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Peru’s Multidimensional Challenge – Part 3: engagement with China

By Evan Ellis / November 20, 2020

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[*To read Part 1 of the Peru's Multidimensional Challenge series, "the political crisis," visit here.*]

[*To read Part 2 of the Peru's Multidimensional Challenge series, "the economic crisis, public insecurity, and organized crime," visit here.*]

As Peru wrestles with mutually reinforcing cries of presidential succession, the COVID-19 pandemic and transnational organized crime, the People's Republic of China (PRC) is poised to significantly expand its already significant commercial presence and political influence in the country.

Peru's mineral wealth made it the first country in the continent in which a Chinese company made a major commodity investment, with the company Shougang purchasing a copper mine in Marcona from the Peruvian state in 1992. It was also the site of China's first significant petroleum operations on the continent, with CNPC acquiring rights to the Talara oilfield in 1993. The PRC relationship with Peru expanded under governments on both the left and right, including ethnonationalist Ollanta Humala, and the neo-liberal, second government of Alan Garcia.

In 2008, against the backdrop of the global recession, China became Peru's largest commercial partner, surpassing both the US and the sum of the eurozone countries, and in 2018, became its largest investor, dominating its mining and oil sectors as well as having a significant presence in electricity production and transmission, logistics and other infrastructure construction, and information technology. Former President Martín Vizcarra, just removed from the presidency by Peru's congress over unrelated corruption allegations, presided over one of the most significant periods of advance in the PRC-Peru commercial and strategic relationship including signing Peru up to China's Belt and Road Initiative in April 2019, and supporting an array of new Chinese infrastructure projects in the country. The Vizcarra government further embraced a response to the current COVID-19 pandemic centered around problematic Chinese tests, donated medical supplies, and the development of a Chinese vaccine. In October 2020, when the Chinese fishing fleet moved toward Peruvian waters after substantial indications that it had violated maritime protected areas around the Galapagos Islands of neighboring Ecuador, Vizcarra's government was quick to tweet—contrary to all appearances—that the Chinese fleet was not violating the country's Exclusive Economic Zone.

As Peru wrestles with political turmoil and seeks to recover from the economic and financial effects of the pandemic, the PRC appears well-poised to significantly expand its commercial presence and associated political influence in the country.

This article is the second in a three-part series examining the multidimensional, and mutually reinforcing challenges facing Peru. The present article examines PRC engagement in Peru, prospects for the expansion of its presence, and the implications for the country, the region, and the United States.

The economic context

As noted previously, the PRC has been an increasingly important commercial partner for Peru, playing into the country's self-concept as a gateway to Asia. Peru-China bilateral trade has grown from $850 million in 2002, the year after the PRC was accepted into the World Trade Organization, to over $24 billion in 2019, compared to only $14.8 billion in Peruvian trade with the United States. Moreover, due to Peru's significant commodity exports to the PRC, its balance of trade with the PRC is slightly favorable, exporting $12.9 billion to the PRC in 2019, and importing $11.1 billion from it.

During the 2008 financial crisis, sustained PRC demand for Peruvian commodities were an important factor in helping the country to be only marginally prejudiced by the global economic downturn. Peru was also the second country in the region to negotiate a free trade agreement with China, signed in April 2009, and is currently working to extend and update that accord.

With the crisis associated with the COVID-19 pandemic, as of September 2020, the Peruvian economy had contracted 9.8 percent from the previous year, with the IMF predicting that the country's GDP will shrink 13.9

percent for 2020 as a whole. In the context of such contraction, and continuing weak demand from sources of demand for Peru's exports, including the US and Europe (as they wrestle with new outbreaks of the virus), the level of PRC purchases of Peruvian products, as well as PRC investment in the country becomes increasingly important for Peruvian prospects of economic recovery.

Petroleum and mining

Chinese companies have long had a significant position in the Peruvian mining and petroleum sectors. Today, PRC-based companies account for 25 percent of Peru's copper production, 100 percent of its iron, and 35 percent of petroleum output.

In Peru's mining sector, the PRC has invested USD $15 billion since 2009, including five megaprojects, valued at a total of USD $10.2 billion: Marcona, Toromocho, Las Bambas, Rio Blanco, Galeno, Cercana, and Pampa del Pongo. In the difficult political and organized labor environment of Peru, many of the projects have suffered serious labor unrest and difficulties in relations with local communities, although some, such as Toromocho, have been better than others in overcoming those challenges and moving to production. The Shougang-operated mine in Marcona, Rio Blanco near Piura , and most recently, Las Bambas have been associated with significant protests and violence.

In the petroleum sector, the major Chinese operator is CNPC, which expanded its presence significantly with the 2014, USD $2.6 billion, acquisition of oilfields that the cash-strapped Brazilian state oil company Petrobras was divesting. As in the oil sector, CNPC has also been the subject of community and labor opposition including the burning of a building in the northern Peruvian town of El Alto in 2019.

Electricity and transportation infrastructure

While the PRC's advance in Peru since the early 1990s has focused on mining and petroleum, arguably the most important expansion of Chinese companies on Peruvian soil in the past five years has been in the electricity generation and transmission and transportation infrastructure sectors.

As in petroleum and mining, the PRC has significantly expanded its footprint in Peru's electricity sector by purchasing assets being sold off by others. China Three Gorges, for example, acquired the Chaglla hydroelectric facility in the remote interior province of Pachitea from the Brazilian conglomerate Odebrecht for USD $1.4 billion after the latter's financial position was imperiled through the Lava Jato corruption scandal, finalizing the transaction in April 2019. Similarly, in September 2019, the Chinese company Yangtze Power paid USD $3.6 billion to acquire the Peruvian assets of the electric utility Luz del Sur as Sempra was looking to sell off its South American assets to concentrate on North America and Asia. The acquisition of 83.6 percent ownership in Luz del Sur gives Yangtze Power a role in serving 33 percent of the entire Peruvian electric grid, including the southern and eastern portions of Lima.

The Chinese have also begun to win new work in the electricity sector including a consortium led by China Three Gorges, which in July 2016, secured a USD $438 million contract to construct the San Gaban III hydroelectric facility in the Carabaya province of Puno.

Prior to these advances, the main Chinese experience with hydrological projects in Peru was a 2010 contract by China Water and Electric (CWE) with the government of Loreto and work on the public sewer system in Iquitos. That project ended in lawsuits over its alleged failure to complete the work.

The geographic position of Peru between the Pacific Ocean and Brazilian agricultural goods, minerals, and markets on the other side of the Andes mountains, has long been an inducement for the construction of road infrastructure, as reflected in the Initiative for the Integration of Regional Infrastructure in South America (IIRSA). The logic of Peru's geographic position led it to build three "bi-oceanic highways" with Brazil, with the first, southern-most route officially inaugurated in 2013.

As far back as 2005, a Chinese company, Shandong Luneng, proposed constructing a railway to transport iron ore from the Bolivian mine at El Mutún to the Peruvian coast at Tacna, although the project was abandoned when the concession for El Mutún was awarded to the Indian company Jindal, which had a different logistics concept, to transport the iron ore to the Atlantic Ocean through Bolivia and Brazil.

Overshadowing the now largely forgotten Tacna-Mutún rail corridor, Peru was also the proposed western end point of a controversial USD $10 billion rail project connecting its Pacific coast to the Atlantic at Santos, in southeastern Brazil. The project was shelved due to President Pedro Pablo Kuczynski's concerns over its economic viability as one of China's "pharaonic proposals" for giant infrastructure projects in the region.

Although none of the aforementioned railroad projects have gone forward, PRC-based logistics firm COSCO has secured an agreement to build a USD $3 billion, 15-dock megaport and logistics distribution hub in Chancay to export mining products from the China-owned Toromocho mine. The port will possibly be complimented by a rail line connecting Chancay to the Toromocho mine operated by the Chinese mining giant Chinalco. Further to the south, China Railway Engineering Group has proposed construction of a cargo terminal in the port of Ilo in the Department of Moquegua. It is not clear whether the recent removal of President Vizcarra over alleged serious acts of corruption regarding infrastructure projects when he was governor of Moquegua will affect the investment.

With respect to highway transportation, China Railway 20 Bureau Group currently has a USD $33 million project to improve the Huanuco-La Union-Huallanca highway in a remote part of the Peruvian Andes.

In the Peruvian Amazon, the Chinese company Sinohydro has a USD $95 million project, the *Hidrovia Amizonica* awarded in 2017, to create a river toll route, navigable throughout the year, for large craft to move commercial cargo. The project has been opposed by the operators of the smaller boats who currently move cargo along the river and do not wish to pay the tolls or to have the competition from larger commercial cargo companies. The project has also been challenged because of the impact of dredging on the ability of local communities to fish in the river, as well as the damage that massive dredging and dumping of the removed sediment would do to the flow of the river and the surrounding ecosystem. The project was suspended just before the COVID-19 pandemic hit Peru and its future remains uncertain.

Technology products and infrastructure

Chinese activities in high-technology sectors include a strong and growing presence by PRC-based companies in telecommunications equipment and infrastructure.

The Chinese company Huawei has a major presence in the country, including not only building 5G and other infrastructure, but also supplying its phones to telecom operators Movistar, Telcel, and Claro (which also sells phones made by the Chinese provider Oppo). The Chinese company Xiomi is also currently expanding in the Peruvian market. The low-cost, Vietnam-based telecom provider, Vitel, uses technology from the Chinese provider ZTE for its backbone.

Under the Vizcarra administration, Chinese companies secured multiple projects to provide cellular telephone coverage to the country—

particularly in remote areas. In July 2019, a consortium led by Yangtze Fiber Optic Cable (YOFC) won a USD $411 million contract to provide 7,500 kilometers of fiber optic cable connections across the country. The contract came on top of previous wins by a YOFC consortium including GMC Telecom and SATEL (delayed due to questions over the award) to install broadband connectivity to the Amazonas and Ica regions, La Libertad, Ancash, Arequipa, and San Martin.

Chinese military engagement

While commercial activities dominate Chinese engagement with Peru, the PRC and Peru also engage in an important range of security sector activities including Chinese arms sales, institutional visits, training and professional military education exchanges, and military exercises.

With respect to military sales, PRC-based companies Beiben, Dong Feng, and Shanxi have provided military trucks to the Peruvian armed forces, although the recipients have expressed concerns over quality on multiple occasions. In 2009, Peru considered the purchase of Chinese MBT-2000 heavy tanks, but cancelled the order following political backlash over the deal. In 2014, Peru announced the purchase of 40 Type 90B truck-based multiple rocket launchers, and ultimately took delivery of 27 in 2015, although the transaction later became the focus of a corruption investigation.

With respect to personnel exchanges, Peruvian military delegations regularly visit the PRC, and Peruvian military institutions regularly receive their PRC counterparts. Members of the Peruvian military attend courses at China's National Defense University in Changping, and Chinese Army and Navy Command schools in the Nanjing area, among others.

In November 2010, a PLA delegation conducted a disaster response exercise with its Peruvian counterparts in conjunction with a mobile field hospital that it had donated to the Peruvian Armed Forces.

China's engagement with Peru over COVID-19

Under then-President Martín Vizcarra, Peru's response to COVID-19 was one of the most reliant on engagement with the PRC government and Chinese companies. Both Huawei and Alibaba donated and sold an extensive quantity of masks, thermometers, test kits, ventilators, and other devices in Peru.

In one of the most controversial aspects of Peru's response to the pandemic, the Vizcarra government made a USD $28 million purchase of 1.4 million uncertified "quick tests" from China Orient Gene Biotech as a key part of its strategy for tracking and limiting the spread of the virus. The high false negative rate of the tests led thousands of Peruvians who had the disease to believe they did not, contributing to its devastating spread and the large number of associated deaths in the country.

The Vizcarra government further authorized the PRC-based company Sinopharm to do large-scale phase three clinical trials of an experimental COVID-19 vaccine in Peru in conjunction with local partner Cayetano Herida University. At the insistence of the Chinese partner, and unusual to standard practice in Peru, the registration of the partnership listed Sinopharm only as the financier of the trials, exempting it from legal responsibility.

Prospects for the future

In the near-term, Peru's political crisis—including the November 9, 2020 removal of President Vizcarra, and the resignation of his successor Manuel Merino five days later—will delay the resolution of problems with existing Chinese projects in the country and commitments to new ones. The implementation of social distancing and other measures in response to the

COVID-19 pandemic, and the associated reduction in demand by Peru's principal export partners, has caused significant economic hardship in Peru—particularly among the country's large informal sector and vulnerable small- and medium-sized enterprises. Indeed, the Peruvian economy contracted by 17.9 percent in the first half of 2020, and may shrink by almost 10 percent over 2020 as a whole. Such economic difficulties increase the importance of Chinese purchases of Peruvian commodities and investments in the country, particularly when the PRC is already Peru's leading trade and investment partner. With China's economy projected to grow by 2.1 percent in 2020 and 8.4 percent in 2021, the PRC appears in far better condition than the U.S., Europe, or Peru's Latin American neighbors to buy the nation's products and invest in its industries.

As in other parts of the region, the closing of Peruvian businesses, including those which have gone bankrupt and persons who have left to seek work in other areas, creates opportunities for Chinese companies to penetrate and expand their position in supply chains in ways not previously possible. As Western companies potentially look to strengthen their balance sheets by selling off Peruvian assets, Chinese companies will be strongly positioned to expand their holdings in the country through mergers and acquisitions—particularly in sectors such as mining, petroleum, and electricity transmission and supply.

Chinese companies are also poised to win a significant number of construction contracts as the Peruvian state turns to infrastructure building in the coming year as a key part of its strategy to stimulate the economy in the wake of the pandemic. Of the 52 projects currently in Peru's national infrastructure plan, 60 percent are to be awarded through public-private partnerships, an arena in which Chinese companies are often more competitive than with traditional public bidding.

The very public removal of President Vizcarra on construction-related corruption charges could oblige reconsideration of an economic reactivation strategy centered on infrastructure projects. Moreover, the public attention on the allegations of corruption in Vizcarra's award of infrastructure projects in Moquegua, the association of Chinese companies with corrupt practices in winning infrastructure projects, and the proliferation of Chinese infrastructure projects in Peru while Vizcarra was Transportation Minister, Vice-President, and President, could lead to a re-evaluation of how Chinese companies gained so many infrastructure projects so rapidly.

On the other hand, over the long-term, the fragile position of the transitional government of Francisco Sagasti, or that elected in April 2021, will be in need of money and quick successes, both of which the PRC can provide.

Conclusion

In Washington, as the incoming Biden administration formulates its approach to Latin America, the PRC's expanding presence in Peru, and elsewhere in Latin America, is likely to be on the minds of the new team. It would be counterproductive for the United States to attempt to block Peru from selling its commodities to China or accepting Chinese loans and investments. The new administration can, however, appeal to the Peruvian government and people, given sensitivity to past corruption, that such engagement be done in the framework of transparency, a level playing field for all, and the universal application of the rule of law in approving acquisitions, awarding contracts, and enforcing compliance with agreements, labor, environmental and other regulations.

In some areas, such as telecommunications infrastructure and security systems, where the personal data of Peruvian officials, businessmen, and citizens may be compromised by using Chinese devices and infrastructure providers, the U.S. should work to provide commercially viable alternatives.

The incoming administration can also expand incentives for the U.S. private sector as a source of demand for value-added Peruvian products in the framework of the 2009 U.S.-Peru Trade Promotion Agreement and invest in the country in ways that are more sustainable and generate more enduring opportunities for the Peruvian people. USAID, with programs such as "Clear Choice," also provide development support without expectation of reimbursement or commercial benefit in ways that Chinese projects seldom do.

Peru plays an important role in the hemisphere upon which the U.S. relies for its security and prosperity, and to which it is tied by bonds of geography, commerce, and family. Helping Peru build a secure future, while including a relationship with the PRC that is healthy and supports Peru's own sustainable development and autonomy of decision, is vital to U.S. interests.

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