Astrid & Gaston	Restaurants	Colombia, Chile, Spain ans others
La Mar	Restaurants	United States, Mexico, Chile, Brazil and Panama
China Wok	Restaurants	Guatemala, El Salvador, Costa Rica, Ecuador and Chile
Pardos Chicken	Restaurants	United States, Chile and Mexico
Rockys	Restaurants	n.a.
Tanta	Restaurants	Bolivia and Chile
Bembos	Restaurants	India and Guatemala
Alfresco	Restaurants	Chile

n.a. : not available

* In progress

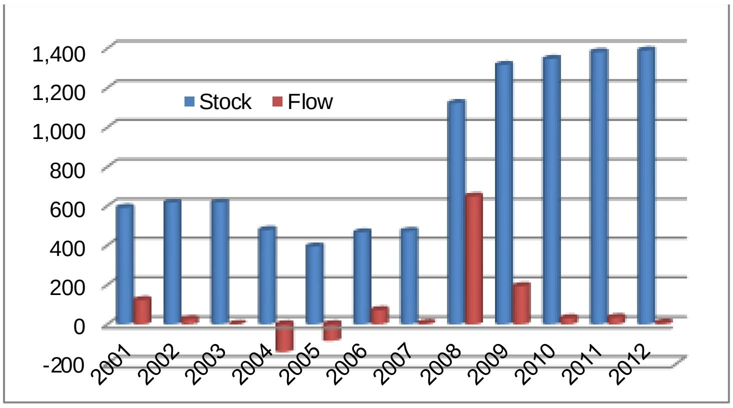
See Table 4 in Illescas, J. (2010)

Peru's Inward FDI from Chile

Currently, Chilean capital flows in Peru are quite significant. According to PROINVERSION, Chile has invested in Peru about US$ 1,390 million in 2012. It is important to take into account that this number is underestimated by the reason above explained. However, it is relevant for analyzing in what sectors Chilean investment is concentrated.

Even though, Chilean investment growth significantly in the nineties, during the 2000s, it has almost been tripled in comparison with what registered at the beginning of the decade. As shown in Figure 26, FDI from Chile to Peru was US$ 591 million in 2001, while in 2012, was US$ 1,390 million, having grown at an average rate of 13.1%.

Table 26: Peru's Inward FDI from Chile
(US$ millions)



Source: Proinversion

At sectoral level, most Chile's investment is in the Financial Services sector, which accounted for a share of 45.5% in 2012. The other most relevant sectors where Chilean investment is concentrated are Mining, Industry, Commerce and Energy with share of 13.8%, 12.8%, 9.8% and 7.0% respectively. In terms of firms, LAN airlines, Ripley, Saga Falabella and Totus are Chilean enterprises established in the Peruvian market for more than 10 years with a significant share in their respective markets. On the other hand, more recent Chilean investment that have entered Peru are located in the Tourist and Commerce sectors with firms such as Atton and Parque Arauco.

Figure 27: Peru's Inward FDI stock from Chile by Economic Sector

Sector	2011 share (%)	2012 share (%)	Growth Rate (%)
Financial Services	45.78	45.51	0.00
Mining	13.90	13.82	0.00
Industry	12.83	12.76	0.00
Commerce	9.26	9.79	6.39
Energy	7.06	7.02	0.00
Construction	5.93	5.89	0.00
Other Services	4.06	4.04	0.00
Tourism	0.89	0.89	0.00
Housing	0.22	0.22	0.00
Agriculture	0.05	0.05	0.00
Transport Services	0.01	0.01	0.00
Communications	0.00	0.00	0.00
Fishery	0.00	0.00	0.00
Oil	0.00	0.00	0.00
Forestry	0.00	0.00	0.00
Total	100.00	100.00	0.59

Source: Proinversion - Peru

Perception of the bilateral investment relations

Perceptions in Chile

Based on qualitative methodologies with depth interviews to key informants (KI), this section analyses the perceptions in Chile about the present, future and potential impact of PDI on the bilateral relationship. These informants were selected for their direct or indirect participation with FDI, and in particular with PDI. In this sense, government officials, union leaders, entrepreneurs, managers, and Chilean and Peruvian scholars were interviewed regarding the current situation and prospects of the PDI in Chile.

Latin American investments are generally characterized by a type of investment that is not intended to natural resource, but rather market seeking, which is conducive to the diversification of the productive area and countries' internationalization, and are usually cases that, somehow, give greater value to the recipient, through improvements in employment, higher value-added and incorporation of technologies, among other things.

During the study, a constant problem was the conceptualization of the FDI and obtaining PDI statistics. We made evident the defects regarding the lack of clear definitions as to what is means direct investment and the absence of statistical records-global and disaggregatedparticularly the lack of records on the PDI in Chile. This absence was highlighted by several interviewees, since the absence of proper accounting information omits relevant knowledge of the Peruvian case, when analyzing the official figures. The Peruvian government has no official statistics on capital exports to the world. This situation forces the seeking of information on secondary sources o third countries, for example, Chile, where exists a record of investment entering through DL 600 and to a lesser extent Chapter XIV, that being merely a change control tool, does not perform a comprehensive record of the destination of this investment. Unfortunately, all PDI under the Central Bank's minimum (USD 10,000), is not recorded. In the case of the PDI is interesting to study this, because this pocket capital may normally be used for areas such as gastronomy, silverware or general retail, sectors with a strong Preuvian presence in Chile.

All this leads to important gaps in knowledge of PDI, which generates voids in public policy at both the Peruvian and the Chilean State. In the Peruvian case, this information could a useful tool to know what the businessmen status is and to take protective measures or bargaining chip, if necessary. In Chile, it may be interesting to generate policies to promote specific sectors that may be of relevance by Peruvian know-how (food, business services).

For the interviewees, a first explanatory factor in Chile's PDI as previously mentioned, is that this is a rather recent phenomenon, due to the growth process experienced by Peru in the last decade, where both the dynamism of economic activity of its domestic market as the space on it to continue its expansion process, has led the Peruvian capital outflows in the form of FDI. Therefore, it would be a relatively similar situation to what occurred with the case of the first experiences of FDI by Chilean firms in the early nineties.

Secondly, it appears the presence of legal bases, such as bilateral agreements, which provide a security framework for FDI in the respective country. Among these agreements one can mention the Protection Agreements Investment Promotion of Double Taxation and Free Trade. It also highlights the presence of other agreements, while not directly related to investments, they have facilitated the installation of Peruvian firms in Chile, such as social security agreements.

A third important element, has been the role played by the private sector in attracting FDI, mainly by the presence of Business Councils and Bilateral Chambers of Commerce.

A first broad agreement among all KI is that the PDI in Chile is underestimated. This is mainly due to the mechanisms of income's limitations, which would not be recording recent investments under USD 5 million or not benefiting from DL 600. A second explanation would lie in the fact that the opening of this kind of business, such as gastronomy, do not always correspond to a capital income from Peru, but rather ventures of Peruvian residents in Chile, so it is not recorded as FDI.

A second relevant coincidence among KI is that an increase in PDI flows to Chile should be observable, due both to the expansion capabilities of Peruvian companies, whose internationalization is recent and have room to continue it, as the large existing space in Chile for growth. Among sectors considered to have potential characteristics for expansion, are mentioned small and medium mining, services associated to this activity, gastronomy and silverware.

Perceptions of Chilean key informants regarding PDI

When analyzing the perception of Chilean KI regarding PDI, is notable the existence of a consensus on the factors that explain it and its potential. One of the first remarkable aspects is related to the done work in Chile in terms of investment. The KI agree that the DL 600 has completed a cycle as a promotional tool and requires a revision of its provisions. According to Chilean scholars, this has guided the PDI entry to Chile through Chapter XIV, since it gives the impression that its use is simpler and less bureaucratic than the DL 600. In addition, it is estimated that a major part of PDI is lower than the amounts required by DL 600. This would result in an underestimation and troubles identifying Peruvian investments in the Chilean market, which can only be followed by secondary sources.

The aforementioned obsolescence of certain clauses of the DL 600, particularly the flat tax of 42%, requires an urgent review, according to national experts, an opinion that is not discussed. Discrepancies arise when arguing the necessity of establishing priority to certain sectors and countries, and how to address them. While a sector, particularly the government, maintains a neutral guideline with Chilean economic policy, and believes it is necessary only to adapt it to respond to reality and current needs, other sectors, academic and business, agree on the need to update DL 600, but are open to define priority areas and provide special schemes of action to enhance certain sectors and countries.

There is unanimity on the importance and necessity of deepening relations between Chile and Peru, and PDI is seen as a way for it, especially given the present Chilean investment levels in the neighboring country. It is admitted that the Peruvian private sector is just maturing and is possible that in the coming years it will generate a greater flow of capitals to Chile. The actual presence of PDI in Chile is lower than other markets of origin, but it is emphasized that this investment does not adress traditional sectors (mining, forestry). Likewise, there are areas where the Peruvian know-how can support national development plans, such as agriculture or services. Finally, there is an agreement that an increased flow of capital between the two countries, is a bridge to ease other areas of historical conflict between both countries.

Perception of Peruvian investors on the experience in Chile

Regarding the Peruvians KI interviewed in the case of Peruvian investors, there included companies with and without presence in Chile. In turn, within installed companies in the country, the sample was distributed in a variety of sectors, which undoubtedly enriches the study, giving a wider picture, thus, avoiding potential biases. On the following lines are presented the key findings on the perceptions of Peruvian investors Peruvians in Chile.

Firstly, there were analyzed the reasons that led to the internationalization of the Peruvian capital, focusing the analysis on the reasons that allowed locating such investments in Chile. According to the collected data, this is mainly due to the abrupt growth experienced by the Peruvian economy in the last decade. As it grew, fortunes began to expand horizontally, expanding its scope beyond its original business in Peru. For example, the Brescia Group began to grow and buy companies in areas outside those originally developed (fishing, paints, agro-industrial businesses, as well as banking, finance and hotels). Another example of this situation is the Rodríguez Pastor Group, which through its arm, Nexus, grow in the retail sector (supermarkets, department stores, home improvement stores, malls, drugstores, fast food, movie theater complexes, hotels, etc.). But once horizontal growth becomes more complex by the depletion of the market (less Peruvian companies available and more expensive), they start to seek new horizons for further growth. The natural step of these groups is to go to another country to keep growing in areas where they have already gained experience in Peru. Thus, Brescia Group acquired companies in painting and cement areas; Pastor Rodriguez Group in entertainment, specifically movies; and the Romero Group concentrates its expansion in food companies and financial services.

A high percentage of the interviewees declared that their interest to settle in Chile responded mainly to the presence of business opportunities, which were consistent with the expanding plans of the companies, along with Chile’s own attractive.

The prior statement can be verified by the behavior that the Brescia Group has taken in its internationalization process, particularly in its entry to Chile, which responds that the "primary motivation was the opportunity to get into the business of building materials, such as the case of Melón" (Estratégica, 2012), along the line that the group has managed in Peru, with several decades of experience in the field. In this sense, rather than an internationalization plan to establish a point of operation in Chile, the investment was made by the commercial opportunity that the acquisition of the assets of Cemento Melón represented. Its expansión in the country responds to the same logic of taking advatage of the presented opportunities. The purchase of Tricolor Paintings during 2011 was due "because we feel comfortable in Chile as investors and were presented with an opportunity in an industry where we have grown a lot in our home market, this operation gives us a broader international insight. This is a prestigious company, with a capable team and very good and valued products by the Chilean market" (Estratégica, 2012).

The environment is considered a relevant, but secondary factor. Special factors are considered the macroeconomic and political stability, and the healthy business climate that the country presents. These elements allow the investor to have a clear vision about market trends and can develop business plans in the medium and long term, with predictable and reliable parameters. Regarding this aspect, one of the controllers of the Breca Group, Mario Brescia, explained to the national press that “Chile is a country with an adequate business climate, that is well respected and gives proper treatment to the investor, has institutions and a market conducive to investment, but that also requires us to be more competitive in order to keep us as leaders in the activities in which we are” (LaTercera, 2012).

Perceptions in Peru

As in the case of the analysis conducted to Chile, key informants were interviewed in order to capture the perceptions in Peru about the present, future and potential impact of FDI on the bilateral relationship. These informants were selected from the entrepreneurial, the academic as well as the government sector, because of their direct or indirect involvement with Chilean FDI in Peru.

Reasons of why Chileans invest in Peru

Key informants were asked about the reasons of Chilean firms to invest their assets in Peru. Those consulted agreed that the main reason is due to the geographical and cultural proximity between the two markets. When Chilean companies began to invest abroad, one of the main destinations of their investments was Peru. According to PROINVERSION statistics, Chilean investments in Peru grew significantly since 1994, year in which they were multiplied by six, mainly because of the entry of firms in the commercial sector such as Falabella and Ripley, which began operations in 1996 and 1997 respectively.

A second stage of Chilean capital inflows was observed from 2008. According to the interviews, this new growth of Chilean investments in Peru is mainly caused by the legal and macroeconomic stability as well as the sustained economic growth experienced by Peru since almost the beginning of the 2000s. Peru is currently one of the countries with higher growth rates throughout Latin America and worldwide, with an average growth of about 5% over the past 10 years. Moreover, the process of structural reform of the nineties has been complemented by a negotiated trade liberalization process both at the bilateral and regional levels. This process is aimed at increasing trade and investment flows, by ensuring legal stability for business transactions carried out between Peru and its main trading partners. As a result of legal and macroeconomic stability achieved, Peru has become an important destination for FDI, being Chile an important partner. In this regard it is noted that during the period 2007 - 2012, Chilean investments have quadrupled. This growth is mainly due to entry of new investors as Atton, Parque Arauco and the growth of business operations of other already established first such as Falabella and Ripley.

When asked about what current legal system tools are the most important in deciding to perform investment relations with Peru, investor disagreed with the opinions expressed by academics and public sector representatives. According to investors, a stable tax system and double taxation agreements are the most important tools considered for doing business in Peru. These two elements are followed, in importance, by a clear labor regime and the existence of a free trade agreement. From the ranking mentioned, it can be inferred that Chilean investors mainly take into account existing tax schemes and flexibilities in Peru in order to make their decisions to invest in the Peruvian market.

On the other hand, academic and public sector representatives deem that the existence of the Free Trade Agreement is what influences the most, the investment decisions. This is because, in his view, investors seek legal stability which is mainly given by a free trade agreement, especially when the FTA contains investment-related provisions. The existence of the trade agreement is followed in importance by stable tax rules, the double taxation agreement and finally by the labor regulations.

Problem that Chilean firms have faced in Peru

Most key informants agreed that, in general, established Chilean investment in Peru is respectful of the internal rules and is careful not to have public exposure. Although high investment flows between Peru and Chile would assume that economic activity is not necessarily linked to political events (given the maritime litigation that Peru and Chile maintain in the Court of the Hague), Chilean investors have clear that they must try to fulfill the laws as their media exposure would be greater than in the case of any other investors from other countries. This is probably one of the reasons why only few Chilean companies are dedicated to the extraction of natural resources, although Chile is a world leader in the production of minerals and fish, given the fact that most existing social conflicts in Peru are related to the extractive industries.

It is worth mentioning that the type of Chilean investment established in Peru is consistent with the strategy to avoid media exposure and social conflicts. According to the classification of the types of investment developed by Dunning, from the point of view of the recipient country, Chilean investment established in Peru can be classified as market-seeking. It means that this investment seeks to gain market share offering products and services which may be generated in the market, its operations are developed. In addition, this type of investment usually creates jobs, which varies according to the level of linkages it has with the domestic market.

On the other hand, key informants stated that the main problem that investments face to be materialized in Peru is to obtain permits and licenses. Although, according to the World Bank's Doing Business, Peru has improved in the ranking, the time to open a business remains one of the longest in the region. Such delays are recorded not only at central government level but also at regional and local governments. In this regard, institutions such as INDECI, Ministries, Regulating bodies and Regional Governments and Municipalities are considered the institutions that generate most delays in the opening of businesses in Peru.

Another aspect that was considered a problem for the materialization of the investments was the existence of corruption. Unfortunately, key informants stated that fir the procedures to be expedited, they had to give payments that were not covered in the legal fees.

How to attract more Chilean investment to Peru

Key informants agreed that Peru is a fairly well known market for Chilean investors. Chilean investments have over twenty years in the Peruvian market so it is natural that most Chilean companies with international operations know about the Peruvian market dynamism. In this regard, key informants agreed that greater efforts should be made by the Peruvian government to ensure greater diversification of Chilean investments in Peru. Finally, strengthening the commercial agencies and increase the activities to the dissemination of the image of Peru abroad are considered actions that may help Peru to attract higher levels of investment.

Final consideration

The close cultural and geographical situation together with the possibilities to increase investment, develop new forms of cooperation and add value to our exports make fundamental to understand and strengthen the bilateral FDI flows. Perceptions and the statistics analysis drove us to extract some relevant issues that could be address by the different agents involved:

- Creation of a coordinated bilateral investment related agencies

One of the main obstacles identified to improve the flow of capital between Peru and Chile, has been the lack of communication between both countries in the field of investment promotion and identification of complementarities that make it attractive for investors to develop a bilateral relationship. Nowadays, the Chilean government has not shown great interest in attracting Peruvian capital and has been the private sector the one that has taken this role. There is no doubt this behavior is likely to change due to the importance acquired by Peruvian investments in Chile. Therefore, a greater coordination is necessary between the agencies responsible for promoting investment between both countries.

The existence of a coordination mechanism between agencies responsible for promoting investment in both Peru and Chile, would allow these institutions to give centralized information more efficiently to investors. Just as it would prove a useful mechanism to promote policies or programs in which the counterparty can play a key role.

- Strengthening relationships between the private sectors

In addition to the creation of a coordinating body, it is of vital importance to the investment incomes to the country strengthening the ties between privates. This is where the Chilean-Peruvian and binational business council can play a role as mechanisms that create bonds and trusts, fostering relationships and investment opportunities between both nations.

- Renewal of the mechanisms of investment promotion

In this regard, it is essential that the executive performs a renewal of promotional tools and mechanisms, such as the DL600 which is obsolete, and the establishment of programs to promote investment.

- Approach from academia to government and private investment

A greater interaction between academia, government and private studies would give a clearer view of the investment landscap,e highlighting strengths, weaknesses and opportunities that FDI may face. This can be a valuable policymaker tool, making it possible to respond more effectively.

- Improve of FDI statistics to conduct well-informed public policy decisions

It is necessary to drastically improve the lack of detailed statistical information regarding FDI industry, especially in the case of Peru. The statistics developed by Central Banks are concentrated on the Balance of Payment (BOP) and do not give information at firm or sectoral. Moreover, statistics do not have enough details to make deeper analysis in order to formulate public policy.

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