REDCAEM

RED CHINA & AMÉRICA LATINA
Enfoques Multidisciplinarios

N° 42

NOVEMBER • 2024

STRATEGIC IMPLICATION OF THE CHINESE-OPERATED PORT OF CHANCAY

R. Evan Ellis

WORKING PAPER SERIES (WPS) - REDCAEM
Geopolitics and Geostrategy Axis

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Ellis, R. Evan (2024). Strategic Implication of the Chinese-Operated Port of Chancay. REDCAEM *Working Paper Series (WPS)*. Magazine N°42, November. Geopolitics and Geoestrategy Axis. China and Latin America Network: Multidisciplinary Approaches (REDCAEM).

REDCAEM publication
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Index

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R. Evan Ellis

Summary

This article examines the Port of Chancay from a strategic perspective, with a focus on how COSCO (China Ocean Shipping Company) achieved unprecedented control over the operation of the new Peruvian megaport, the impact that the port is likely to have on the global logistics system, and its strategic implications in time of war with the United States. It argues that the project is illustrative of how the PRC uses its economic leverage, coordination across its government and multiple commercial entities, and predatory practices in its contracting to secure commercial advantage, expanding market power and value added in a range of industries. It also illustrates how the physical infrastructure, presence and human networks created through its growing commercial presence creates opportunities that the PRC military can exploit in time of a conflict with the West, even when the military value being the primary driver of the projects per se.

Key Words

Port of Chancay, China, Perú, Latin America, Ports, Logistics, Strategic Competition

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I. Introduction

The new deepwater port of Chancay, on the Pacific coast of Peru, owned and to be operated by the People's Republic of China (PRC) logistics giant COSCO, has become the focus of international attention due to the impact it will have on the global logistics industry and possibly the global security environment, as well as irregularities associated with how the Peruvian government contracted with COSCO for the port. The outgoing head of U.S. Southern Command, General Laura Richardson, has expressed concern over the military-civilian "dual-use" potential of Chancay (Richardson 2024). On the Peruvian side, the government of Dina Boluarte saw the port as so important to good relations with China, that it changed Peruvian law, giving COSCO unprecedented exclusive control over the port, in order to take a dispute over the issue off-the-table before her June 2024 state visit to Peru (Chen, et. al., 2024).

In November 2024, Chinese President Xi Jinping will make a State Visit to Lima Peru in conjunction with the Asia Pacific Economic Cooperation (APEC) forum leaders' summit, his first trip to Lattin America since prior to the Covid-19 pandemic. In Lima, he is expected to participate in the inauguration of the Port of Chancay on November 14 (El Universo, 2024), as well as possibly signing new cooperation agreements and launching new project with his Peruvian counterparts. Following his stop in Lima, President Xi will go to Brasilia to attend the G-20 summit. There, he may preside over Brazil's formal adhesion to China's Belt and Road initiative (Patrick, 2024), as well as signing major new cooperation agreements with Brazil for infrastructure and other projects. These could include plans for a new railway connection, as well as improved Atlantic to Pacific roads to better connect the agricultural and mining belt in the interior of Brazil to the Port of Chancay on the Pacific.

The inauguration of the initial capabilities of the port when Chinese President Xi Jinping travels to Peru to attend the Asia Pacific Economic Cooperation Forum (APEC) leaders' summit in Lima in November 2024, and President Xi's subsequent trip to Brasilia for the G-20, coming on the heels of the November 5, 2024 U.S. Presidential election, will put Chancay, China's relationships with Peru and Brazil, and the advance of the PRC in Latin America, at the center of international attention.

This article examines the Port of Chancay from a strategic perspective, with a focus on how COSCO achieved unprecedented control over the operation of the new Peruvian megaport, the impact that it is likely to have on the global logistics system, and its strategic implications in time of war with the United States. This work argues that the project is illustrative of how the PRC uses its economic leverage, coordination across its government and multiple commercial entities, as well as predatory practices in its contracting to secure commercial advantage, and to expand its market power and value added in a range of industries. This work also highlights how the physical infrastructure, presence and human networks created through the PRC's growing commercial presence creates opportunities that its military can exploit in time of a conflict with the West, without that military value being the primary driver of the commercial projects per se.

II. Background on the Port of Chancay Project

In 2019, COSCO acquired a 60% interest in the Port of Chancay from the local Peruvian owner, Volcan, in which Australia-based mining giant Glencore also has a stake (Aquino and Jourdan, 2024). COSCO invested in the property with the intention of developing it into a major new hub port serving trans-Pacific shipping. The acquisition was made at the high-point of growth in maritime logistics connecting the rest of the globe to the PRC, as the "factory of the world," and as an increasingly important consumer of its commodities and foodstuffs.

At the time that COSCO acquired Chancay, it was not yet fully clear that growing US concerns over strategic risks associated with trade dependence on China would impede those growing trade flows in any significant way, through the phenomenon known as "decoupling". The acquisition also occurred before the Covid-19 pandemic, and disruptions to global supply chains from Russia's invasion of the Ukraine dramatically increased transpacific container shipping costs and demonstrated the vulnerabilities of over-reliance on global supply chains (Stackpole, 2022).

The characteristics of Chancay as a deepwater port, with significant room for future expansion, made it a logical site for the COSCO's major maritime shipping hub for the eastern pacific. Its proximity to a number of important PRC-owned Peruvian mines and other facilities suggested a logical synergy with Chinese and other port users. The market-oriented Peruvian government of the time, of Martin Vizcarra, who had himself traveled to the PRC, associated Peru with China's Belt and Road project (Ellis, 2022) arguably bolstered COSCO's confidence in Peru's continuing openness and positive attitude toward the PRC.

The posture of the Vizcarra government also came on top of that of a long series of prior governments which recognized Peru's position on the Pacific and potential as a gateway to Asia as a cornerstone to the country's economic development. Peru hosts one of the largest

Chinese immigrant communities in the hemisphere, dating back to immigration associated with the collapse of the Manchu dynasty at the end of the 19th Century. Since the 1990s, Peru had hosted PRC-based companies in the petroleum, mining, electricity, telecommunications and other sectors. In 2009, Peru signed an important Free Trade Agreement with the PRC (Ellis, 2022), only the second in South America, and by 2019 was working to upgrade it for trade in services. Peru is also a member of and has made a substantial capital contribution to the China-led Asian Infrastructure Investment Bank (Asian Infrastructure Investment Bank, 2022). In April 2013, Peru became a "Strategic Partner" of the PRC, and in April 2019 Peru joined its Belt and Road Initiative (Aquino, 2019).

As a compliment to COSCO's comfort with Peru, Peru's long history with the Chinese arguably gave its government officials at least some understanding of the risks and complexities associated with working with the PRC.

At the time the COSCO project was before Peruvian authorities for their approval, the PRC was also discussing a number of different Atlantic-to-Pacific rail, road and other connections, including the "Twin-Oceans" railroad project (Berti, 2020), that would potentially give a major Pacific-coat hub port even more utility, connecting the Pacific to commodities and markets in Brazil and elsewhere in the continent. Indeed, for Brazil, with the construction or improvement of complimentary infrastructure, the port could permit the export of agricultural products to China from states in the interior of Brazil such as Rondônia, Acre, Mato Grosso and Amazonas. A road or rail route to the Peruvian coast and the port of Chancay could potentially provide an alternative to long transits by road to Atlantic Ocean ports and either a long easterly transit, or use of the expensive and volume-restricted Panama Canal to go west to the PRC.

At the time that Peruvian officials were reviewing the Chancay project, some Peruvian experts consulted by the author worried that the development of the port might occur at the expense of the more size-restricted government-operated port of Callao near the capital Lima. Not only would the contemplated size and throughput of Chancay eventually eclipse that of Callao, but the potential for Callao to expand its own operations to compete with Chancay was limited due to the properties that already surrounded Callao (See also Guerra Vásquez, 2024).

Beyond competition with Callao, logistics experts consulted by the author at the time of the initial acquisition worried that the Chinese could potentially use ownership of the port to confer unfair advantages to PRC-based firms or other preferred customers using it or use access as leverage to secure other commercial and strategic goals. Peruvian officials consulted by the author about such concerns at the time, however, insisted that Peruvian law would not permit Chancay to be operated exclusively, or with improper preferences.

Following the government's approval of the acquisition and the project, COSCO proceeded forward, even expanding the scope of its additional plans, adding additional terminals (Andina, 2019). As with other infrastructure projects, it experienced some delays due to the Covid-19 pandemic but overcame them. By 2022, at least 2,200 Chinese, Peruvian and other workers were engaged on the project (Simmons and Saravia, 2023). By early 2024, COSCO had invested over USD$1 billion in the port complex in support of its initial operating capability, projected for November 14, 2024 (Aquino and Jourdan, 2024).

As the project proceeded, it raised a number of concerns about its impacts on the local community and the environment, including the effect of construction it cracking the older, brittle cement homes in the area (Andres Bello Foundation, 2024). Some also expressed concern the port could cost the jobs of 3,000 traditional fisherman in the surrounding community (Andres Bello Foundation, 2024; see also Simmons and Saraiva, 2023) as well as the local wetlands (Aguilar, 2024; Republica, 2022). Such concerns did not, however, impede the progress of the project, with it hoped-for economic benefit.

In early 2024, it came to light that the language of the contract that the Peru's National Port Authority (APN), had agreed to in February 2021, indeed allowed COSCO to operate Chancay exclusively, thus controlling who could use it, under what conditions. Such terms raised the risk that, as the port became an important logistics hub for Peru and the region, its use in a preferential fashion could confer significant advantages in both the maritime logistics industry, to both COSCO, and the companies it allowed to use the port on favorable terms (FirstPost, 2024).

When the right of exclusivity granted to COSCO came to light, the Peruvian government sought to amend the agreement, arguing that Peru's National Port Authority (APN) did not have the authority under Peruvian law to grant such exclusivity to COSCO (Reuters, 2024a). The nature of the government statement thus suggested that APN officials had either not paid sufficiently close attention to the contract terms in the zeal to receive COSCO's investment or had deliberately overlooked such concerns due to direct or indirect personal benefits for those approving the contract or their associates.

COSCO argued that it's investment of over USD$1.3 billion in phase one the project had been based on precisely on Peru's contractual commitment exclusively (Stott, 2024). COSCO thus suggested that it might invoke its right in the contract to initiate arbitration proceedings, pursuing damages against the Peruvian government due to the substantial investment it had already made, if the Peruvian government insisted on modifying the contract (Shipping Herald, 2024). Under the provisions of the contract, the disagreement set in motion a "cooling off" period of six months.

The dispute over the port coincided with Peru's preparations to host the APEC leadership summit in Lima in November 2024. The summit would include the first trip by Chinese President Xi Jinping to the region since before the Covid-19 pandemic and would also be attended by Brazil's President Luis Ignacio "Lula" da Silva and a range of other South American, as well as Asian leaders. President Xi's state visit to Peru would further include his participation in the scheduled November 14 inauguration of the initial operating capability of the port. The events around the summit would thus be a critical moment to internationally showcase Peru, and her government, in a positive light. Boluarte's very low 5% public approval rating, the lowest in Latin America (Bloomberg, 2024), made the success of the summit and the inauguration of Chancay even more critical for her, and her government, in political terms.

Pursuant to the summit, in June 2024, President Boluarte had scheduled a state visit to the PRC. Its purpose was to discuss not only President Xi's visit to Peru and e the Chancay port inauguration, but also a range of other PRC projects that Boluarte's domestically unpopular government hoped to realize (State Council of the People's Republic of China, 2024). These included construction of an additional, smaller USD$405 million port further to the south, near Ica, which had been awarded to the PRC-based mining giant Jinzhao (Aquino, 2024). Also on the agenda was discussion of a major hoped-for investment by the Chinese car maker BYD to build a facility for electric cars in the country (Reuters, 2024b). President Boluarte also had a visit to the Chinese telecommunications firm Huawei scheduled in Shenzhen (Patrick, 2024b), as well as with other current and potential new Chinese economic actors in Peru. The dispute over the port of Chancay thus threatened a broad range of important economic and political objectives for the Boluarte government.

In the end, to avoid putting such a broad range of strategic interests in jeopardy, the Boluarte government withdrew its objections over the contract for Chancay, and its Congress changed Peruvian law to make its grant of Chancay's exclusivity in operating

Chancay consistent with Peruvian law (Chen, et. al., 2024). In addition, to further eliminate unresolved issues with China that could undermine the success of President Boluarte's visit to the PRC, her government also quietly finalized its approval of a controversial acquisition by China Southern Power Corporation (SPIC) of the Peruvian holdings of Enel, giving Chinese companies 100% control of electricity distribution in the greater Lima area (Squires, 2024; Cassinelli, 2024).

The PRC use of contractual details to secure advantage over their Peruvian counterpart, who may not have looked sufficiently closely at what they were signing, was not unlike the case of billionaire investor Sarkis Izmirlian in the Bahamas, who believed that he could control the risks of contracting with China Construction Americas (CCA) to build the multi-billion dollar Baha Mar resort on Nassau, only to find himself trapped by a contractual clause obliging mediation in Hong Kong, when CCA could not deliver the facility on time, with 2,000 people on the payroll (Eyewitness News, 2024). Indeed, a comprehensive study of debt contracts by the AIDDATA project at the College of William and Mary suggests that what happened with APN in Peru is part of a broader pattern of widespread use of predatory contractual clauses by PRC-based firms (Gelpern, et., al., 2021), securing advantage from partner governments which may lack the technical capacity, or motivation (due to enthusiasm to contract with the PRC for reasons of politics or for personal benefit) to fully assess the implications and risks of what they are signing.

Beyond Peru, the story of how COSCO obtained legal permission to exclusively operate the port of Chancay, even inducing the government to change its own laws to accommodate the Chinese, illustrates both how, far from how the PRC common representation of its commercial dealings as "win-win" in character (Ross, 2024), the outcome is often far less favorable for the partner. Chancay shows how such unfavorable outcomes commonly occur, through the PRC use of predatory contractual clauses and other techniques to secure legal advantage, as well as PRC exploitation of the economic and political vulnerabilities of their partners to induce them to cede to their demands.

III. Strategic Commercial Implications of Chancay

The strategic importance of port of Chancay goes far beyond COSCO's imposition of a disadvantageous deal on an inattentive bureaucracy and an economically and politically vulnerable Peruvian government. The port has the potential to transform the logistics dynamics of the Pacific (Jay, 2024), affording significant benefits to COSCO and those customers and users to whom it gives preferred access, at the expense of both its global logistics rivals, as well as customers engaged in trans-pacific shipping without favored access to Chancay.

By the end of October 2024, COSCO had invested USD$1.4 billion in the port of Chancay, with the first four of its berths planned to be operational, supported by 27 loading cranes, some up to 90 feet in height, and 40 autonomous cargo handling vehicles for the inauguration of the port on November 14 (El Universo, 2024). Chancay plans to begin operations with two ships per month providing direct service to its counterpart mega-facility in the PRC port of Shanghai, continuing this "testing" pace until ramping up operations in May 2025 (Reuters, 2024c). Even with this ramp-up period, Chancay's throughput in the first year is expected to be a million containers (TEU) (El Universo, 2024), already 2/3 of the 1.5 million TEU throughput achieved by logistics firm DPWorld in 2022 in Chancay's rival port, Callao (Labrut, 2022).

To support its capacity to significantly expand its throughput while maintaining low costs, COSCO has built an 1,840 foot-long tunnel through the mountain separating the coastal port from an area just inland that that provides ample patio space for cargo handling (El Universo 2024). The port itself, initially focusing on container shipping, will later be supplemented by capabilities to handle bulk cargo (El Universo, 2024).

When at full capacity, Chancay, as a 15-berth deepwater port, will be able to receive and accommodate simultaneous loading and unloading of multiple, of the biggest container ships (Aquino and Jordan, 2024), of 18,000 to 21,000 TEU in size (El Universo, 2024) and in the future, 24,000 TEU ships (Reuters 2024c). Capabilities to handle roll-on-roll off ships, break-bulk cargoes, or handle petroleum and other liquid bulk cargoes, including liquid natural gas (LNG) could eventually be added as well.

Chancay will also be geographically closer to major Chinese ports such as Chancay than other options on the Pacific coast of the Americas. Its location and geographic characteristics thus make it ideal to serve as a hub port for COSCO's operations on the eastern coast of the Pacific Ocean (Caceres, 2022). Using the new classes of very large container ships, rather than small ones, will reduce the per container cost for trans-pacific transit. At the same time, the more direct route (Aquino and Jourdan, 2024) will reduce fuel, crew, and other costs associated with steaming days. In addition, Chancay will incorporate state-of-the art automation and other “smart port” technologies, expected to further reduce the cost of and throughput time for cargo handling (Simmons and Saravia, 2023).

The combination of reduced times and costs, both in transit and at the port, is expected to reduce the per container costs that COSCO can offer for its trans-pacific shipping routes. This will benefit not only COSCO itself, but the “Ocean Shipping Alliance” in which COSCO collaborates with fellow global logistics companies CMA-CGM, OOCL, Evergreen. In the process, it will likely help the position of the Ocean Shipping Alliance in their competition for global routes with the other alliances (Gemini Cooperation, 2M and the new Premier Alliance (Shipping Universe, 2024).

Although Chancay will be COSCO’s first port in South America, its long experience as a major global logistics player, operating 38 ports globally (Simmons and Saravia, 2023), will facilitate its success in its bid to dominate shipping routes in the region.

In the course of its competition with the other shipping alliances, Chancay may also force a restructuring of existing maritime shipping routes. To understand how, it is important to understand the functioning of Chancay as a hub in a maritime logistics “hub and spoke” model, similar to the concept used in by commercial airlines, such as Delta with its major hub in Atlanta, or American with its hubs in Miami, Charlotte, and Dallas Fort-Worth.

By contrast, prior to the present, trans-pacific shipping has primarily employed “circuit” routes, picking up cargo in various ports in Asia, then transiting the Pacific, then dropping cargo off and picking up new cargo in a succession of ports on the Latin American side. Although in the traditional model some ports are also used to consolidate cargo, the prevailing structure is akin to a bus route with stops. From the perspective of the container being shipped, like passengers on a bus, that structure significantly increases the amount of time and distance that the container has to travel before reaching its final destination. For high-value cargo, the additional time impacts customer inventory carrying costs. For perishable cargo, the high time in transit generates losses due to spoilage, and/or imposes additional costs for refrigerated containers.

At the heart of COSCO’s hub and spoke model will be the previously noted use of very large ships to move large volumes of freight economically between Chancay and Shanghai or other ports in Asia. Because Peru generally imports merchandise in containers from China, but exports bulk cargo, COSCO’s need to avoid the cost of empty containers traveling back to Asia will oblige it to focus on feeder routes receiving Asia-bound containerized cargo from a broad range of other ports on the Pacific Coast of the Americas. Its control over access to Chancay will help it to ensure that to the extent possible, its own ships and not those of its competitors, operate those feeder routes.

COSCO's new system, if successful, will have a dangerous reinforcing negative effect on its competitors in the other shipping alliances. As its lower prices offered for trans-pacific shipping divert cargo from its competitors, they may be forced to use smaller ships on their routes, or even cutting services to non-economical routes, making their service even less attractive.

Beyond its effect on routes and the competition between shipping alliances, over the long-term, COSCO's hub-and-spoke system centered on its exclusive operation of Chancay may facilitate PRC control over a range of port and other infrastructure projects in Peru and beyond, as well as helping it to win the infrastructure construction work associated with such projects.

As mentioned previously, the Chinese company Jinzhao has been awarded a USD$409 million contract to build a minerals port near Ica, in the south of the country. In addition, COSCO's launching of Chancay has reignited talk of the construction of an intercontinental railroad linking Chancay and other China-controlled ports on Peru's coast, to the Atlantic through the interior of Brazil, with routes possibly transiting Bolivia as well (Small, 2024). Even more than when the PRC previously proposed such a "twin oceans" railroad project (Chen, 2015), COSCO's exclusive operation of Chancay, the availability of PRC-based construction companies in the region, and the possibility of funding from PRC-based banks, would increase the possibility of PRC construction of the train line, or lines, using its own companies. It would do so with the objective of facilitating its access to Brazilian iron, soy and other agricultural products, and possibly Bolivian lithium, through operations of its own companies there.

As such complimentary Chinese-controlled infrastructure expanded, access to it could give customers important cost and time benefits, as well as stimulating the economies of the areas through which such infrastructure passed, generating benefits for the governments of those territories. Such benefits, in turn, would give COSCO, the other PRC-based operators, and the Chinese government leverage over those customers and governments.

In the process, such China-operated infrastructure could give PRC-based companies more secure access to the mining, agricultural and other products of the region needed for the Chinese economy, possibly at the expense of the shipment of those goods to other markets.

IV. Military Implications in Time of War

In time of a war between the PRC and the United States, the port of Chancay could potentially be used by the People's Liberation Army (PLA) Navy to resupply forces and otherwise support operations against the US in the eastern Pacific, even in the absence of a formal basing or military alliance agreement (Ellis, 2023; Berg, 2022).

From a military perspective, Chancay would be particularly useful as a large capacity deepwater port that could receive the largest PLA Navy warships and submarines. Its distance from the United States is sufficiently far to partially shield it from attacks by military forces coming from the Continental United States, while still allowing PLA Navy forces launched from there to influence the US West Coast.

It is unlikely that the current government of Dina Boluarte, or the US-friendly Peruvian Armed Forces would knowingly allow Chancay to be used against the United States in time of war (Simmons and Saravia, 2023). Nonetheless, a number of factors could conspire in wartime to allow such a possibility. First, COSCO's operational control of the port, with an unknown but probably minimal level of Peruvian government supervision, could permit the storage of materials for supporting PLA warships and other forces in the port's cargo areas without the knowledge of the Peruvian government. The collaboration of commercial Chinese entities with the PLA is well established within the Chinese doctrine of civil-military fusion (Pompeo, 2020), and COSCO has regularly supported the PLA in the past including in noncombatant evacuation operations from Libya and Yemen (Yung, 2016).

In peacetime, a future Peruvian government would be hard-pressed to deny COSCO permission to receive PLA Navy ships in its port, given expanding Peruvian dependence on exports of minerals to the PRC, loans for infrastructure and other projects, and reliance on the PRC for a substantial portion of the country's electrical transmission, telephone, and other infrastructure (Ellis, 2022). Indeed, in 2012, the PRC used similar leverage over the government of Sri Lanka, to persuade it to allow the resupply the PLA Navy ship Yuan Wang

5 in the port of Hambantota (Mogul, 2022), also operated by COSCO, even though the PRC had no military basing agreement with the country.

During wartime, COSCO's ability to receive and send military cargo, and resupply PLA Navy military vessels, might be facilitated by a political crisis in Peru, in which control of the government is uncertain, and one of the claimants to power is disposed to allow COSCO to use the port for in such a fashion. Multiple Peruvian governments have fallen in recent years, including most recently the ouster of President Pedro Castillo following his attempt to dissolve the Peruvian Congress (Daniels, 2022). Peruvian Cabinets, including Defense Ministers change even more regularly. The Peruvian Congress is currently fragmented across numerous parties, generally opposed to President Boluarte, whose own popularity, as noted previously, is a mere 5%. In such a wartime contested leadership situation, as occurred previously with the fall of Pedro Castillo, the Peruvian military could find itself with a difficult choice regarding how to respond.

V. Conclusions: Projections on the Path Forward

As the Boluarte government prepares to receive Xi Jinping at APEC 2024 and inaugurate the Port of Chancay, the strategic importance of the port in both commercial and other terms highlights the need for Peru's government, in conjunction with other stakeholders, to establish mechanisms and make difficult decisions concerning its oversight and control. Such decisions include managing the country's port, rail and other transport infrastructure to ensure that COSCO's operation of Chancay does not allow it to capture a monopoly position in Peru's logistics sector, or give unfair advantage to Chinese port users over others. The Peruvian government should also think about, and establish processes and capabilities by which the Peru's National Port Authority (APN) and other Peruvian government organizations will maintain an adequate presence in the port to ensure that COSCO is using it in ways consistent with Peru's sovereign authority over its territory, and its international responsibilities to allies such as the United States. Peru's government, in anticipating risks and associated responsibilities in time of war, should plan now for how to maintain visibility over what COSCO brings into and out of the port, and to ensure that it cannot be used against the United States or others in time of war.

Beyond Peru, other states in the region should learn from the lessons of Chancay. This includes how the PRC's employment of commercial leverage and lawfare can enable it to secure bureaucratic advantage, particularly when Latin American bureaucracies with inadequate legal and technical assessment capabilities, or permeated by personal interests, conduct non-transparent negotiations with PRC-based companies over infrastructure or other matters of strategic importance.

Chancay should further be a cautionary tale to the region that even when governments do not intend to make military commitments to the Chinese, their choices in negotiating commercial, scientific and other agreements with it, may inadvertently plunge those countries into commitments with unintended military consequences in time of war.

The most important lesson of Chancay is arguably that transparency, strong institutions, and strategic analysis are fundamental for countries to secure the hoped-for benefits of projects with the Chinese, while avoiding severe, if unintended, negative consequences. Such attributes and efforts can make the difference between such a project propelling the country forward in its international development and reputation, or, in the case of Chancay, becoming a high-profile symbol of poor choices and institutional problems, overshadowing through concerns, what was supposed to be the country's moment of triumph in the international limelight.

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