

Chinese Investment in Peru's Mining Industry: Blessing or Curse?

WORKING GROUP ON DEVELOPMENT AND ENVIRONMENT IN THE AMERICAS

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Peru's trade and investment relationship with China is overwhelmingly concentrated in the mining sector. Peru is well-positioned to oversee a positive mining-based relationship with China, having recently taken several important steps to increase transparency and accountability in this sector. They have been regional leaders in this aspect, by joining the Extraction Industry Transparency Initiative and becoming the first Latin American government to implement ILO Resolution 169, for example. In 2014, Chinese mining firms have demonstrated their commitment to these standards by joining the EITI program in Peru.

Overall, there is no one Chinese way of doing business in Peru. Chinese mining firms do not appear to be either the best or worst in the country, but their experiences have been emblematic of the challenges that all foreign investors face. In the instances we have found where Chinese firms have failed to meet environmental and social responsibility standards, responsibility must be shared between missteps on the part of firms as well as the reluctance or inability on the part of the government to enforce these standards. However, there are important, positive signs that Chinese investors and Peruvian regulators are willing to work together to improve this record. For example, after the recent acid water spill at the Chinese-run Toromocho mine, regulators stepped in immediately and shut down production until the firm addressed the problem, which took only a few days. Furthermore, after the incident the Association of Chinese Companies in Peru asked the Ministry of the Environment (MINAM) for training on local environmental regulations. That type of training for

foreign investors could provide yet another opportunity for Peru to lead the region in its proactive framework for mining.

Two other important recommendations emerge from our findings. First, the EITI program could be substantially enhanced by including local governments. EITI reporting is a powerful tool for citizen empowerment, but it is incomplete without the inclusion of local government, which receives 50% of mining tax revenue. Secondly, while mining firms have higher labor standards they must meet than other firms, the sector has a history of circumventing these protections through the heavy use of subcontractor labor, contributing to conflict between the firms, labor, and the surrounding communities. One way of addressing this problem may be to extend mining-sector labor protections to include contract workers, eliminating the financial incentive for offering informal work.

1. Introduction

Peru has been one of Latin America's most important economic success stories over the last decade, by achieving sustained growth under political democracy, cutting poverty in half and producing an expanding new middle class. These results have been driven in large part by global demand for the minerals and other primary commodities that Peru exports, as well as by sound macroeconomic policymaking and a strong commitment to international trade. Expanding relations with China, while not the whole story, have been an important chapter.

In recent years, copper, iron, gold and other minerals have accounted for around 60 percent of total Peruvian exports, 25 percent of total Foreign Direct Investment (FDI) and 15 percent of total tax revenues. While investors from more than 30 countries are involved in Peru's mining industry, China has become the leading market for these resources and Chinese demand for them is credited with helping Peru weather the

financial crisis of 2008. Peru is considered the leading location for Chinese mineral investment in Latin America, and Chinese firms hold around 30 percent of the country's total mining investment portfolio. Chinese firms also have an important presence in Peru's hydrocarbons and commercial fishing sectors ("Las inversiones chinas" 2014; Sanborn 2014).

Although economic relations with China are seen by many in Peru as a blessing, the global rush for resources has revived concerns about the "resource curse", the risks of excessive dependence on primary commodity exports, and the structural challenges to achieving a more diversified and productive economy. As Chinese demand for minerals and oil appears to be higher than the world average, some argue that this contributes to reinforcing this pattern. At the same time, the main motivation behind Peru's aggressive pursuit of free trade agreements (FTAs) with the United States, China and 16 other countries, as well as diverse multilateral trade agreements and alliances, has been to diversify the country's trade and investment opportunities (Sanborn and Yong 2014). The evidence to date is mixed.

Dependency on mineral exports has also raised new concerns about the social and environmental implications of large-scale extractive activity. For some, the advantages of attracting Chinese investment have been tempered by concerns over the ability of Chinese-owned firms to comply with global standards in such areas as revenue transparency, environmental and labor policies (Kotschwar, Moran, et al. 2011; Friedman 2006). The mining industry within China has had severe problems with safety and environmental regulations as well, and Chinese companies have not practiced the kind of transparency that many in Latin America have come to demand, nor have they been active participants to date in voluntary efforts and initiatives. However, analysts have also argued that the key issue is not whether a company is Chinese, or of any other nationality, but rather the willingness and capacity of host countries to regulate them adequately (Irwin and Gallagher 2013; Gonzalez Vicente 2012).

These issues are put to the test in Peru today. Peru has taken important steps to establish new standards for the extractive industries, and to use the abundant revenues that they generate to advance various development goals (Arellano-Yanguas 2011). Peru joined the Extractive Industries Transparency Initiative (EITI) in 2007 and in 2011 became the first country in the Americas to be declared compliant within that framework. In 2008 Peru established a new Ministry of the Environment, which has vied with the Ministry of Energy and Mines (MINEM) to oversee the extractive industries. In 2011, the Humala administration became the first in Latin America to create domestic legislation to implement ILO Convention 169, guaranteeing the right of indigenous and tribal peoples to prior consultation on major public policies that affect their lives, including the granting of concessions and permits for extractive activity.

But as global prices fluctuate and have taken a downturn from 2012 to 2014, the drive to increase mineral production in Peru has tended to conflict with efforts at effective environmental and social regulation. Government initiatives in this area have been hampered by institutional weaknesses, conflicts of interest and strong resistance from investors. There have been numerous and often violent disputes between companies and communities over land and water rights, revenues and environmental contamination, including high-profile cases that have engaged national and transnational activists and the international media. Such conflicts pose potential challenges and delays for all firms, including Chinese investors new to the country.

In this context, it is important to examine Chinese involvement in the Peruvian mining sector, and ask:

- Does it matter if China is a major market for Peruvian minerals? Is Chinese demand different from that of Peru's other trading partners, as a driver of primary commodity dependency and/or of the social and environmental risks this may pose?

- Does Chinese investment in Peru’s mining industries have social or environmental ramifications that are significantly different from that of other investments?
- Do Chinese mining companies comply with Peruvian laws and regulations to a lesser or greater extent than others? Are different standards applied to them?
- Have Chinese firms reacted differently than their industry peers to conflict over such issues as land and water rights or environmental contamination?

In order to address these questions, we examine the Chinese presence at three levels:

1. At the macro level, we examine data on Peruvian trade and investment relations with China in the last decade, to assess the extent to which recent trends reinforce or modify this country’s primary commodity dependency.
2. At the meso level, we examine some of the main policies aimed at regulating the extractive industries in Peru and improving their impact on development, asking about the extent to which Chinese firms have been engaged in or influenced by them.
3. At the micro-level, we briefly examine three cases of Chinese firms operating in Peru today, using the “net benefits” framework proposed by Zarsky and Stanley (2013).

This paper presents findings at all three levels, and ends with initial conclusions regarding the current and potential impact of the Chinese presence in this case.

2. Peruvian – Chinese Relations: the Macro Picture

China has had a major social and cultural presence in Peru for more than 160 years. Starting in the mid-19th century, when some 100,000 Chinese men were brought to Peru as indentured agricultural workers, relations between China and Peru have gradually expanded (Lausent-Herrera 2011). In the 20th and 21st centuries, larger waves of Chinese immigrants came to the country, along with a growing influx of Chinese goods and enterprises. Today, Peru has the largest Chinese ethnic population in Latin America.

Diplomatic ties with the People’s Republic of China can be traced to 1971, but for years these relations mainly focused on economic and technical cooperation. Direct Chinese investment in Peru began in 1992, when the state-owned Shougang Group bought the state-owned iron ore company *Empresa Minera de Hierro del Peru* (Hierro Peru). In 1993, SAPET, a subsidiary of the China National Petroleum Company (CNPC) purchased state-owned assets in the Peruvian oil industry. Yet fifteen years would pass before more significant Chinese investments would flow towards the Andes.

The bilateral relationship began to accelerate after 2004, when Peru granted market economy status to China, and in 2008 it entered a new phase, when both countries established a “strategic partnership”, leading to the Peru – China Free Trade Agreement (FTA) in 2009. By 2011, China replaced the United States as Peru’s main trading partner. That same year, the Association of Chinese Enterprises was formed, with 43 members and support from the Chinese Embassy. By 2014 the Association had 61 members, and some 120 Chinese firms were legally registered to operate in Peru, in mining and energy, telecommunications, machinery, agriculture, construction and commerce (“Las inversiones chinas”, 2014).

Peru’s relations with China took a new leap forward in 2013, when the two nations’ leaders celebrated their “comprehensive strategic partnership” by signing eleven bilateral accords aimed to optimize trade and strengthen cooperation in agriculture,

infrastructure, minerals, and social development. In November of that year, the first Chinese bank, Industrial and Commercial Bank of China (ICBC) was authorized to operate. China Fishery Group also purchased shares in a major Peruvian fishing firm, giving it a quarter of the country's commercial fishing quota and turning it into the world's largest producer of fishmeal, while CNPC announced its purchase of the Peruvian holdings of Petrobras, the Brazilian oil giant, giving Chinese firms control of around 40% of Peru's hydrocarbon production. In December, President Humala inaugurated the *Toromocho* copper project, operated by the Aluminum Corporation of China (Chinalco), which promises to increase total copper production by 20% and help Peru meet its dream of surpassing Chile as the world's leading producer of that metal ("Chinalco eleva" 2013). This was followed in 2014 by the announcement that MMG (backed by China Minmetals) would purchase *Las Bambas*, another copper mega-project, and consider Peru as its hub for regional expansion ("Glencore Xstrata Sells Las Bambas" 2014).

2.1 Trade and Investment: A Summary

China has been Peru's most important trading partner in recent years, representing its single largest export market and second largest source of imports after the United States. Total exports to China more than quadrupled as a share of Peru's GDP between 1995 and 2012, from 0.8% of GDP in 1995 to 4.1% in 2012. In contrast, Peruvian exports to the world as a whole doubled as a share of Peru's GDP over the same period. In 2013 China bought USD 7.3 billion worth of Peruvian goods, or 17.7 percent of total export value from Peru.

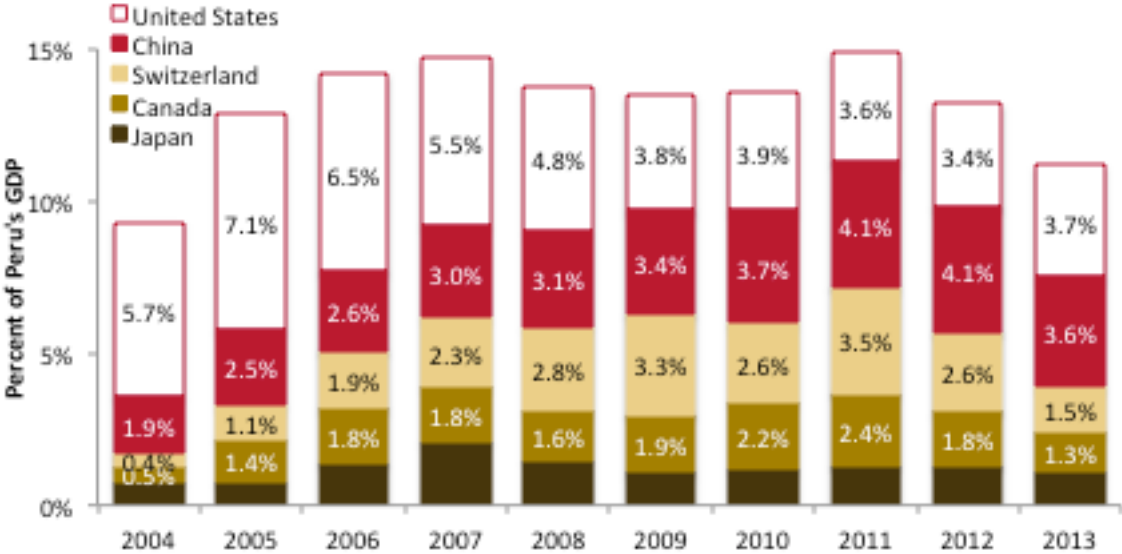
Peruvian exports to China remain largely primary goods, with four products – copper, iron, lead, and fishmeal – comprising the lion's share of the total, and largely explaining the positive overall trade balance through 2012. The relative share of these goods has changed, however, since the 1990s. In 1997, nearly 80 percent of

Peruvian exports to China came from the fishery sector, while around 16 percent was minerals and oil. By 2004 fishery exports had fallen to 36%, and by 2013 the shares were reversed from 2004: fisheries accounted for 13 percent of exports to China in value, and mineral and oil products together were 87 percent (CAPECHI 2014). Indeed, in 2013 China was the main market for Peru's mineral exports, at 26.5% of the total, followed by Switzerland with 13 percent.

Meanwhile, imports from China to Peru have increased more than those from any other country (Aquino 2013). From 1993 to 2012, Peru's imports from China grew more than 10-fold relative to the size of the economy (from 0.3% to 4.1% of GDP), far outpacing overall exports, which roughly doubled as a share of Peru's GDP in the same period. Although Chinese imports compete with local producers in sectors such as footwear, textiles and garments, and metal products, in which the trade balance remains negative, this has not exactly led to "de-industrialization". The overall effect of an expanded market and better access to competitive intermediate goods, for example, appears to have outweighed the negative effects of Chinese imports on specific sectors (Cardenas y Gavilano 2013).

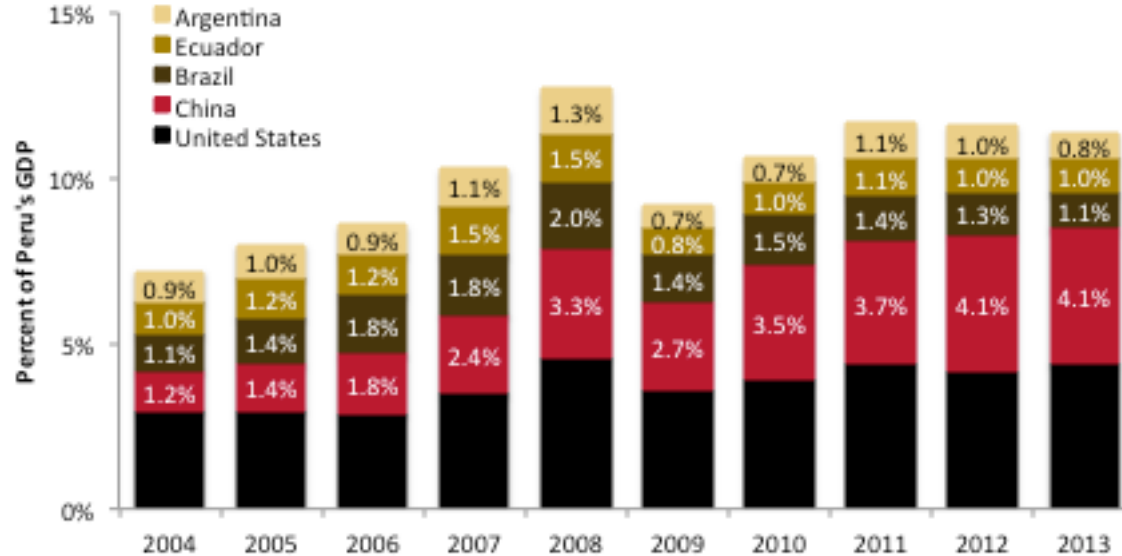
The FTA that Peru has signed with China has also been important. It covers merchandise, services and investment, allowing 83.5 percent of Peruvian exports to enter China with zero tariffs and providing some protection for Peruvian products most vulnerable to Chinese competition, like textiles (Gonzalez Vigil 2012).

Figure 1: Peru's exports destinations 2004-2013



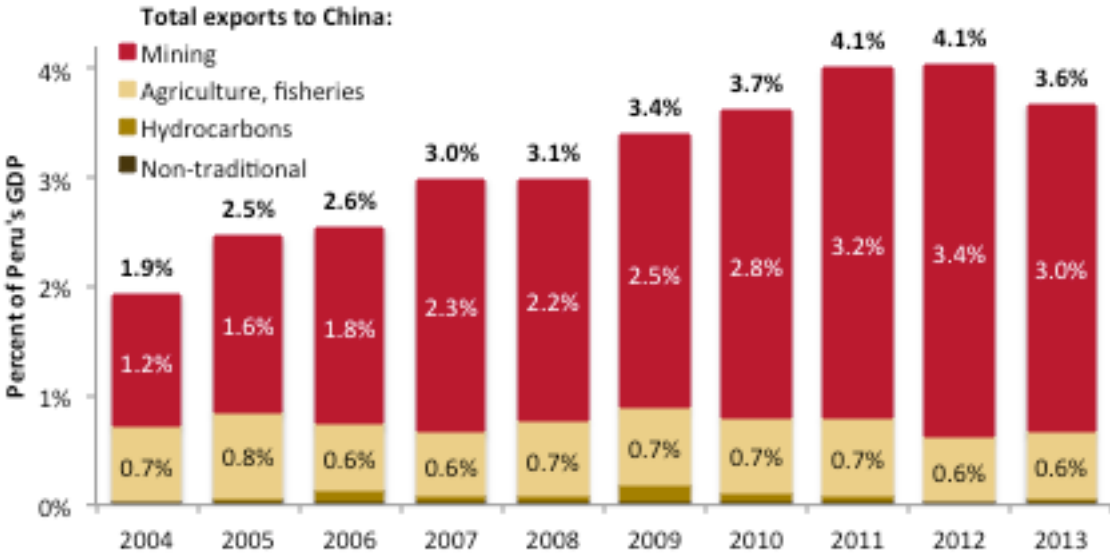
Source: Authors' calculations based on UN Comtrade, IMF WEO data.

Figure 2: Top Five Sources of Peruvian imports 2004-2013



Source: Authors' calculations based on UN Comtrade, IMF WEO data.

Figure 3: Peru’s exports to China 2004-2012, by sector, in Percent of Peru’s GDP (FOB)



Source: Authors’ calculations based on UN Comtrade, IMF WEO data.

In summary, China today is the primary market for Peruvian exports, which consist mostly of primary or related commodities. Chinese demand for these products is higher than world demand, while promotion of primary exports – especially minerals – remains a high priority for the Peruvian government, as well as attracting foreign investment to this sector – Chinese or otherwise.

In regard to investment, Peru ranked second only to Brazil in overall Chinese FDI in Latin America from 1990 to 2012, and in 2014 Peru had captured nearly half of all projected Chinese investment in the region (Chen and Perez 2013; Capechi 2014). For 2014 alone, the Peru-China Chamber of Commerce (Capechi) predicted as much as US \$12 billion in new Chinese investment.¹ This is concentrated in three primary sectors - mining, fishing and hydrocarbons - and most comes from SOEs managed by the central or local governments.

¹ In September 2014, the Peru-China Chamber of Commerce estimated total projected Chinese investment in Peru as US \$9.27 billion for the prior twelve months, or 48% of the regional total of US \$19.3 billion (Capechi 2014).

However, in comparison to other sources of investment in Peru, the actual stock of Chinese FDI in Peru remains low. Although it is difficult to trace the total amount of FDI coming from China into Latin America due to tax havens, Peruvian authorities estimate this at just USD 1.8 billion in 2013: 48 percent in minerals, 40 percent in fisheries and 10 percent in finance (Capechi 2014). China was the 17th largest investor in Peru by nationality in 2013, while Spain was first with 19% percent, followed by the United Kingdom and the United States (Proinversión 2014). In mining, however, China is the largest single investor, and it now holds an estimated 30 percent of the total projected portfolio.

The main attraction of Chinese FDI in Peru remains the size of projected investments, especially in mining, and the ability of Chinese firms to commit resources over the longer term. Although Chinese SOEs purchased two older state-owned mining companies in Peru in the early 1990s, more significant investment did not take place until this century. The majority of Chinese mineral investment is concentrated in copper and iron, and since 2007 this has involved primarily green field projects obtained through the takeover of Western-owned junior firms.

While Chinese investors have shown interest in other sectors of the Peruvian economy, interviews with businesspeople and diplomats from both countries suggest that there are numerous obstacles for foreign investors in Peru. Some of these are related to Peru's regulatory requirements for all investors, like obtaining work and family visas, translating and officiating documents, and obtaining various permits for operation. Tender processes for infrastructure investments also tend to be complicated. More specific obstacles stem from lack of compatibility between the Chinese and Peruvian tax and legal frameworks and financial systems. These become harder to resolve when there is a lack of professionals on both sides with appropriate language and cultural skills.

At a higher level, although policymakers have been successful at negotiating FTAs and other accords, Peru to date has not had a clear strategy for following up on these opportunities. The state has done relatively little to accompany, finance or otherwise support private entrepreneurs in this process, and cultivation of ties with foreign investors and political allies is mostly driven by private companies and individuals, with little assistance from government, such that opportunities for better negotiation and deals can be lost (Wise 2012).

Chinese investors also find that they may have to communicate – and negotiate – with a large number of other parties after winning a concession and complying with the initial central government rules and regulations. These may include popularly-elected regional and municipal authorities, indigenous communities, non-governmental organizations (NGO) and diverse media, as well as local bankers and business competitors. Such diversity of actors is normal in a volatile democracy like Peru's and successful investors have learned over time how to respond to them. Chinese businesspeople and diplomats may be less experienced at multi-stakeholder relations than their Western counterparts, and less accustomed to demands for accountability from non-state actors. However, as our research and other recent studies of Chinese investment in the mining sector suggest, they are learning quickly.

Table 1: Main Chinese investments in Peru²

Year	Investor	Partners	Project	Sector
1992	Shougang Corporation/ Shougang Hierro Perú S.A.A		Marcona	Mining
1993-1994	China National Petroleum Corporation (CNPC)/ SAPET		Lot VI/VII (Talara, Piura)	Energy, oil and gas
2002	Tiens Group/ Tianshi Perú SAC.			Manufacturing
2005	China National Petroleum Corp. (CNPC)/ SAPET		Lot 111 (Madre de Dios)	Energy, oil and gas
2007	Aluminum Corporation of China (Chinalco)/ Minera Chinalco Perú S.A		Toromocho	Mining
2007	Zijin Mining Group/ Río Blanco Copper S.A.	Zijin (45%), Tongling Nonferrous (35%), Xiamen C&D (20%)	Rio Blanco	Mining
2007	Beijing Rich Gold/ Jintong Mining		Llama TY01	Mining (Exploration)
2008	China Minmetals Corp.-Jiangxi Copper Corp. / Lumina Copper S.A.C.^ ^	Minmetals (60%), Jiangxi Copper (40%)	Galeno	Mining
2008	Junefields Company Limited/ Junefield Group		Cercana	Mining
2009	Shougang Corporation/ Shougang Hierro Perú S.A.A		Marcona Expansion	Mining
2009	Nanjingzhao Group/ Jinzhao Mining Peru S.A.		Pampa del Pongo	Mining
2010	Bank of China	Bank of China, Interbank	China Desk Perú	Financial
2010	Industrial and Commercial Bank of China (ICBC)/ ICBC Peru Bank~			Financial

² **Source:** Authors' elaboration based on information from various sources, including American Heritage Foundation, ITC calculations based on UN Comtrade statistics, Prolnversion, MINEM, Sanborn & Yong, Irwin & Gallagher.

2011	Minera Shouxin Peru	Baiyin Nonferrous Group (51%), Shougang (49%)	Proyecto Explotación Relaves	Tailings
2012	China National Petroleum Corporation (CNPC)/ SAPET	CNPC (45%) Pluspetrol Norte S.A. (55%)	Lot 1AB (Olaya, Loreto)	Energy, oil and gas
2012	China National Petroleum Corporation (CNPC)/ SAPET	CNPC (27%), Pluspetrol Norte S.A. (73%)	Lot 8 (Trompeteros, Yanayacu, Loreto)	Energy, oil and gas
2013	China National Petroleum Corporation (CNPC)/ PetroChina*		Lot X (Talara), Lot 58 (Camisea)	Energy, oil and gas
2013	China National Petroleum Corporation (CNPC)/ PetroChina*	CNPC (46.16%), Repsol (53.84%)	Lot 57 (Camisea)	Energy, oil and gas
2013	Pacific Andes International Holdings Ltd. /China Fishery Group			Fishery
2014	MMG Ltd.	MMG Ltd. (62.5%), Guoxin Investment Corp. (22.5%), CITIC Metal (15%)	Las Bambas	Mining

3. Extractive Governance Reforms and Chinese Engagement

Latin America today accounts for nearly a third of total world mineral investment, and a growing share of this is expected to come from Chinese-owned firms, which own or participate in at least 35 major projects across South and Central America. Policymakers are concerned not only with avoiding the negative macroeconomic effects of excessive dependency on mineral exports, but also with issues of revenue transparency and distribution, with achieving adequate environmental and labor standards in the industry, and with having companies practice good community relations and corporate social responsibility. The overall objective is to obtain net benefits from the extractive industries and improving their impact on longer term development.

In recent years Peru has been something of a laboratory for extractive industry reforms. Yet while a number of agencies at the national and subnational level are making efforts to apply global standards, others – including the powerful ministries of Economy and Finance (MEF), and Energy and Mines (MINEM) – are primarily concerned with bringing new projects on line and accelerating production, which leads to efforts to weaken enforcement of laws and regulations that could hinder this effort. On the corporate side, Peru is host to virtually all of the major multinationals involved in the International Council on Minerals and Mining (ICMM), EITI and other industry-led corporate social responsibility (CSR) initiatives, but many local business leaders tend to see these reforms as “trabas” or obstacles to investment, and engage in passive or aggressive resistance.

China has also undergone major efforts at industrial and environmental reform over the past decade. This includes new regulations and guidelines that seek to promote corporate governance and CSR (Global Witness 2013, Tan-Mullins 2012). Yet, although there is increased awareness in China of what is required of firms to

comply with global standards, Chinese authorities are still lacking in implementation and enforcement. According to some experts, for some Chinese corporate and political leaders, issues of transparency and accountability are not necessarily considered part of CSR practices (Tan-Mullins 2012: 13). As they go overseas, leaders of Chinese firms understand the need to fulfill the expectations of local governments and communities and contribute to local development, yet they may remain hesitant to open up to the media or civil society groups, or to share what they consider sensitive information (Global Witness 2013, Sanborn and Torres 2009).

In this section we examine selected areas of extractive industry reform in Peru, focusing on how Chinese firms are engaged in or influenced by them, and whether Peruvian policymakers apply them any differently to the Chinese, because of the size and value of the investments they bring. Alternatively, are they monitored more closely than others? Of course, an alternative hypothesis is that all firms doing business in this country must meet the same regulations. Such questions are rarely asked about firms of other nationalities in this region, but have been the focus of recent research on the Chinese from both sides of the Pacific (see Torres and Sanborn 2009; Gonzalez Vicente 2013; Irwin and Gallagher 2013, Guo Jie 2014). A summary of our findings in this section can be found in Table 3.

Table 2: Peru - Extractive Governance Reforms and Chinese Engagement

Areas of Extractive Industry policy	Subareas	Description	Comparison or Cases
Revenue Transparency and Distribution	Revenue Transparency	Voluntary or mandatory efforts to make companies more accountable to the citizens and governments as well as shareholders. Since 2005, Peru has participated in the Extractive Industries Transparency Initiative (EITI) and was the first country in the Americas to become compliant in 2011.	Almost all major mining and oil companies in Peru participate in EITI. Until 2014, the only two Chinese companies that paid significant taxes were Shougang Hierro Peru and CNPC (Sapet), but they did not participate in EITI. However, both confirmed participation for the IV EITI Peru report (still in process in 2014). Lumina Copper (China Minmetals) participates.
	Revenue Distribution	Efforts to ensure that revenues generated are used to promote development goals. Since 2003, Peru redistributes 50% of income taxes paid by mining firms to subnational governments where extractive activity is located.	Shougang makes significant contribution to tax revenues in Marcona, Ica. Chinalco, based in Junín, will not be paying income taxes for several years.
Voluntary Social Investment		Private firms in Peru are motivated to intervene directly in areas where they operate, through social programs and community relations initiatives. The Peruvian government promotes this in several ways: required social funds as part of concession contracts, voluntary giving related to overall profits (“Programa Minero de Solidaridad con el Pueblo”, PMSP), and tax deductions for investment in social programs and public works (“Obras por Impuestos”).	i). Programa Minero de Solidaridad con el Pueblo, PMSP Of all major contributors, non-Chinese firms have higher spending rates. Shougang is the only Chinese participant. Neither Shougang nor other firms are very transparent about what they spent. (Grupo Propuesta Ciudadana 2011). ii). Other social investment Shougang inherited the commitment to provide housing and services to the city of Marcona. Chinalco created a new “company town”, Nueva Morococha.

			<p>iii) Obras por Impuestos</p> <p>Fourteen mining firms engaged in this program. The only Chinese firm participating is Chinalco, in alliance with two Peruvian companies.</p>
Corporate Guilds and Multi-stakeholder Fora	Corporate Guilds	Sectorial and national business associations have political clout, and engage with government and civil society (i.e. National Mining Society)..	Chinese firms are not active in National Mining Society. Many Western multinationals are also not active. Chinese firms are active in the Association of Chinese Companies in Peru.
	Multi-stakeholder forum	Grupo de Dialogo Minero (GDM) , founded in 2000, is a multi-stakeholder forum for dialogue and conflict mediation. It involves representatives from companies, government, NGOs, community and indigenous organizations.	The only Chinese-owned firm to attend GDM events for more than one year is Lumina Copper (China Minmetals).
	Specific cases	Peruvian authorities have established multi-stakeholder “mesas” or roundtables, to manage social conflicts.	<p>Chinalco: “Mesa de Dialogo para el Proceso de Reasentamiento Poblacional de Morococha”, organized to support the relocation process of the 5,000 residents of the town.</p> <p>Shougang: “Mesa de Dialogo para el Desarrollo del Distrito de Marcona”, created in June 2013 to negotiate agreements on various urban development issues.</p>
Labor	Labor rules and regulations	Wages and benefits for mineworkers on payrolls of the larger firms in Peru are above national average, with a special labor regime that includes profit sharing. However, companies may try to bypass labor unions and rights by subcontracting large numbers of workers off payroll.	<p>Few Chinese firms in Peru have large labor forces. Hiring of tertiary workers appears less prevalent among Chinese (Shougang, Chinalco) than other firms.</p> <p>Shougang places in the middle range in regards to compliance with Peruvian safety and labor standards, but it has a higher rate of strikes and labor protests.</p> <p>Chinalco is apparently</p>

			paying wages above the market average compared to other mining firms in the central highlands.
	Local Hiring	Demand for local employment is widespread among communities adjacent to mining projects, and most companies commit to this.	Chinese firms vary in their hiring policies in Peru, but most seem to offer some degree of local hires and/or training programs. Shougang' case is different since Marcona is a company town.
Environmental rules and regulations		Ministry of Energy and Mines approves EIAs, but since 2008, the Ministry of Environment (through OEFA) monitors compliance and penalizes infractions.	Four Chinese firms have received warnings or sanctions: Lumina Copper, Rio Blanco Copper, Shougang and Chinalco. But in overall Chinese firms have fewer environmental sanctions than other firms. Shougang has had 10 infractions cited by OEFA (MINAM) in the last 10 years, but the fines are higher than bigger firms like Antamina and Yanacocha. In 2014, OEFA ordered Chinalco to halt activities at the recently inaugurated mine due to acid wastewater runoff. Company responded quickly.

3.1 Revenue Transparency and Distribution

As numerous experts on the “resource curse” have stressed, greater transparency on the part of companies and governments is the first step in making both more accountable to citizens and shareholders, and to ensuring that the revenues generated by the extractive industries are used to promote the longer term development needs of the societies in which they operate (Karl 2006).

China still does not have a strong system of regulation of information disclosure by its companies operating abroad. Although there are government agencies that authorize and supervise overseas investments, such as the Ministry of Commerce (MOFCOM), the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), the National Development and Reform Commission (NDRC) and the China Development Bank (CDB), the policies that influence operations of Chinese firms overseas are usually too general to have strong effect, and the data reported by these firms back home varies considerably (Global Witness 2013, Lin 2012).

Meanwhile, in Peru individual and corporate taxpayers can protect the confidentiality of what they pay to the State in taxes, through what is called “*reserva tributaria*”—an equivalent to tax secrecy. This means that the Superintendencia Nacional de Aduanas y de Administración Tributaria (SUNAT), the agency responsible for tax collection, cannot reveal information regarding what companies tribute unless they have explicit permission from the firms. However, companies with annual earnings of over 3000 UIT or tax units³ are required to declare these to the Superintendency of the Stock Market, which makes this information publicly available. Starting in the early 2000s Peru has developed numerous other mandatory mechanisms to promote transparency in the corporate sector (see Grupo Propuesta Ciudadana 2013).

Since 2005, Peru has also been a participating country in the EITI, a global initiative that involves meeting common standards for reporting taxes and other payments made by companies to governments, in the mining and hydrocarbons industries. The idea is to prevent significant tax evasion or irregular payments, and demonstrate to citizens the real fiscal contributions made by these industries. Peru

³ For 2014, 1 UIT has a value of S/. 3,800 (Nuevos Soles) or around USD \$1,300, so this applies to firms with more than USD \$4 million in annual earnings (virtually all medium and large mining companies).

was the first country in the Americas to become Compliant with these standards. Furthermore, Peruvians successfully lobbied EITI International to include a new standard involving transparency in subnational government revenues, to begin with the IV national EITI Peru report in 2014.

Although the EITI is voluntary, the majority of leading producers and taxpayers in the mining and hydrocarbon sectors participate, including all of the ICMM members operating in Peru (EITI Peru 2013). How do the Chinese compare? Given the recent nature of most Chinese mining investments, there are only two Chinese companies that pay significant taxes in Peru; Shougang Hierro Peru and CNPC (Sapet). Neither of them participated in the first three EITI Peru reports, covering taxes paid in 2004-2007 (I), 2008 – 2010 (II) and 2011 – 2012 (III). Because they were among the few major firms absent from this initiative, this marked a notable difference from other multinationals and contributed to their reputation for lack of transparency. However, this situation began to change in 2013.

According to Chinese executives in Peru, the absence of their firms from EITI Peru was due to the lack of authorization from their mother companies in China. Since 2011, the Humala Administration assigned permanent staff from MINEM to work with a tripartite EITI commission, involving representatives from industry and civil society, and to encourage executives of non-participating companies to join.⁴ In 2012 one Chinese-owned firm, Lumina Copper, participated in the second report, and in 2013 the others began to express interest. In 2014, representatives of Shougang and CNPC (Sapet) announced their commitment to participate in the fourth EITI report.

⁴ Cynthia Sanborn has been involved in this Commission since 2007: <http://eitiperu.minem.gob.pe/>

Because Lumina's main Peruvian project is not yet in operation, their involvement is symbolic. However, now that the owner of Lumina, China Minmetals, is also the majority owner of MMG, which recently purchased the Las Bambas copper project in Apurimac, the firm has announced plans to be more actively involved in this initiative.

Regarding revenue distribution, since 2003, 50 percent of all income taxes paid by mining firms to the central government are redistributed to the regional, provincial and municipal governments in which their extractive activity is located. This is called the "mining canon", and in some parts of the country it means that enormous revenues are in the hands of mayors, regional presidents and others who could invest in much-needed infrastructure and services for their communities. Many of these communities are extremely poor, rural and indigenous.

Does this income provide net benefits for communities where mines are located? This is a hotly debated issue in Peru, and the answer varies. While there have been success stories in such regions as Moquegua and Arequipa, there are also regions such as Cajamarca and Huancavelica, where these revenue flows have had little positive impact, while mining has brought high environmental and social costs, suggesting a form of "subnational resource curse" (Arellano-Yanguas 2012). The relevant question here, however, is whether the presence of Chinese firms in certain regions of Peru has a significant impact on tax revenues, and on the ability to invest those revenues in promoting development goals.

In the mining sector, there is only one Chinese firm that is fully operating and paying significant taxes: Shougang Hierro Peru based in the district of Marcona, in the region of Ica. As it happens, Ica is one of the most economically dynamic regions in Peru, with socioeconomic indicators above the national average and close to full employment. This is due not just to mining, but also to the presence of commercial agriculture, fishing and tourism. Within Ica, Marcona also has the best social and

economic record, and Shougang is the largest taxpayer as well as employer: around 70 percent of the town's adult population works for Shougang or depends on someone who does. According to the Ministry of the Economy, since 2006 over 50 percent of the monetary transfers that Marcona receives comes from the mining canon.

The company itself claims that as of late 2012, it has provided an estimated USD 967 million in tax payments and other contributions, and that between 2004 and 2012 it contributed USD 74.75 million (Shougang 2013; Kong Aimin 2014). In an interview with the authors, Shougang's General Manager, Kong Aimin, stressed that although the company complies with its tax obligations, how that revenue is redistributed and used depends on the priorities of local authorities.

Although Chinalco inaugurated its Toromocho mine in December 2013, it has suffered setbacks in the original timetable, and will not be paying income taxes for several years. Furthermore, the region of Junín – where the mine is located – is a longtime mining area, and within the same province other companies have been operating and paying taxes for years, so the specific contribution from this one will be challenging to separate out.

3.2 Voluntary Social Investment

Although tax revenues from the extractive industries have been abundant in recent years, Peruvian governments have had considerable difficulty investing these revenues in ways that address basic needs and sustainable development goals. Given this situation, private firms have been motivated to intervene directly, through numerous social programs and community relations initiatives. A recent World Bank study identified some 40 foundations, NGOs, trusts and social funds created by the mining industry in Peru in recent years (World Bank 2010).

Peruvian governments have actively promoted this corporate social investment, by requiring the creation of social funds as part of initial concession contracts, and through legislation and tax incentives to encourage voluntary giving. The *Programa Minero de Solidaridad con el Pueblo* (PMSP), which ran from 2006 to 2011, was the result of a negotiation between mining industry leaders and the Alan García Administration. It involved 40 companies that signed agreements to “voluntarily” invest 3.75% of their profits in social infrastructure and development programs in their areas of influence, in lieu of a windfall profits tax, which García had promised voters in his presidential campaign. Under President Humala, this program was halted and the tax rate on mining was raised modestly; however, the *Obras por Impuestos* (Public Works for Taxes) program offers tax benefits for investment in social programs and public works.

Shougang was the only Chinese company eligible to participate in the PMSP. From 2007 to 2011, according to MINEM (2012), Shougang designated about S/. 33.5 million (USD 12 million) to the program, although only an estimated S/. 13.5 million (USD 4.8 million) was spent when the program closed. This is considerably less than the top contributors in the same period, such as Antamina (S/. 775 million destined, S/. 631 million spent) and Yanacocha (S/. 268.5 million destined, S/. 207.5 million spent). Because the amount committed is related to overall profits, it is not fair to compare Shougang’s net contribution with that of larger companies in the sector. But if we examine their relative capacity to spend what they committed to, over 2007- 2011, Antamina had the highest completion rate (81.4 percent), followed by Yanacocha (77.3 percent), and Shougang was farther behind at 40 percent.

Shougang’s PMSP contribution was channeled through a nonprofit created by the company in 2007, “*Asociacion Civil del Hierro: Progreso y Desarrollo*”. According to the company, this association has invested close to S/. 19.17 million (USD 6.89 million) in education, health and other projects. However, in a ranking of how transparent mining companies were in PMSP in 2011, this association was ranked

32 out of 39 (“No se cumplió” 2011). Other companies with similarly low transparency were Cerro Verde (a U.S.-owned firm), Xstrata Tintaya and Minsur. So while Shougang has not been transparent about what it has spent, it is not the only firm in that position.

This relatively modest level of investment in the PMSP does not take into account the ongoing commitment that Shougang has to provide services for the town of Marcona, including water and electricity as well as housing for its workers (around 2000 homes). Unlike most new mining projects in Peru, Marcona had been a “company town” well before Shougang purchased the operation, and the Chinese investors were expected to pick up the tab. According to a recent Shougang publication, and interviews with company staff, between 2007 and 2012 the company invested USD 39 million in services and infrastructure for its workers and Marcona as a whole, including maintenance and improvement of housing, water and sewage systems, streetlights, roads and public transportation and recreation. They also claim to have invested over USD 13 million in expanding the nearby highway, built homes and provided services for local school teachers and fishermen, and donated another USD 11.5 million for various social activities in Marcona, Ica and Northern Arequipa (Shougang 2013).⁵

Ironically, the most recent Chinese mining investment in Peru, Toromocho, also involves investment in what might be called a 21st century “company town”. As part of its investment commitment, and to make way for the mine, Chinalco agreed to relocating the 5,000 residents of Morococha six kilometers away, and creating a new city for them. Although this process has not been without controversy, the level and

⁵ This data is based on a company publication received in 2014. In 20 years of operation, Shougang claims to have invested USD 1 billion in renovation of the mine, plant and related infrastructure, including environmental remediation, and another USD 1 billion in local purchases, and to have created 4200 direct or indirect jobs (Shougang 2013).

complexity of investment proposed was unprecedented in Peruvian mining history (Sanborn and Chonn 2014). And while Chinalco does not yet pay income taxes, in March 2014 it established a consortium with two Peruvian firms, Volcan and Ferreyros, to implement social infrastructure projects under the “*Obras por Impuestos*” program (“Volcan, Ferreyros y Chinalco” 2014). These projects would include improved access to drinking water, sewage, and water treatment for the residents of the district of Yauli, in Junín.

3.3 Corporate Guilds and Multi-stakeholder Fora

Although five Chinese firms are formally members of *the Sociedad Nacional de Minería, Petróleo y Energía* (SNMPE), the main corporate guild for the industry, they have little active involvement in this group. Yet according to some testimonies, the major Western multinationals also have low participation in this organization, which they see as dominated by older Peruvian firms, and which tends to play a conservative role in Peruvian politics. Representatives of the larger multinationals may defend their interests by addressing MINEM or other government agencies directly rather than working through guild channels, and in this sense the Chinese may be no different. However, Chinese mining companies do participate actively in the Association of Chinese Companies in Peru, and two of their executives are on the Board of Directors (whose President, Gong Bencai, is Vice President of CNPC for Latin America).

The *Grupo de Dialogo Minero* (GDM) is a multi-stakeholder forum for dialogue and conflict mediation that was founded in 2000 and involves representatives from companies, government, NGOs, community and indigenous organizations. According to annual reports, the only Chinese-owned firm to attend GDM events for more than one year is Lumina Copper. For the participating firms, it has allowed

them to get to know other actors, although the effect of participation on the evolution of social conflicts is questionable.

The low profile of Chinese firms in such fora has reinforced their negative image among some sectors engaged with this industry, and has encouraged the perception that they are not transparent in other ways. Chinese companies in Peru have also stood out for their reticence to address the media or invest in ambitious communications programs. This lack of participation and seeming disinterest has also generated some hostility toward Chinese investors in general.

More recently, Peruvian authorities have encouraged Chinese firms to participate in multi-stakeholder “*mesas*” or roundtables, organized by the *Oficina Nacional de Dialogue y Sostenibilidad* (ONDS), an agency within the *Presidencia del Consejo de Ministros* (PCM) tasked with managing social conflicts. In theory there are two types of *mesa*: the “*mesa de diálogo*”, aimed at conflict resolution, and the “*mesa de desarrollo*”, aimed at assessing local needs and delivering services and social programs, in theory to prevent conflict. In practice, their objectives overlap.

Both Chinalco and Shougang have been involved in such efforts. In the case of Chinalco, the “*Mesa de Diálogo para el Proceso de Reasentamiento Poblacional de Morococha*” was organized in 2010 and put into action in 2013, to support the relocation of the 5,000 residents of the town. In the case of Shougang, the *Mesa de Diálogo para el Desarrollo del Distrito de Marcona* was created in June 2013, with the involvement of national and local authorities and representatives of the company. Meeting for nearly a year, participants have negotiated agreements regarding various urban development issues, including land use planning and the construction of a new shipping terminal. (Marcona Digital 2014).

3.4 Labor rules and regulations

The situation of mineworkers in Peru varies considerably depending on the size and nature of the firm and project. Overall, the bonanza experienced by the sector in recent years has meant better wages and working conditions for formal sector workers on the payrolls of the larger firms (Sanborn and Dammert 2013).

Mineworkers also enjoy a special labor regime compared to other formal sector laborers, including a higher minimum wage, more stringent health and security requirements, a social security fund covered by companies, and annual profit-sharing requirements (MINTRA 2014; MINEM 2014).

The principal complaints made by mineworkers' unions tend to involve non-compliance with these legal requirements, or the tendency of firms to subcontract large numbers of workers through tertiary "services" that do not provide full benefits. In theory, companies are only authorized to hire through such intermediaries for activities that are temporary or complementary to regular operations, such as construction or food service provision. However, by 2013 such subcontracts represented 67.4 percent of total direct employment in mining and labor leaders charged that they were being used to bypass union rights (MINEM Empleo Minería 2013).

Critics of Chinese firms operating overseas often claim that they have less respect for free labor unions, or a greater tendency to violate workers' rights. In some countries they have also been criticized for bringing in large numbers of Chinese workers instead of hiring locally. In Peru, however, there are still few Chinese firms operating with significant labor forces, and no Chinese company is hiring large numbers of Chinese nationals.

Shougang has the largest work force among Chinese firms in Peru, employing 4200 people including 2000 direct hires, and just 20 to 40 of whom are Chinese (Kong

Aimin 2014). Irwin and Gallagher (2013) examine government data from 1993 to 2006 and place this company in the middle, among industry peers, for compliance with labor standards. The authors argue that the total pay and benefits received by Shougang workers are among the highest in the industry, including a larger than average number of workers on regular payroll and participating in profit-sharing. This is also the only mining firm in Peru that continues to provide housing for all of its employees as well as basic services to the community in which they live.

So why does Shougang have the highest number of strikes and days lost over union disputes in Peru's mining sector? Authors' interviews with union leaders suggest that the main disagreements involve a dual salary scale that applies a less favorable regime to newer workers. Another point of contention is the company's failure to provide a safer working environment. Outdated machinery, apparently more common in Shougang than the industry average in the firm's early years, contributed to workplace accidents. For their part, company officials argue that they inherited a highly politicized union leadership that is unwilling to recognize major new investments the company has made in the mine and plant in recent years (Kong Aimin 2014).

Most other Chinese mining firms still have few workers on payroll. Chinalco began operations in December 2013, and by April 2014 company sources claimed 1,247 direct hires, out of a total 2,500 that they expect to have in place when fully operational. Only six employees at that time were Chinese (Barrenechea 2014). Initial observations and interviews with staff from rival firms suggest that Chinalco is paying wages above the market average for skilled labor.

Mining is a high-risk activity, but firms should take measures to reduce accidents and protect their workers. Since 2011 the Ministry of Energy and Mines has published annual fatal accident rates by firm, with totals of 42 to 52 per year. In these four years, Shougang had two fatalities, one in 2012 and the other in 2014.

Chinalco had three, one in 2011 and two in 2013. In contrast, Buenaventura reported three to four fatalities per year and Southern Peru Copper (part of Grupo Mexico) had two or three per year. The majority of fatal accidents involve older Peruvian firms (MINEM 2014).

In general, there is high demand for skilled workers in the Peruvian mining industry and it would be hard for any major company to systematically violate labor law laws or pay low wages without losing their work force. However, there is a tendency among some firms to avoid granting union rights and full benefits by hiring tertiary workers. So far, this practice seems less prevalent among the Chinese companies in Peru (Irwin and Gallagher 2013).

One of the most frequent demands by communities where mining operations take place in Peru is for local hiring. Companies are often pressured to hire workers from adjacent areas, and this is a key issue when negotiating exploration or construction permits. Some companies include explicit promises of local hiring in contracts or in published agreements with community leaders. In the mining industry overall, MINEM reported that in 2012 around 53% of employees were members of local communities, 46% from other regions, and just 0.26% foreigners (MINEM Empleo Minería 2013). While Peru does not demand a specific percentage of local hires, mining companies are expected to promote local employment, including workers' training programs, and to report such efforts to the Ministry.

Shougang officials claim that 70 percent of the population of the city of Marcona depends economically on the company (Kong Aimin 2014). This is an exceptional case as Marcona has been a company town since the 1950s. Chinalco has not published local employment numbers, but has reported investing considerable sums in 2012 – 2013 in temporary hiring for remediation, construction and other tasks, and is expected to give preference to locals in the longer-term hiring process, although the lack of people with appropriate technical and physical qualifications

makes this a challenge. Chinalco is investing in scholarships and training programs for local residents in order to increase prospects for hiring.

In 2010, Lumina Copper signed a “Social Accord” and a series of agreements with the adjacent community of La Encañada, Cajamarca, in which the company agreed to designate 90 percent of all non-skilled jobs to local residents (MINEM 2010).

However, the project has been stalled since 2013. In the Las Bambas project in Apurimac, the new Chinese-owner (MMG) agreed to honor a prior commitment to provide at least one job per family in the local community (“MMG: Sin Comunidades” 2014).

In sum, mining company officials in Peru agree that it is necessary to establish and maintain good relationships with local residents for the successful operation of their projects, and that local hiring plays an important role. Community leaders are also becoming more aware of their negotiating powers and demanding training and hiring in these operations. Although there is still limited evidence on Chinese hiring policies in Peru, to date they appear to be making as much effort as other firms in the sector to meet these expectations.

3.5 Environmental rules and regulations

Since the mining industry was privatized in the early 1990s, authorities have struggled to establish a viable legal framework for regulating the environmental impact of this inherently risky activity⁶. Primary responsibility for such regulation lies with the central government, and until 2008 it was the task of MINEM to review and approve the Environmental Impact Assessments (EIA) presented by investors.

⁶ Specific regulations include the Environment Code of 1990, the Law to Promote Investments in the Mining Sector of 1991 (Legislative Decree 708) and the General Law of Mining in 1992.

This meant that that ministry acted as judge and jury, since it is also responsible for promoting new mining investment. In 2008, however, the Ministry of the Environment (MINAM) was created, with nationwide authority to manage environmental plans and oversee environmental regulatory compliance. Tensions between the two ministries have been constant, with the Ministry of Economy and Finance often siding with the MINEM.

Although the MINAM began with a modest staff and budget, it has enjoyed broad legitimacy and considerable international development assistance. Within the ministry, the Office of Environmental Assessment and Control (OEFA) is responsible for monitoring the environmental conduct of firms in the mining, energy, fishing and industrial sectors, and for applying sanctions where appropriate. In 2012 the government also announced the creation of a National Service of Environmental Certification for Sustainable Investments (SENACE), tasked with reviewing and approving EIAs for high-risk projects. However, by mid - 2014 the agency was not yet functioning and its implementation was seen by some in the administration as an obstacle to new investment.

What has been the response of Chinese firms to environmental regulation in Peru? For the most part, it has been compliance rather than contestation, and overall Chinese firms have had fewer environmental sanctions than many others in Peru.

As mentioned, Shougang invested in a fully operating state-owned company that had already fallen below global standards for worker safety and environmental safeguards, and the Chinese owners delayed in investing in technology to reduce these risks. Through 2006, however, Irwin and Gallagher argue that Shougang's performance was around average for the industry in Peru. More recent data from OSINERGMIN and OEFA, covering 2007 – June 2014 (Table 3), suggest the situation remains roughly the same; the amount paid by Shougang in fines for environmental infractions has been less than Doe Run, Volcan or Buenaventura, but higher than

Yanacocha or Antamina. In total, the firms that have had to pay the most in infractions are not Chinese, but of U.S. or Peruvian origin.

Table 3: Environmental fines on mining firms in Peru, 2007-2014, by regulatory agency⁷

	By Agency (UIT) ⁸		Total: Real (2014) Value		
	OSINERGMIN	OEFA	UITs	Soles (UIT=3800)	USD (2.87 soles)
Doe Run	865	10,133	10,998	41,791,374	14,561,454
Volcán	1,287	5,746	7,033	26,723,880	9,311,456
Buenaventura	530	1,012	1,542	5,858,042	2,041,130
Shougang	213	1,004	1,217	4,626,234	1,611,928
Minera Yanacocha	268	381	649	2,467,036	859,594
Milpo	190	406	596	2,263,698	788,745
Antamina	14	359	373	1,419,110	494,463
Rio Blanco (Zijin)	100	0	100	380,000	132,404
Chinalco	0	71	71	270,256	94,166

More recent Chinese-owned projects are not comparable due to the shorter time frame; for example, Rio Blanco was halted in the exploration stage. In March 2014, however, in what is considered by environmental authorities as an emblematic case, the OEFA ordered Chinalco to halt activities at its recently-inaugurated Toromocho mine, after inspectors detected a runoff of acid wastewater into two nearby lakes (“OEFA ordena” 2014). Apparently, unusually high rainfall caused an overflow before the adequate drainage was built. Given the expectations riding on this

⁷ Sources: Organismo Supervisor de la Inversión en Energía y Minería- OSINERGMIN. Gerencia de Fiscalización Minera. (http://www.osinergmin.gob.pe/newweb/pages/Publico/1514_.htm?6423). Organismo de Evaluación y Fiscalización Ambiental- OEFA. Dirección de Fiscalización, Sanción y Aplicación de Incentivos. Registro de Actos Administrativos. (<http://publico.oefa.gob.pe/sifam/faces/page/fiscalizacion/registroInfractor/principal.xhtml>). Superintendencia Nacional de Aduanas y Administración Tributaria. SUNAT. (<http://www.sunat.gob.pe/indicestajas/uit.html>)

⁸ *UIT (*Unidad Impositiva Tributaria*) is a tax unit that serves as a benchmark to determine tax obligations and penalties under law. Its amount varies from year to year and is established by decree, according to macroeconomic calculations made by the Peruvian tax authority, SUNAT).

project, this was a dramatic move by MINAM and a blow to the company's public relations efforts. Yet the company's response was rapid, the structure was reinforced, and a few days later OEFA authorized Chinalco to resume operations ("Chinalco resumes" 2014). As a result of this incident, the Association of Chinese Companies in Peru asked MINAM to organize informational meetings for all of their members to explain Peru's environmental regulations to newcomers.

4. Case Studies – Learning from the Details

So is there a "Chinese way" of doing business in Latin American mining? If so, can we draw conclusions about the net benefits or costs of the Chinese presence in this sector? Based on the Peruvian experiences analyzed so far, the short answer to both questions is no. Diverse Chinese firms operate in this region, most are SOEs associated with different levels of government in China, and some of them are based on private capital. The policies of the Chinese government and state banks towards their overseas companies are also evolving, and some may receive more support than others. Rather than generalizing at this stage, therefore, it is important to analyze more closely the nature and operations of each firm and project. The following section focuses on three cases which represent this diversity of situations: Shougang (Marcona), Chinalco (Toromocho), and Zijin Mining Group (Rio Blanco).

4.1 Shougang: Starting off on the wrong foot

Marcona was the first Chinese mine in South America, and is currently the largest iron ore operation in Peru. It is located in the Ica region, several hours south of Lima, and involves a mine and smelter initially founded in the 1950s by the U.S.-based Marcona Mining Company. In 1975, Marcona was expropriated by Peru's military government and became *Empresa Minera de Hierro del Peru* (Hierro Peru).

In 1992 it was sold by the Fujimori administration to the Shougang Group, a state-owned conglomerate in Beijing whose chairman had close ties to the highest echelons of power and considerable autonomy to operate overseas. Seeking to turn Shougang into China's leading steel producer, company officials paid USD 120 million for Marcona; more than Peru expected to receive at the time and a price analysts thought was too high.⁹

At the time of purchase Hierro Peru had significant economic losses, an aging labor force and a politicized union. Marcona, a former mining camp, had also seen better days. The concession included not only the mine and processing plant, but also rights to use of surface lands, on which the entire town had been built. In preparation for the sale, the Peruvian government fired half of the work force, but apparently left the unemployed in company housing. According to several sources, when Shougang arrived it evicted them and brought in Chinese workers to take their place. Facing violent protests, the foreign workers were quickly sent back home. In this sense Shougang had already started on the wrong foot, provoking conflict with both its remaining labor force and the surrounding community¹⁰.

Today, Shougang Hierro Peru is still the sole iron producer in Peru. With two decades under Chinese management, it has become highly profitable. In 2011 it produced more than seven million tons of iron ore and recorded a 50 percent growth in its net profits, and revenue increased another 21.26 percent in 2013. Since 2007 the company also embarked on a series of investments to increase production capacity and safety, including the purchase of new machinery and plants, an expansion plan, and a project to process tailings. All of this is estimated to

⁹ This transaction was later scrutinized by anti-corruption investigators in China and Perú. In 1995, Shougang Chair Zhou Guanwu was forced to resign and his son Zhou Beifang given a suspended death sentence on corruption charges related to Shougang operations. http://articles.latimes.com/1995-02-21/news/mn-34483_1_hong-kong-companies In 2001, a Peruvian congressional commission investigated alleged corruption by Fujimori government officials in this sale, but no charges were brought.

¹⁰ For more on this history, see Gonzalez Vicente 2012 and Irwin and Gallagher 2013. Company officials interviewed for this project say that 171 workers were brought from China for one year only.

require a USD 1.3 billion investment (“Mineros de Shougang” 2012; Shougang 2013; Kong Aimin 2014).

Yet Shougang also remains one of the most criticized foreign mining firms in Peru. In part this is due to reneging on its original investment commitment and postponing plans to modernize the mine. The company had agreed to invest USD 150 million over 1992-1995, but apparently the political and financial problems in the parent company in China during this period made it impossible to comply (Nolan 2001; Gonzalez Vicent 2012, Irwin and Gallagher 2013). According to Shougang’s general manager, their request to extend the time period for this commitment was denied by the government, even while others were approved, and instead they were fined for noncompliance (Kong Aimin 2014).

Privatization in the 1990s had come with the promise of improved conditions for workers, but the company efforts on that score during the first decade of operations were limited. The main priority was reviving production, and with debts and with limited cash back home, Shougang executives took a hardline approach to union negotiations, leading to frequent strikes and protests that grabbed media attention. This backfired politically, as the Hierro Peru workers were leaders in the national miner workers’ confederation, with allies in media and politics. Even as things improved for the firm, labor relations remained difficult to manage and the union tends to stage annual strikes as part of negotiation. In 2013 and 2014, the company continued to have labor troubles and poor relations with the community as a whole.

Shougang has also been criticized for its noncompliance with some environmental regulations, and has had conflicts with the surrounding community over the provision of water and electricity. Before Shougang’s arrival, Hierro Peru provided water and electricity without charge to Marcona. Although this was not included in the privatization package, apparently local authorities were unwilling or unable to assume these responsibilities and Shougang found itself continuing to provide these

services to Marcona. Today this is done through a contract with the municipality, though problems with access and distribution are often attributed to the firm. Local fishermen in Marcona also have longstanding complaints regarding the environmental impact of Shougang's mining activities.

For many Peruvians and the international media, Shougang represents the negative stereotype of a Chinese company that lowers standards in the race to feed the demand for ores. But is this really the case? The mine has been operating since the 1950s and the town surrounding the mine continues to depend heavily on its operation. Living standards in Marcona are relatively high by Peruvian standards, and the poverty rate is relatively low. Yet many community members have fond memories of the old company town with a benevolent U.S. owner providing housing and all basic services. Some older workers also miss the days when the State was the owner and the union was more powerful. Although the Marcona mine has been in Chinese hands for years, its owners have not won over the hearts and minds of their neighbors.

How different is this from other older operating mining firms in Peru? As discussed in Section II, our research confirms Irwin and Gallagher's prior observations, that objectively, Shougang has not performed significantly worse in terms of labor standards or environmental impact, than its Peruvian or international counterparts. From 1996 to 2006, Shougang apparently spent USD 12.7 million to build a new tailings deposit, reduce dust and gases and protect against oil spills (Irwin and Gallagher 2012). In 2007, the company completed the construction of a plant destined to wastewater treatment for the town, though according to Shougang officials, it did not start operating until 2013 due to the lack of prepared personnel within Marcona city hall. By 2012, the company had spent 77 percent of what it committed in the original Program of Environmental Compliance and Management (PAMA).

One conclusion to be drawn from this is not that Chinese firms have especially low standards, but rather that Peruvian authorities have been weak in enforcement of norms with virtually all operating firms. Shougang also inherited a more difficult situation than most, and one that is not comparable to greenfield projects without prior constraints. But this does not explain the persistent conflicts the firm has generated locally, the delays in adhering to the EITI process, absence from the *Grupo de Dialogo Minero*, or reticence to invest more time and resources in improving community and public relations. For some observers, these problems can be attributed to cultural and political differences between Peruvian and Chinese managers, the idea being that the Chinese do not know how to deal with free trade unions, a free press or local democracy. Chinese enterprises overseas do need to learn how to negotiate with workers and local communities, and develop a serious management team for doing businesses abroad (□企海外遇阻 2012; 秘□ 2013).

Yet more recent cases suggest that Shougang's problems may have more to do with the company rather than its general Chinese origins. Shougang Corporation has been facing an increasing number of challenges in an industry with more and fiercer competition, and appears to be trailing behind other more modern Chinese mining firms. Whether it is at home or overseas, the group will require better strategies to adapt to different economic, political and environmental demands.

Shougang's relationship with the Peruvian state is also distinct from others, including other Chinese firms. The company had a good initial relationship with the Fujimori administration, but that relationship soured by the late 1990s. Under Toledo (2001-2006), congressional investigations into the privatizations of the 1990s included scrutiny of the Shougang deal, and company officials were suspected of corruption; however, the charges were eventually dropped. Members of Congress from Ica have been closer to the union than the company and remain critical of Shougang's operations, and company officials claim they are subjected to far more scrutiny than other firms.

In mid-2013 a *Mesa de Diálogo para el Desarrollo* was installed in Marcona, convened by the ONDS-PCM, with the purpose of bringing together representatives from the Regional Government of Ica, the Municipality of Marcona, and local civil society, including artisanal fishermen, to discuss local development issues (“Shougang mesa diálogo” 2013). Although this involves public sector coordination, a representative of the firm has been asked to join the process. In September 2013, the participating institutions agreed on a plan to address the population’s main concerns, and as of mid-2014 they were working on a master plan for urban development (MINEM Proyecto Marcona).

Meanwhile, Chinese companies moving into Peru in the past decade have explicitly tried to learn from the mistakes of their predecessors, including not only Shougang but also Western-owned firms. En route to becoming truly global firms, a number of Chinese companies are making efforts to act with social responsibility, and to be perceived as such. The leading example in Peru so far is Chinalco.

4.2 Chinalco: Holding to a New Standard?

The Aluminum Corporation of China (Chinalco) is an SOE founded in Beijing in 2001 after the merger of a group of aluminum companies as part of China’s efforts to consolidate and restructure its industry. Today it is one of the world’s largest aluminum producers. In 2007, Chinalco acquired the Canadian junior firm Peru Copper Inc., obtaining the Toromocho project, an open-pit copper mine and processing plant in the Junín region of central Peru. (Sanborn and Chonn 2014).

According to media reports, Chinalco has invested over USD 3 billion in this project, making it one of the top 20 copper projects in the world (“中□秘□” 2013; “Toromocho solo produjo” 2014). Built over a six-year period, it is expected to have

an operating lifespan of 32 years and to provide almost 18 percent of China's total copper resources, as well as helping Peru to increase its copper production by 20 percent¹¹. The project also involves a limestone quarry, concentrator, conveyer belt and tailings dump. It is expected to generate close to USD 7.5 billion in income tax revenues, USD 760 million in royalties, and USD 3.8 billion locally through the mining canon, as well as 2500 direct jobs during the production period and 7500 indirect jobs over the project lifespan. Located in a high-altitude historic mining region, this project stands out for its promise to use state-of-the art construction, invest in an acid water treatment plant for the area, and undertake a complex process of relocation of the nearby town of Morococha.

In this case, aware of Shougang's problems, Chinalco executives explicitly aimed to establish this as a socially and environmentally responsible company that would comply with global standards. The first CEO of Minera Chinalco Peru, Gerald Wolfe, had previously run Antamina, considered a global model for "new" mining and CSR. The current CEO, Huang Shanfu, has retained a management team and work force that are primarily Peruvian. Indeed, since the Shougang protests in the early 1990s, no subsequent Chinese mining company in Peru has tried to bring its own labor force. Chinalco also retained the community relations consultants originally hired by Peru Copper – Social Capital Group (SCG) -- and worked with them to conduct the relocation. Putting this commitment into practice, however, has been challenging for Chinalco from the start.

By objective standards, the old town of Morococha is a bleak site. Built as an earlier mining camp, it is rundown, with communal latrines and a limited water supply. The majority of residents were renters who lived in overcrowded and dilapidated

¹¹By September 2014, the company had reduced its short-term production figures by 56%, due to delays caused by various factors, including a shortage of adequate power supply, problems with its equipment, and community relations challenges. See "*Toromocho solo produjo*" (2014).

buildings, while working in mines nearby. At the edge of town sits a toxic tailings dump around which, until recently, the local children played (Sanborn and Chonn 2014). Yet moving is always hard, and Chinalco initially encountered resistance, led by the town's mayor and an influential group of property owners. The relocation of the population of old town was a project that the former holders of this concession had already begun to negotiate with the population of Morococha before the sale to Chinalco in 2007. According to interviews with representatives from SCG, the relocation was initially going to take place with the help of the Peruvian government, but after Chinalco became the owner of the project, it was decided that the company would assume this responsibility.

By late 2013, after prolonged negotiation, the majority of Morococha residents had agreed to relocate. For the minority that resisted, the main concern appeared to be the desire to negotiate a better deal with the company. At this point, however, the Peruvian government issued a controversial Declaration of Emergency, with an evacuation order to be complied with by February 21, 2014 (INDECI 2013). The argument was that the area is unfit for occupation due to severe environmental contamination, mudslides and seismic risk – a situation that has been in place for decades. Temporary tents were installed for housing those who would not be considered beneficiaries of Chinalco in the new town, and electricity was interrupted in old Morococha. This action was viewed as the government's forceful attempt to make the remaining people leave (Servindi 2014). While Chinalco repeatedly emphasized that it would not use force in the relocation, the presence of a small group of holdouts remained a challenge for the company.

Other challenges emerged around conditions in the new town and nearby communities. Nueva Morococha is a city created by a law approved by Congress in September 2013. All of the families relocated there by Chinalco were offered their own home, with running water, a modern sewage system, and – most importantly – property titles. However, as of late 2014 the granting of such titles by the State was

delayed and the company remained the legal owner of the town (PCM 2014). Furthermore, at least 169 families from old Morococha remained in a temporary shelter, while civic and religious leaders called on the government resolve their plight (INDECI 2014; Arzobispado Huancayo 2014).

Some residents of the new town received employment offers in Toromocho, while others work in other nearby mines, or seek new forms of income generation, which are still uncertain. Unlike the old town, Nueva Morococha is farther away from Peru's busy Central Highway, causing a decline in business for local entrepreneurs, who used to sell to local miners from projects in the area. In the Environmental Impact Assessment (EIA) for Toromocho, Chinalco mentioned that it would promote local employment. However, no explicit agreements were made, and instead a dialogue process, supervised by the PCM, is being arranged to reach an agreement ("*convenio marco unificado*").

Meanwhile, in September 2014 Chinalco faced conflict with the community of Pachachaca, where they plan to locate the limestone quarry (an element necessary for processing the copper). Around 500 people, including community members and supporters, blocked the central highway to prevent access to the plant while demanding that the company honor alleged commitments made, including promises of jobs to community members, purchase of local products, and respect for the environment¹².

In sum, although Toromocho is less than a year old and not fully operating, it has produced both benefits and challenges for Peru, and for its Chinese owners. For starters, it has raised the bar for community relocations, by prioritizing dialogue and consensus-building rather than sheer use of force, and by the scale and

¹²<http://elcomercio.pe/peru/junin/oroya-pobladores-rechazan-construccion-planta-chinalco-noticia-1755693>

complexity of investment in building a new town (PCM – ONDS 2014). Chinalco is also offering better wages and benefits than the industry average, and its financial backing appeared unparalleled even by other Chinese firms operating in this region.

However, whether its operations will fulfill the promise of meeting the highest social and environmental standards in the industry remains to be seen. As noted above, Toromocho has already suffered a setback on the environmental front, when the OEFA ordered temporary suspension of its operations after heavy rains led to acid water runoffs into two local lakes (OEFA 2014). Although this was an accident, and the company quickly complied with authorities to fix the problem, this incident – as well as the conflicts with neighboring communities – have further increased the global scrutiny of this operation and others that follow.

4.3 Zijin Mining Group: Not Getting Off the Starting Block

Both Shougang and Chinalco are engaged with populations whose residents have long worked in or around mines, and do not challenge the presence of mining operations per se. However, many new concessions in Peru involve territories belonging to peasants and indigenous communities, who make their living from agriculture, follow communal forms of governance, and are resistant to hosting large-scale mining operations.

To compare the social impact of Chinese-owned mining operations with those of other national origins, we have included one such case: the Rio Blanco copper and molybdenum project in Piura, on the Peru-Ecuador border. This project would involve a major investment and an enormous engineering feat since the future mine is in a remote high mountain area, and the minerals would be sent to the Pacific coast through an extensive pipeline. Investors in this project must build the mine, the pipeline and their own port facility.

Since 2007, this project has been in the hands of a consortium of Chinese investors led by Zijin Mining Group (with a 45% stake), followed by Tongling Nonferrous Metals (with 35%), and Xiamen C&D Inc (with 20%). This joint venture allowed them to purchase 90% of British junior Monterrico Metals Plc, the parent company of Rio Blanco Copper S.A. in Peru. For reasons that later became evident, they were the only bidder for this project.

This case is interesting for several reasons. First, even before its sale to the Zijin-led group, Rio Blanco was a high-priority project for the Peruvian government. Both presidents Toledo and Garcia gave special authorization to the investors to hold the concession, because Peru's constitution does not allow foreigners to operate within 50 km. of Peru's border unless there are reasons of national urgency (Sanborn and Torres 2009). The project was marketed to Chinese investors by former British and Peruvian diplomats with a stake in the outcome. Subsequently, during a state visit to China, President Garcia promised the CEO of Zijin and other investors that his administration would smooth the way legally and socially for this project.

At the same time, this project was resisted from the start by the peasant communities in its area of influence: Yanta (Ayabaca), and Segunda and Cajas (Huancabamba). Community leaders claim the agreement for use of the surface land was fraudulent, and they have consistently expressed their opposition to the mine. Although the mine site is remote, the communities have important social and political allies in their struggle to drive out investors, including other communities in the region and along the path of the proposed pipeline, members of the local Catholic Church, peasant self-defense leagues (*rondas campesinas*), national and global NGOs and British MPs, who sent a delegation to the site in 2006 (Peru Support Group 2007). A referendum or "*consulta popular*" was held by local leaders in 2007, in which 98.3 percent of residents voted against the development of mining in the region. Yet the results were contested at the time by the regional government of Piura, and rejected by the Garcia Administration.

A third factor is that the project is in an area that has not historically had mining operations, and involves at least two fragile ecosystems, raising significant environmental concerns. Virtually all of the groups that oppose it also have other sources of income and do not perceive a copper mine as bringing net benefits. Resistance to the project turned to violent confrontations resulting in the deaths of seven people between 2005 and 2009. In August of 2005 a group of 32 community leaders was detained and tortured by security guards and police, allegedly hired by the firm. In 2009 the case reached global public opinion and a lawsuit against the firm was presented in British courts, resulting in a freeze of company assets. In July 2011, Monterrico Metals – now in Chinese hands -- agreed to indemnify the community leaders involved in this case.

The level of social opposition to this project helps explain why no other major investors were willing to bid on it. Yet when Zijin Consortium became the new owner in April 2007, their staff was apparently unaware of the extent of local resistance, or believed that government authorities in Peru would really smooth the way. If they were not purposefully misled, they at the least did not conduct due diligence. Furthermore, they retained the same community relations staff as the prior owners, who tried to continue with exploration activities despite widespread opposition. This produced more violent conflict and soon forced the consortium to suspend development of the project altogether.

At one stage, Rio Blanco staff tried to shift strategy and engage one of Peru's most powerful private economic groups as a minority shareholder, in exchange for helping move the project along (Sanborn and Torres 2009). They also promised to invest USD 80 million in development projects in the area. However, locals accused them of using a corporate-sponsored NGO to harass anti-mining activists, and of launching a smear campaign charging the peasants involved with covering for drug traffickers ("Afirmar que ONG" 2009). This campaign backfired, and the alliance with local economic brokers also expired. A new regional president elected in 2010

agreed to respect the will of the locals, and defined the project as “nonviable” for the foreseeable future (“Javier Atkins” 2013).

Over 2012 – 2014, the Zijin Consortium tried to reopen dialogue with the communities and prepare the EIA required to construct the mine. To date this has not been successful. In April 2013, a group of Chinese men was detained by community leaders as they tried to visit the site. According to a subsequent communiqué by the company, they were potential investors interested in joining the project, but Rio Blanco agreed to desist with site visits as a condition for their release (Cooperación 2013). Since then Zijin has renewed its local staff, secured new political allies and hired the same community relations firm that works with Chinalco, but community resistance remains firm.

By most assessments, the Rio Blanco project does not appear to offer net benefits to Peru, or to the Piura region where it would be based, even though the central government continues to list it among the top 25 priority projects. It does not have the consent of those who own the land nor the “social license” needed from the various communities that would be affected along the pipeline route. This situation is not unique to Zijin, however, and indeed there are numerous cases of non-Chinese mining companies with concessions on lands belonging to peasant communities that do not want mining, or that fear the negative environmental and social impacts it may bring.

5. Conclusions

There is no doubt that the relationship with China is fundamental for Peru today, as for most of Latin America. China is Peru’s number one trading partner, the leading investor in the mining sector, and an increasingly important presence in hydrocarbons and commercial fisheries as well.

Whether expanding ties with China will help or hinder countries like Peru in their efforts to sustain growth and raise living standards for their populations, remains a subject of intense debate. In the Peruvian case, there are deep historical ties with China, which have facilitated the relations being forged today. At the same time, since the 1990s all Peruvian governments have maintained a strong emphasis on free trade and private initiative, and have been giving high priority to the extractive industries, especially mining, as a driver for growth. Hence the promotion of foreign investment in primary sectors has gone hand-in-hand with the opening of new channels of interaction with numerous Western, Eastern and Southern partners. Trade with China – but also with the rest of the world – contributed to Peru’s booming economy over the last decade, and to its ability to weather the effects of global financial crisis.

A closer analysis of the dynamics of Peru’s relationship with China suggests that although this tends to reinforce Peru’s overall position as a mineral exporter, the country has not experienced significant de-industrialization. Although the relations are highly asymmetrical and not all sectors of the economy have benefitted, the net effect of expanded markets and access to lower priced intermediate goods appears to be positive for Peruvian industry. Meanwhile, new investment from China has allowed Peru to develop large-scale mineral projects with important spinoffs in other sectors of the economy, even amidst a context of global uncertainty.

What about the impact of Chinese firms “on the ground”? Some analysts claim that the differences between Chinese and other transnational mining firms today are not that significant. Others have argued that the key issue is not whether a company is Chinese, or of any other nationality, but rather the willingness and capacity of host countries to regulate them adequately. Based on the case studies undertaken for this project, and reports by other researchers, there is no clear “Chinese way” of doing business in Peru’s mining sector. Although Chinese firms may have some

factors in common – especially the SOEs – on the ground they may differ as much from each other as from other companies in this sector.

In several cases, neither the Chinese investors nor their country’s diplomats did due diligence on the social conditions they would face, and Peruvian authorities were not forthcoming about these conditions either. This was true with the investments made by Shougang in the early 1990s, but also with Zijin and the Rio Blanco project in 2007. In all three cases, company staff – either Chinese, or Peruvians they hired – also made mistakes in engaging with unions, communities and local elected officials in Peru’s volatile democracy. Although the Chinese government had a strong interest in making these investments work, their overseers may have initially been too inexperienced, or too far away, to guide such efforts.

Nonetheless, what we are observing today are processes of learning on the part of Chinese investors and their political allies. This includes learning from other firms in the industry, and hiring better managers and consultants to guide them through the process. There are also increased efforts by both Chinese and Peruvian government authorities to help these firms develop major projects, which for the most part are not different from the support received by other investors in this industry.

At present, the most widely watched cases of Chinese mining investment in South America are the Toromocho mine in Junín, and the Las Bambas project in Apurímac, purchased in 2014 by MMG (China Minmetals). In both cases, Chinese SOEs committed to building state-of-the art mining operations, and moving entire communities to new quarters where living conditions are expected to improve. This has not been done before in Peru, and is apparently rare in China as well. For China, and for Peru, a lot is riding on showing the world that both sides are serious about complying with global standards. Only time will tell if this is the case.

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