

GENERAL

E/CN.12/166/Add.11  
7 May 1951

ORIGINAL: ENGLISH

ECONOMIC COMMISSION FOR LATIN AMERICA  
Fourth session

ECONOMIC AND LEGAL STATUS OF FOREIGN INVESTMENTS  
IN SELECTED COUNTRIES OF LATIN AMERICA

(Prepared by the Secretariat)

FOREIGN INVESTMENTS IN PERU

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## PART I. THE NATURE OF FOREIGN INVESTMENTS IN PERU

A. External Public Debt

During the nineteenth century the Peruvian Government borrowed repeatedly in the London capital market. In the period 1822 to 1825 several loans were raised totalling about £2 million. Several years later these loans went into default; they were refunded in 1849 and again in 1853. In 1860, a loan was raised in connexion with a monetary reform. The refunding loan of 1853 and the 1860 loan were repaid in full prior to maturity.

During the period 1869-1872, £35 million was raised in London for the construction of several major railroad lines. In 1876, Peru defaulted on these foreign loans since sufficient foreign exchange was not available. The payment difficulties persisted till 1890, when a settlement with the bondholders was made; the sterling debt by that time, including interest arrears, amounted to £57 million. The settlement of 1890 was a milestone in Peru's financial and economic history because by it most railroad lines in the country were turned over to the Peruvian Corporation, an organization established for this purpose by the British creditors. The Peruvian Corporation obtained possession of the railroad lines for a period of 60 years and also obtained the right to operate the Government-owned steamers on Lake Titicaca, which connects the railroad lines in Peru with those in Bolivia. Furthermore, the Government agreed to pay an annual subsidy of £80,000 for 33 years and to turn over to the Peruvian Corporation 2 million tons of guano.<sup>1/</sup> The agreement relieved the Peruvian Government from all foreign debt except the annual subsidy due to the Peruvian Corporation. The terms of the agreement were not fully met and in 1907 a new agreement was concluded which extended the life of the previous contract for an additional 17 years. In 1928, the annual subsidy and the guano rights were cancelled, and the Peruvian Corporation was accorded possession of the railroads in perpetuity. The Corporation, however, was obliged to pay the Peruvian Government an annual tax of £20,000 during nine years.

<sup>1/</sup> Pan-American Union, The Peruvian Economy, Washington 1950, p. 132.

Only one additional sterling loan was raised in the London market prior to World War I: the city of Lima in 1911 obtained £600,000 at 5 per cent, guaranteed by the Peruvian Government.

After World War I, Peru floated many bond issues in New York and two in London. The record of the inter-war period is as follows:

National Government Loans

<u>Rate of Interest</u>	<u>Year of Issue</u>	<u>Amount Issued</u> (in millions of currency indicated) <u>U.S. dollars</u>
8 per cent	1922	2.5
8 "	1924	7.0
7 1/2 "	1925	7.5
8 "	1926	2.0
7 1/2 "	1926	16.0
7 "	1927	15.0
6 "	1927	50.0
6 "	1928	25.0
		<u>£ sterling</u>
7 1/2 "	1922	1.3
6 1/2 "	1928	2.0

} refunded by subsequent issues

Provincial and Municipal Government Loans

			<u>U.S. dollars</u>
7 1/2 "	Province of Callao	1927	1.5
6 1/2 "	City of Lima	1928	3.0

Not all dollar loans constituted new obligations of the Peruvian Government. The first five loans issued between 1922 and 1926 were completely refunded by the loans obtained in 1927 and 1928; the total issues of the national government net of refunding were \$60 million. The effective interest rates were somewhat higher than those shown in the above table, particularly for two issues of dollar bonds of 1927 and 1929 which had an issue price to the public of 92.8 and 91.0 respectively, with effective rates of 6.7 and 6.6 per cent.

During the world economic depression after 1929 both the prices and volume of major exports declined greatly, and the previous inflow of capital for business investment was discontinued. On 29 May 1931, the Peruvian

National Government suspended service on its foreign debt. The issues of the city of Lima and the province of Callao went into default at the same time. Internal Peruvian financial conditions were chaotic in 1931; at the same time political disturbances occurred and unrest was widespread. The foreign exchange reserves of the Central Reserve Bank fell drastically and the exchange value of the sol declined. From 1931 to 1948 only the loan of 1922, the so-called "Guano Loan", was regularly serviced. A reduction of the interest rate to 4 per cent was agreed upon with the bondholders in 1938. The reason for continued service on this loan was that it was secured by a charge on the revenue from a tax levied on all guano sold in Peru and by the pledge of 50 per cent of the stock of the Government Guano Monopoly (Compania Administradora del Guano).<sup>1/</sup>

Various attempts without success were made from 1931 to 1947 to arrive at a satisfactory settlement with the United States and British creditors. However, on 20 February 1947, the Peruvian Congress passed a law authorizing the Peruvian Government to resume payment of interest and amortization on all outstanding dollar and sterling loans except the municipal loan of the city of Lima of 1928. This law provided that all interest unpaid since 1931 was to be cancelled and that for the years 1947 and 1948, 1 per cent interest was to be paid; for 1949 and 1950, 1 1/2 per cent; for 1951 and 1952, 2 per cent; and 2 1/2 per cent after that date. The Foreign Bondholders Protective Council of New York did not recommend acceptance of this plan to the bondholders since it considered the interest rate too low and the cancellation of all interest arrears inequitable.<sup>2/</sup> In spite of this objection, which was supported by the British bondholders' organization, the Peruvian Government proceeded with the plan and made the offer directly to the bondholders. As can be seen from Table I below, more than 50 per cent of all United States bonds became eligible for the new plan through the direct assent of the individual bondholders. British bondholders subject to United Kingdom Exchange Control regulations

<sup>1/</sup> The Council of the Corporation of Foreign Bondholders, Annual Report 1947, (London, 1948), p. 278.

<sup>2/</sup> Foreign Bondholders Protective Council, Report 1946 through 1949, (New York, 1950), pp. 313-314.

could not accept the offer, since they were not allowed to acquire dollar securities, without a permit, which was not given.

Table 1: Peru: External Public Debt Outstanding at the end of 1949

		In millions of currencies indicated	Equivalent in millions of U.S. dollars
<u>Dollar Bonds</u>			
<u>Assented</u>			
(including dollar bonds issued for assented sterling bonds)			
Series A	National Government	\$ 2.9	
B	" "	19.5	
C	" "	9.2	
D	Province of Callao	.6	
E	Converted from E bonds	.5	
			32.7
<u>Unassented</u>			
7 per cent	National Government 1927	5.0	
6 per cent	" " 1927	20.7	
6 "	" " 1923	9.7	
7 1/2 "	Province of Callao 1927	.4	
6 1/2 "	Lima Municipality 1928	2.9 (x)	
			38.7
(x) not eligible to participate in plan.			
<u>Sterling Bonds</u>			
<u>Assented (under the 1938 settlement)</u>			
4 per cent	Guano loan	1922 £ .5	
		(at \$2.80)	1.4
<u>Unassented (under the 1947 settlement)</u>			
6 per cent	National Government 1928 E	1.9	
5 "	City of Lima 1911	.4	
		E 2.3	
			(at \$2.80) 6.4
<u>United States Government Credits</u>			
	Export-Import Bank (30 June 1950)	\$ .3	
	Maritime Administration	3.4	
	Surplus Property	.3	
			4.0
Total			83.2

Sources: Foreign Bondholders Protective Council, Report 1946 through 1949, (New York, 1950), pp. 312-321.  
United States Department of Commerce, Clearing Office for Foreign Transactions, Foreign Transactions of the United States Government (Washington, September 1950), p. A-54

The Peruvian Government has obtained several credits from the United States Government. The Export-Import Bank on 12 June 1945 granted Peru a credit of \$450,000 for use by the Santa Corporation, a government enterprise for the development of the Santa River valley. Of this credit \$444,000 has been disbursed: the Peruvian Government has repaid approximately \$161,000, leaving an outstanding balance of \$284,000 on 30 June 1950. The repayment was made despite the fact that according to the loan conditions the credit was repayable quarterly in 5 3/4 years, beginning 15 October 1950. In 1946, the Export-Import Bank set aside \$37 million for additional credits to Peru, but no loan contracts have been concluded.<sup>1/</sup>

The Export-Import Bank recently granted a credit of up to \$20.8 million to the United States-owned Cerro de Pasco Copper Corporation for the construction of a zinc refinery and other facilities in Peru.<sup>2/</sup> The Peruvian Government is not involved in this transaction.

Finally, Peru has obtained from the United States Maritime Commission a credit of about \$4 million for the acquisition of ships and from the United States Surplus Property Administration a credit of \$1.4 million. Both of these credits are being gradually repaid. As is shown in Table A, the amounts outstanding on 30 June 1950 amounted to \$3.4 and \$.3, respectively.<sup>3/</sup>

From 1946 to 1948, the Peruvian Government, authorized by the Peruvian Congress, has tried to obtain several large dollar credits abroad. The only loan actually raised amounted to \$5.6 million, granted by the International Petroleum Company, a company largely owned in the United States.<sup>4/</sup> It was fully repaid by 12 January 1950.<sup>5/</sup>

#### B. Direct investments

No census of foreign business investments in Peru has been taken by the

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- 1/ Export-Import Bank, Semi-Annual Report to Congress, January-June 1950, (Washington, D. C.), pp. 34-35.
  - 2/ The New York Times, 2 February 1951.
  - 3/ United States Department of Commerce, Clearing Office for Foreign Transactions, Foreign Transactions of the United States Government, (Washington, D. C., September 1950), p. A-54.
  - 4/ International Monetary Fund, International Financial Statistics, January 1951, p. 138.
  - 5/ Banco Central de Reserva del Peru, Boletin, January 1950, p. 49.

Government. It is known, however, that the only substantial foreign business investments belong to United States and British enterprises.

Before World War II there were substantial investments in Peru owned by German, Italian and, to a smaller extent, Japanese nationals who had migrated to Peru but had retained their original nationality. According to one estimate the total of such investments was more than \$74 million.<sup>1/</sup> German investments were largely in agriculture and trade. The largest sugar plantation in the country was owned by a German national. Italians owned one of the large commercial banks. Japanese interests were substantial in cotton farming and small manufacturing industries. So far as the country's international transactions were concerned, such investments were, however, akin to domestic investments. Most of the resident owners assumed Peruvian nationality after the outbreak of the War.

United States Investments  
American direct investments in Peru are substantial in mining, petroleum extraction and agriculture. The United States census of foreign direct investments as of 31 May 1948 reported such investments at \$71.2 million. The corresponding figure for the end of 1949 was about \$75 million.<sup>2/</sup> The investments in 1943 were distributed as follows:

	<u>Millions of U.S. dollars</u>
Mining and smelting . . . . .	29.1
Agriculture . . . . .	13.4
Petroleum extraction . . . . .	10.9
Public utilities and transportation . . . . .	7.9
Manufacturing . . . . .	5.5
Miscellaneous . . . . .	4.4
<u>Total</u>	<u>71.2</u>

Source: United States Treasury Department, Census of American-Owned Assets in Foreign Countries, (Washington, D. C. 1947), pp. 70. Data refer to 31 May 1943.

Two United States-owned mining companies and one petroleum company account for a large share of all United States investments in these fields.

1/ George Wythe, Industry in Latin America (New York, \_\_\_\_\_), p. 234.

2/ Cf. United States Department of Commerce, Survey of Current Business, November 1949, pp. 22-23 and January 1951, p. 23.

The two

The two major United States mining concerns are the Cerro de Pasco Copper Company and the Northern Peru Mining and Smelting Company; the latter is a subsidiary of the American Smelting and Refining Company. The Cerro de Pasco Copper Company was formed in 1902 subsequent to the construction of the Central Railway across the Andes. Although this railway did not touch the area which contains the rich mineral deposits, it offered great inducement to the developers. In the first five years of its existence, Cerro de Pasco spent about \$12 million for the building of a railway connecting its properties with the Central Railway; it also constructed a copper refinery and opened a coal mine. Ten years later, over \$40 million had been invested; additional investments were made in the 1920's. By 1935, Cerro de Pasco's total investment was estimated in excess of \$50 million. Operations were very profitable and by 1935 a total of about \$60 million had been paid in dividends to the stockholders.

The Cerro de Pasco Copper Company is by far the largest foreign-owned mining concern in Peru. The Northern Peru Mining and Smelting Company is of secondary importance, as is the United States-owned Inca Mining and Development Company, engaged chiefly in the production of silver. The United States' oil investments in Peru are owned by the International Petroleum Company, a subsidiary of the Standard Oil Company of New Jersey. In agriculture and manufacturing, W. R. Grace & Company is the most important United States enterprise.

The reported value of United States investments in mining and petroleum has been written down to a level well below those recorded in 1929 and in the mid-1930's - investments in mining and smelting from \$58 and \$54 million in 1929 and 1935 respectively to \$29 million in 1943, the book value of the Cerro de Pasco Copper Corporation and those in petroleum production, from \$59 million and \$54 million in 1929 and 1935 respectively to \$11 million in 1943.

#### United Kingdom Investments

According to the most recent official estimate, the nominal capital of the British investments in Peru was £25 million in 1938 and £22 million in 1949.<sup>1/</sup> If the sterling obligations of the Government of Peru are deducted, one

<sup>1/</sup> Bank of England, United Kingdom Overseas Investments, 1938 to 1948, London, 1950. The data relate to the overseas investments of United Kingdom residents "quoted on, unofficially dealt in, or otherwise known to the London Stock Exchange."

arrives at a figure in the neighbourhood of £20 million representing the remaining business investments.<sup>1/</sup> The bulk of this investment is in the Peruvian Corporation, a railway enterprise to which reference was made on a previous page. No dividends have been paid by the Peruvian Corporation for several decades and the interest on debentures is more than six years behind schedule. Total interest and dividend payments on the £22 million of United Kingdom investments in Peru were estimated at £300,000 in 1949.<sup>2/</sup>

<sup>1/</sup> According to another estimate by a resident United Kingdom official in Peru, the total amount of British investments in the country in 1949 was about £30 million, of which £22 million represented the value of the Peruvian Corporation. (See United Kingdom, Overseas Economic Surveys, Peru, p. 10).

<sup>2/</sup> Bank of England, op. cit.

## II. ECONOMIC SIGNIFICANCE OF FOREIGN INVESTMENTS

A. Industrial DistributionAgriculture

Through its mineral production has grown rapidly during our century, Peru is still largely an agricultural country. Practically all major foodstuffs can be produced in the country and several crops such as sugar and cotton are being raised on a large scale for export. However, the development of agriculture is hampered by climate and topography. The coastal area can only be cultivated provided sufficient irrigation water is available and has in large part remained desert. Only part of the land in and east of the Andes is cultivated because of the lack of adequate transportation facilities.

Foreign capital has assisted the development of agricultural production. Cotton is grown on foreign-owned plantations. Large-scale sugar cultivation was developed by German settlers who acquired Peruvian nationality at the outbreak of World War II. The major foreign producer of sugar now is W.R. Grace and Company, a United States concern. In 1949, cotton accounted for 30 per cent and sugar for 16 per cent of the export value.

During World War II, the United States Government encouraged the collection of wild rubber in the upper Amazon area of Peru. For this purpose the Peruvian Government organized in 1942 the Peruvian Corporation of the Amazon. During the war, the rubber collected and not domestically used was sold to the United States Reconstruction Finance Corporation; since that time all of it is used by the United States-owned tire factory in Lima.

Mining

Peru is rich in metallic minerals and exports of such products account normally for more than 25 per cent of the export value. Of particular importance are copper, zinc, lead, silver and vanadium; to a lesser extent, iron ore and coal deposits are exploited. Most of the mineral wealth is located in the Andes, which means that mining activities have to be carried out at high altitudes; thus, a large vanadium mine is located 16,000 feet above sea level.

As a producer of silver, Peru ranks fourth in the world and first in South America. Peru's production of vanadium is exceeded only by that of the United States. Twenty per cent of the world's copper production comes from Peru.

/Foreign

Foreign capital, primarily from the United States, is largely responsible for the development of the mining industry in Peru, but a large number of smaller Peruvian-held mining enterprises have been developed at the same time. Of the total labor force of approximately 26,000 persons employed in mining in 1946, approximately half worked in foreign-owned companies; the Cerro de Pasco Copper Company alone employed approximately 9,000 persons, or over a third of the total.<sup>1/</sup>

The Cerro de Pasco Copper Company generally produces more than half the metallic mineral output of the country. The percentage for copper is considerably higher. This company also produces lead, zinc, silver and coal, the coal being used primarily in its own smelters. The production of refined zinc is currently being rapidly expanded; in February 1951, the construction of a new zinc refinery was started partly with funds obtained from the United States Export-Import Bank. The Northern Peru Mining and Smelting Company, subsidiary of the American Smelting and Refining company, and Cerro de Pasco own the only two copper refineries in the country. These two companies also produce a large portion of Peru's silver output.

Vanadium is produced by the Vanadium Corporation of America. Prior to 1930, this company's mine in Peru supplied more than half of the world's production. As the richer veins became gradually exhausted and lower grade ores had to be mined, however, Peru's share in world production declined to about 30 per cent.

The following table shows that the output of metals other than zinc has tended to decline since 1939:

Table 2:

Exports of Metals

(including metal content of ores)

(in metric tons)

<u>Year</u>	<u>Copper</u>	<u>Zinc</u>	<u>Lead</u>	<u>Vanadium</u>	<u>Silver</u>	<u>Gold</u>
1938	37,750	14,566	57,937	1,474	635.3	7.9
1943	31,132	27,620	26,015	1,512	415.5	5.4
1946	26,120	52,243	44,017	592	317.6	4.4
1949	27,842	60,001	53,316	532	286.4	3.5

Source: Banco Central de Reserva del Peru, Boletín, December 1950, p. 36.

<sup>1/</sup> Pan American Union, The Peruvian Economy, Washington 1950, p. 107.

/There

There are several reasons for the decline. The foreign-owned concerns have been reluctant to add to their investments owing partly to unfavourable economic and political factors in the country. The mining code previously in force and taxation conditions have also been considered deterrents to foreign investments.

Since early 1950, however, the judicial situation of such investments has been improving as new legislation was approved by Congress.<sup>1/</sup>

#### Petroleum Extraction

Peru is endowed with large petroleum deposits, only part of which have been exploited so far. Of the three principal oil-bearing areas, one is located along the Pacific Coast in the northern part of the country; the second is in the upper parts of the Ucayali River, a tributary of the Amazon; and the third area in the north-eastern region, between the Colombian and Ecuadorian borders. Access to the last-mentioned two regions is difficult, involving either passage across the high Andes or approximately 3,000 miles down the Amazon River.

Foreign capital was largely responsible for the original exploitation of petroleum deposits of the country, though the Peruvian Government as well as Peruvian private investors have during the last two decades acquired some oil properties. Of some 9,200 workers employed in this industry, less than 900 are working in domestically-owned enterprises; more than 6,000 work for the International Petroleum Company, a Canadian company owned since 1948 by the Standard Oil Company of New Jersey.<sup>2/</sup>

More than 80 per cent of the petroleum output in 1948 came from the properties of the International Petroleum Company, which has operated in the country since about 1914 and in addition to extracting crude oil operates a refinery at Talara on the Pacific Coast. Its operations are confined to the area around Talara, although in 1946, it tried to obtain an additional concession for exploration and drilling in the Sechura Desert, also situated in the coastal area. Negotiations for this concession were never concluded since the terms of the contract stirred much local opposition and political disturbances prevented

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<sup>1/</sup> For further details see section below on Government Policy and Foreign Investment.

<sup>2/</sup> Pan American Union, op. cit., p. 107.

effective parliamentary action. In July 1950, the Company received authorization to undertake geological surveys in another area along the Pacific Coast.<sup>1/</sup>

Of secondary importance and considerably smaller than the American-owned concern is the Compania Petrolera Lobitos, which is a British-owned concern operating at Lobitos and El Alto (in the coastal area) since 1908.<sup>2/</sup> It contributed about 17 per cent of the country's petroleum output in 1948. Since this company owns no refinery, its production is either exported in crude form or refined by the United States refinery at Talara.

The remainder of the petroleum output comes from (a) the Zorritos fields, near the Ecuadorian borders, purchased in 1939 by the Peruvian Government from Italian owners, and (b) the Compania Petrolera Ganao Azul operating in the upper part of the Ucayali River. The latter company is jointly controlled by United States and Peruvian interests. The President and Vice-President are American and the Directors are Peruvians.<sup>3/</sup>

The export of petroleum products from Peru has seriously declined since the 1930's - in 1935, it exceeded 2 million tons, but in 1949, it amounted to only about 1.1 million tons.<sup>4/</sup> There are two reasons for this decline. First, production by the major oil companies shows a long-term declining trend; secondly, the domestic consumption of petroleum products has greatly increased owing partly to the fact that the petroleum companies are required to supply the domestic market at low prices. It has been estimated that should these two factors continue to operate, Peru will have no exportable surplus of petroleum products by about 1955. The major remedy for the situation would be the exploitation by the oil companies of additional deposits, not only along the Pacific Coast, but also in the north-eastern area. Since such development would involve large additional capital out-lays - thus a pipe-line would have to be laid across the Andes, and changes in constitutional or legislative provisions would have to be made.<sup>5/</sup>

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1/ Banco Central de Reserva del Peru, Boletin, July 1950, pp. 51-58.

2/ United Kingdom, Overseas Economic Surveys, op. cit., p. 47.

3/ United Kingdom, Overseas Economic Surveys, op. cit., p. 48.

4/ Banco Central de Reserva del Peru, Boletin, December 1950, p. 36.

5/ See section on Government Policy and Foreign Investment.

### Railroads

As was pointed out above, most of Peru's major railway lines were built with the aid of British capital by the Peruvian Government in the second half of the 19th century. Reference was made above to the event which led to the ceding in 1890 (and from 1928, in perpetuity) of these railroads to the British-owned Peruvian Corporation. At the present time, the Peruvian Corporation operates 1,386 miles out of a total of Peru's 2,581 miles of railroad; other private interests, some of them foreign, own another 868 miles; the remainder is owned by the Government.<sup>1/</sup>

The mountainous character of the country has limited railroad construction to a few major lines. They connect the important mining centres in the Andes, or the agricultural areas of the South, with the major ports along the Pacific Coast. So far, it has not become feasible to build an economic railway between the upper Amazon area and the major consuming areas of the country.

The Peruvian Company's system includes two main and several smaller lines. One of the main lines connects Callao, the major seaport, with Lima, the capital, and then runs across the Andes, overcoming an altitude of 15,665 ft., to Huancayo. This line does not touch the area exploited by the Cerro de Pasco Copper Corporation which has, however, constructed a line connecting this area with the main line; the two lines are now used primarily to transport minerals to the coast for export. The other main line runs from the port of Mollendo to Cuzco and to Puno at Lake Titicaca, where steamers operated by the Peruvian Corporation establish a connexion with the Bolivian railroad line running to La Paz which is also owned by the Peruvian Corporation. The other small lines of the Peruvian Corporation in Peru serve primarily the agricultural area of the South.

Most of the other privately-owned lines connect mining properties with the major railroads. Several of them were built with foreign capital since they serve foreign-owned properties. Most of the government-owned lines are short, connecting various regions with important cities or with the Pacific Coast. Since no railroad line connects the North with the South of the country, the construction of the Pan American Highway was of considerable significance. In contrast with

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<sup>1/</sup> See section on Government Policy and Foreign Investment, p. 61.

many other countries, Peru has not obtained funds from the United States Government for this highway construction programme. A portion of the expenditure is financed by a special tax payable by the Peruvian Corporation on freight carried on its railway across the Andes.<sup>1/</sup>

#### Other Activities

Most of the major public utility enterprises in Peru were also developed with private foreign capital. The Lima Light and Power Company (Empresas Electricas Asociadas), which provides most of the electrical power for the Lima-Callao area, was organized in 1906, mostly with Italian capital. Since World War II, it is considered a Peruvian corporation. Other electric power properties belong to the several foreign-owned mining companies and serve primarily the requirements of these companies.

The telephone service in Lima is supplied by the Compania Peruana de Telefonos, a subsidiary of the United States-owned International Telephone and Telegraph Company. In the south of Peru, the telephone service is provided by a subsidiary of a Swedish concern, L. M. Ericson.

Manufacturing in Peru is still small in comparison with the agricultural and mineral output. Foreign as well as domestic capital is responsible for the industries which have been developed during the last few decades. In the textile field, the United States-owned W. R. Grace & Company, and the British-owned Milne & Company, operate probably two-thirds or more of the country's installed loom capacity. Considerable amounts of United States and British capital are also invested in the flour milling, brewery, lumber and cement industries. The United States-owned Goodyear Rubber & Tire Company operates the only tire factory in the country.

Three of the nine large commercial banks are branches of foreign banks - the National City Bank of New York, the Grace National Bank, and the Royal Bank of Canada.

#### B. Foreign Investment and the Balance of Payments

Peru's balance of payments has in recent years been characterized by a small export surplus, which, frequently combined with other small current earnings, have contributed to the payment of interest and dividends abroad. The

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<sup>1/</sup> Pan American Union, op. cit., p. 138.

yield of investments recorded in the table below exceeds interest and dividend remittances abroad by the amount of re-invested earnings which are recorded also on the credit side as an inflow of foreign capital.

The stimulation of foreign investments in Peru is of particular significance because a substantial share of Peru's exports - petroleum is a case in point - represents goods produced by foreign-owned enterprises. Of ores and metals, which in 1948 constituted about 24 per cent of all exports, at least 50 per cent of the output was derived from foreign-owned mines. In the case of sugar and cotton, the remaining two major export products, foreign capital accounts, however, for a minor share of the output.

Little exact information is available with respect to the yield of foreign investments in Peru in recent years, since most of the foreign-owned enterprises do not publish separate figures for their Peruvian operations. However, according to the balance of payments statements for 1938, 1946 and 1948, the amount of investment income remitted abroad has not increased but tended to decline; this fact combined with a decline in the exchange value of the sol has resulted in a smaller rate of return in terms of dollars, to the foreign investors. As previously noted, yields on United Kingdom investments have been small, and the Peruvian Corporation, which owns a large portion of the railroads in the country, has not paid any dividends for decades on its ordinary or preferred shares.

Table 3

Peru: Balance of Payments 1938, 1948 and 1949

	Inward (+) or outward (-) payments (In millions of U.S. dollars)			
	<u>1938</u>	<u>1946</u>	<u>1948</u>	<u>1949</u>
<b>Merchandise:</b>				
Exports (f.o.b.) <sup>a/</sup>	+67.2	+140.5	+167.5	+171.1
Imports (c.i.f.) <sup>b/</sup>	-52.1	-137.3	-167.0	-163.5
Miscellaneous services, etc.	+2.7	-6.6	+3.2	+6.3
Yield of investments	-26.5	-18.4	-13.5	-11.3
Balance of above items	-8.7	-21.8	-9.8	+2.6
<b>Long-term capital:</b>				
Loans	-	+8.7 <sup>c/</sup>	+3.9 <sup>d/</sup>	-3.2
Direct investments	-	+5.5	+8.3	+2.5
Short-term capital and monetary gold	+8.9	+6.3	-3.0	-0.9
Balance due to errors and omissions	+0.2	-1.3	-0.6	+1.0

Source: International Monetary Fund, International Financial Statistics, January 1951, p. 138.

- a/ After adjustment for changes in foreign-owned stocks in Peru.
- b/ Including surplus property.
- c/ Chiefly credit by the United States Government Agencies.
- d/ Including a loan of \$5.6 million by the International Petroleum Company.

The earnings of the Cerro de Pasco Copper Corporation have recently been lower than before the war. Expressed as a percentage of the invested capital, the net earnings were as follows:<sup>1/</sup>

<u>Year</u>	<u>Per Cent</u>	<u>Year</u>	<u>Per Cent</u>
1929	8.1	1941	6.2
1936	9.2	1942	8.3
1937	13.7	1943	3.8
1938	4.8	1944	1.9
1939	6.3	1945	3.1
1940	6.7	1946	3.9
		1947	3.7

From mid-1949 to early 1951 the company paid no dividends, although it continued to earn a profit of about half the 1929 amount. With the recent increase in the price of metals and the revision of the tax provisions in the new Mineral Code, the profit prospects of the company have improved.

<sup>1/</sup> Standard & Poor's Corporation, Standard Listed Stock Reports, New York, 20 December 1950.

### III. GOVERNMENT POLICY AND FOREIGN INVESTMENTS

#### A. Entry and Status of Foreign Capital

Under the Peruvian Constitution (Article 32), nationals and foreigners have equal status in regard to the acquisition and ownership of property, except that foreigners are prohibited from acquiring land within 50 kilometres of the frontier or in the vicinity of military establishments.<sup>1/</sup> Foreigners and foreign companies may engage freely in business according to the Code of Commerce.<sup>2/</sup> There is a decree, though, which provides that the number of foreign commercial and industrial establishments "may not exceed 20 per cent of the domestic firms in a given place."<sup>3/</sup>

At the present time, there are no exchange control restrictions which limit or control the entry of foreign capital into Peru. The Decree Law of 13 December 1947, which provided for the licensing of incoming capital and authorized the use of the official rate of exchange for dividends and capital repatriation under certain conditions, was suspended in December 1948. Since that time, most remaining exchange restrictions and the official rate of exchange have been abolished.

The investment of private capital in Peru is limited to some extent by the existence of a number of government monopolies and the participation of the Government in several branches of the economy. Government monopolies created primarily to raise revenue include tobacco, salt, industrial alcohol, matches, playing cards, imported wines and liquors, and explosives. However, with the exception of the tobacco monopoly, the monopolies no longer produce large revenues. The Government has also established a monopoly for the exploitation and distribution of guano. This valuable fertilizer collected from several islands off the shore of Peru is distributed within Peru at low prices. The reason for this monopoly is that guano is considered a natural resource which must be guarded from private exploitation. Furthermore, since the amount of guano that can be

1/ Inter-American Development Commission, A Reference to the Laws of Peru, Washington 1947, p. 2.

2/ United States Department of Commerce, International Reference Service, Establishing A Business In Peru, September 1946, No. 36, p. 1.

3/ Inter-American Development Commission, op. cit., p. 17.

collected periodically is limited, and the demand is far in excess of the supply, the price of guano would become too high for Peruvian farmers unless regulated by the Government, which then has, of course, to allocate the sales.

In only three fields has the Peruvian Government established specific limitations on the amount of foreign capital which may be invested. Three-fourths of the capital of shipping companies must be held by Peruvians domiciled in Peru. Twenty-five per cent of the capital stock of petroleum companies must be offered to the state or private Peruvian interests.<sup>1/</sup> However, should these parties not buy the stock offered, that stock may be legally held by foreign concerns. Finally, the activities of foreign insurance companies in Peru are limited by a Law of 1944 which requires insurance companies to invest their capital in the country and to have a majority of Peruvian directors and share-holders. It is reported that only one foreign insurance company, a Brazilian concern, still operates in the country; a Canadian company was recently liquidated.<sup>2/</sup>

In recent years, the Peruvian Government has made substantial investments in new enterprises in the country. Certain activities were entered upon not in competition with private capital, but to develop resources which did not seem to attract either foreign or domestic capital. Thus, the Peruvian Corporation of the Amazon, fully owned by the Government, was formed in 1942 to encourage rubber production east of the Andes. It has also broad powers to develop other resources of that area. Little development of such resources has taken place, however, primarily because of the inaccessibility of the area and the lack of labour. Another Government corporation, the Peruvian Shipping Corporation, runs ships on routes, not usually served by foreign ships, between Peruvian ports and those of other South American countries such as Argentina, and maintains regular steamship service between Peruvian ports along the Pacific Coast, via the Panama Canal and up the Amazon, to the Peruvian Provinces east of the Andes. Finally, the Peruvian Santa Corporation, created in 1943, exploits the resources of the Santa River Valley, including the region around the port of Chimbote. The corporation has a large hydro-electric plant under construction and contemplates establishing iron and steel production in that area, since iron ore and coal are available.

1/ Inter-American Development Commission, *op. cit.*, p. 18.

2/ United Kingdom, *Overseas Economic Surveys, Peru*, January 1949, p. 10.

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In general, it is the policy of the Government to encourage private investments for the development of the country's resources but foreign capital cannot be attracted. The Government has indicated it may undertake the task itself. In June 1950, several agencies were established to collaborate with the International Bank for Reconstruction and Development on the financing of possible projects.<sup>1/</sup>

As mentioned above, mining and petroleum output tended to decline during the last decade. The decline has been attributed partly to the incidence and the complexity of the stipulations of the Mining and Petroleum Codes and of the administrative regulations pertaining to the export taxes and other taxes, the exchange control on foreign transactions and similar matters to which the mining and petroleum industries have been subjected. As regards mining activities, the Government recognized these difficulties as early as 1949, when it revised the exchange regulations then prevailing so as to permit the export of minerals at a more favourable rate than accorded to other exports.<sup>2/</sup>

A new Mining Code was promulgated by Decree of 12 May 1950 and was subsequently ratified by the newly-elected Peruvian Congress. This Code provides that all mineral substances are the property of the State except when exploitation rights are legally acquired. Foreigners and Peruvians may obtain concessions without discrimination. In order to make mining more attractive, the new Code specifically exempts mining concessionaires for a period of 25 years from all contributions or taxes now existing or going to be established in the future, except the income tax and under certain conditions the land tax. In particular, this means that mining companies have no longer to pay the export tax, the unemployment tax, and the excess profits tax, which in recent years have placed a financial strain on these enterprises. Finally, the Government decreed on 16 February 1951 that all machinery, equipment and materials destined for the mining industry may enter the country duty-free.

With reference to petroleum, the Peruvian Government created early in 1948 the enterprise known as Empresa Petrolera Fiscal, with the task of administering the government-owned oil properties. It was also given the authority to make contracts

<sup>1/</sup> Banco Central de Reserva del Peru, Boletin, June 1950, pp. 58-59.

<sup>2/</sup> Ibid., August 1949, p. 43.

with domestic or foreign private companies for the exploration and exploitation of these properties. It was hoped that foreign capital might be willing to negotiate contracts with this new governmental body for such exploration and exploitation, but experience has shown that the oil companies prefer to operate on the basis of a congressionally-approved law, rather than through contracts with government agencies. The Peruvian executive has recognized this situation and introduced a new Petroleum Code at the regular session of Congress in 1950. When no action was taken, an extraordinary session was called in January 1951 to study a new Petroleum Law, but it adjourned on 13 February without action.<sup>1/</sup>

It is reported that considerable opposition to the new Petroleum Code exists because several of the political parties in Peru would like the state to operate any expansion of the oil industry in the country. It is apparently felt that petroleum lands should be leased by the government petroleum organization for a fixed period only and that remuneration to the oil companies should be in the form of oil to be retained by the companies. In view of the capital required for large-scale expansion of oil production, it is doubtful whether such an arrangement would be satisfactory to the oil companies. Another problem faced by the oil companies in recent years is the legal requirement of supplying increasing quantities to the domestic market in Peru at prices fixed by law which sometimes do not cover the cost of production. Peruvian labour regulations require that not less than 80 per cent of all persons employed in an enterprise be nationals of Peru and that 80 per cent of the payroll be paid to such nationals.<sup>2/</sup> Management or technical personnel is not affected by this regulation.

The Peruvian Constitution contains no provisions with respect to expropriation of property for public use. This is in sharp contrast with provisions in the constitutions of many other Latin American Countries. So far, this has been of limited importance; the only recent case relates to a slaughtering house (Frigorifico Nacional S.A.), the expropriation of which was ordered by a special law of 29 June 1946. However, this law was not enforced by the Government and the property remains in the possession of the private owners.<sup>3/</sup> It may be observed

<sup>1/</sup> United States Department of Commerce, Foreign Commerce Weekly, 19 March 1951.

<sup>2/</sup> Inter-American Development Commission, op. cit., p. 53.

<sup>3/</sup> United Kingdom, Overseas Economic Surveys, op. cit., p. 39.

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that when the Government ceded its railroad lines to the Peruvian Corporation in 1928, a clause was inserted in the contract to the effect that should the Government expropriate these lines, it would have to pay £16.8 million, plus the value of capital investments made after 1928.<sup>1/</sup> It is sometimes alleged that the Government's policy with respect to rates to be charged to consumers by certain public utility services comes close to expropriation. In recent months however, the Government has recognized the justification of a plea of a foreign-owned telephone company and has permitted a considerable increase in rates; the telephone companies, however, were obligated to extend their services.<sup>2/</sup>

B. Exchange Control

No exchange restrictions are currently in effect which limit or restrict the remittances abroad of interest, dividends, royalties, profits or capital. There is complete freedom to effect any non-merchandise transaction through the free market, in which the exchange rate has recently been stable at 14.95 soles for the dollar. In addition to this free market, there exists the so-called "certificate" market in which exporters have to sell the foreign exchange proceeds from their sales and in which importers may buy such exchange for their own merchandise requirements. The rate quoted in this market has recently coincided with that in the free market, or 14.95 soles per dollar. In the past, the certificate rate has frequently been one to two soles below the free rate. Since under the law of 3 December 1948, payments of interest and dividends were also eligible to the certificate rate but could not be remitted because of administrative difficulties. A mission from the United States (the "Economic and Financial Mission"), invited by the Peruvian Government to visit Peru in 1949, in its report of 5 November 1949 recommended that each application for the purchase of exchange in the "certificate" market in respect of such payments be decided on within ten days.<sup>3/</sup>

C. Taxation

Peru has a complicated tax system, levying a number of taxes on business income, personal income and property. With one exception, these taxes apply to

<sup>1/</sup> Moody's, Railroads, 1950, p. 1434.

<sup>2/</sup> United States Department of Commerce, Foreign Commerce Weekly, 15 May 1950.

<sup>3/</sup> Banco Central de Reserva del Peru, Boletin, November 1949, p. 15.

foreign and domestic enterprise alike. Corporation profits are taxes at progressive rates ranging from 7 per cent on profits under 10,000 soles to 20 per cent on those in excess of 100,000 soles. In addition, an excess profits tax is levied on profits which exceed a "normal" level; rates are progressive ranging from 10 per cent on excess profits under 50,000 soles to 20 per cent above 1 million soles. Foreign enterprises are also subject to a "complementary" tax of 12 per cent of net profit and interest paid by subsidiary companies to their main offices abroad.<sup>1/</sup> Income tax on exporters of agricultural products is levied in the form of export duties.<sup>2/</sup> Some of the export duties are specific, some are on an ad valorem basis, and others are collected as a percentage of the difference between the f.o.b. value of the goods and the cost of production. Export taxes paid are deductible from the liability on account of the profits and excess profits taxes to the extent that they do not exceed that liability.<sup>3/</sup>

Personal incomes are subject to a flat 5 per cent tax and a progressive surtax ranging from 2 per cent on incomes of 10,000 soles to 20 per cent on incomes over 100,000 soles. Special taxes are levied on income from interest and dividends and from rent.

The complicated tax structure summarized above has caused considerable confusion and is believed to have acted as a deterrent to business and foreign investments. The terms of reference of the "Economic and Financial Mission" of 1949, mentioned above, specifically include studies of the financial conditions and legislative reforms in the fields of money and banking, public debt and budget.<sup>4/</sup>

#### Miscellaneous

The Peruvian Government has tried to encourage private enterprise by establishing three Government banks: the Industrial Bank, the Mineral Bank, and the Agricultural Bank. Their purpose is to grant loans to domestic industrial, mining and agricultural enterprises if such loans cannot be obtained from regular commercial banks.

<sup>1/</sup> Inter-American Development Commission, op.cit., p. 38.

<sup>2/</sup> The same system applied to exporters of mineral products until adoption of the new mining code on 12 May 1950, as noted above.

<sup>3/</sup> Pan-American Union, op. cit., p. 163.

<sup>4/</sup> Banco Central de Reserva del Peru, Boletin, July 1949, p. 50.

In the field of commercial policy, tariff legislation is designed to raise revenue as well as to protect domestic industry. Tariff rates on goods not produced locally are frequently set high in order to encourage the establishment of domestic production.<sup>1/</sup>

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<sup>1/</sup> United States Tariff Commission, Economic Controls and Commercial Policy in Peru, Washington, 1945, pp. 6 to 7.

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