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Giant Pencils and Straw Hats: What's Next for Business in Peru?

Following a razor-thin voting margin, the Peruvian population elected schoolteacher and left-wing candidate, Pedro Castillo, to the presidency. Castillo's election has brought uncertainty to businesses in Peru due to a palpable fear of radical leftist reforms that would threaten Peru's image as a nation welcoming of foreign investment. However, those concerns may be premature and overblown.

We believe that Castillo is likely to step back from implementing the sort of radical change promised during the run-up to the election. Promises made during campaigns are frequently disregarded when governing, and we believe a pragmatism is likely to prevail. Castillo has limited maneuvering room and will focus his attention on fixing the obvious divide within the country and regenerating the heavily COVID-19 hit economy. Even if he is pressured to implement anti-market reforms – possibly as a result of pressure from stalwarts in his party *Peru Libre* – gathering the

necessary legislative support to achieve meaningful changes to the Peruvian economy will be a difficult task for a new, inexperienced president with a very limited mandate and an obstructive Congress.

Castillo's election looks more like Humala in 2011 (or Lula in 2002) than Chávez in 1998, with the new Peruvian president likely to maintain a market friendly economy coupled with an increased focus on programs to attempt to address social inequality.

Peruvian Political Context

The 2021 presidential elections in Peru occurred in a moment of extreme volatility: a nation disproportionately suffering one of the worst global per capita outbreaks of COVID-19, corruption scandals ranging from Odebrecht to *vacunagate*, a polarizing conservative opposition directly connected to endemic corruption in Peru and the historical schism between Lima and the rest of the country, most notably in terms of social development and economic opportunity. These and other factors have increased political uncertainty in recent years, with the country having had four presidents in just the last five years.

Former president Pedro Pablo Kuczynski (PPK) was elected in 2016 but resigned in March 2018 due to corruption and bribery accusations.¹ Following his resignation, Martín Vizcarra, then vice-president, ascended to the presidency. But in November 2020, the Peruvian Congress impeached Vizcarra due to corruption allegations. After the impeachment, Peru's congressional President, Manuel Merino, took office and promptly resigned after five days due to protests. Subsequently, Peru's Congress elected Francisco Sagasti as interim president until the recent election of Castillo on June 6, 2021.²



The political volatility has been supercharged by animosity towards Peru's traditional political class, symbolized by the revelation in February 2021 that high ranking officials and their families, including Vizcarra, received the Chinese Sinopharm vaccine for COVID-19 months before the vaccination rollout even began in Peru. This scandal, known as *vacunagate*, compounded the population's discontentment with the traditional political elite in the country.³

The first round of the April 11, 2021 presidential elections in Peru clearly displayed the Peruvian population's disapproval of the acting government and Peru's political class, more generally. The elections were highly fragmented with 18 candidates participating in the first round, with a majority of the field not belonging to any of the traditional political parties in Peru.⁴ The combination of corruption scandals, *vacunagate*, political volatility and the COVID-19 pandemic eliminated the possibility of a center candidate reaching the second-round of the presidential elections, and instead led to the run-off of two radically polarized candidates; namely, a run-off between a left-wing candidate from the *Peru Libre* political party, Castillo, who received 19.099% of votes, and right-wing candidate and daughter of former president Alberto Fujimori, Keiko Fujimori, from the *Fuerza Popular* political party, who received 13.368% of votes.⁵ Neither candidate had widespread support in Peru. Castillo and Keiko represented markedly divergent platforms on political, economic and social issues. A divided Peru then narrowly elected Castillo by a wafer-thin margin of 44,058 votes, receiving just 50.125% of the vote.⁶

What does a Castillo government mean for business in Peru?

Future Political and Economic Panorama in Peru: Campaigning isn't Governing

During his campaign, Castillo announced he would implement radical leftist reforms if elected, including changing the current Constitution to authorize the executive government to regulate the market in order for it to be

¹ <https://www.bbc.com/mundo/noticias-america-latina-43481060> (translated by the author)

² <https://www.bbc.com/mundo/noticias-america-latina-54965252> (translated by the author)

³ <https://cnnespanol.cnn.com/2021/04/09/peru-elecciones-presidente-2021-votantes-expectativa-orix/> (translated by the author)

⁴ <https://cnnespanol.cnn.com/2021/04/09/peru-elecciones-presidente-2021-votantes-expectativa-orix/> (translated by the author)

⁵ <https://canaln.pe/actualidad/elecciones-2021-onpe-publicara-primeros-resultados-11-abril-1130-p-m-n433611> (translated by the author)

⁶ <https://www.resultadossep.eleccionesgenerales2021.pe/SEP2021/EleccionesPresidenciales/RePres/T> (translated by the author)

“decentralized, redistributive of wealth and nationalized”,⁷ since according to Castillo, the Peruvian Constitution prioritizes private interests over the public interest.⁸ He also proposed the renegotiation and revision of all state contracts, suggesting a new distribution of profits; 20% in favor of the private sector and 80% in favor of the government.⁹ He defended the nationalization of the mining, oil and gas sectors.¹⁰ He also promised that he would stop the imports of any products that are produced in Peru, such as rice and potatoes, and at the same time he reinforced his intention to implement agrarian reform.¹¹

This was good red meat to energize Castillo’s rural base, but does not reflect his governing agenda. Once in office, Castillo will likely be faced with the harsh realities of governing a bruised nation and could take a more moderate stance. During his first week as president-elect, he stated: *“We respect the economy and we are going to give legal security to all businessmen.”* Also, he assured his audience that he was going to be *“respectful of the current political constitution until the people decide to vote for a referendum.”*¹² Above and beyond mere rhetoric, he has appointed Pedro Francke, a well-known and respected economist in Peru, as a key economic advisor. Francke has indicated that the new government will welcome and promote private investment to develop the Peruvian economy.¹³ Francke gathered with business leaders in Lima immediately after his appointment to explore how the public and private sectors will work together to address the monumental economic challenges the country now faces, particularly the health crisis and accompanying economic downturn caused by COVID-19.¹⁴

As of June 28, 2021, Peru had the highest number of per capita deaths caused by COVID-19 in Latin America. The country’s GDP contracted by 11%¹⁵ in 2020 and

unemployment reached 13.6%.¹⁶ It seems that Castillo would have no choice but to prioritize a plan to bring Peru out of the pandemic as expeditiously as possible and stimulating much needed economic growth. This suggests that he would need to focus during his first weeks in office on obtaining vaccines and implementing a vaccination strategy to immunize the Peruvian population, as well as passing proposals that will encourage employment generation and economic growth. To gain any momentum, he will need to establish a working relationship with the business sector, including national and international businesses involved in the mining, and oil and gas sectors, which are industries that collectively account for approximately 61% of Peru’s total exports.¹⁷



⁷ <https://rpp.pe/economia/economia/debate-presidencial-estas-son-las-principales-propuestas-economicas-de-pedro-castillo-noticia-1339714?ref=rpp> (translated by the author)

⁸ <https://andina.pe/agencia/noticia-pedro-castillo-peru-libre-plantear-cambiar-constitucion-asamblea-constituyente-841992.aspx> (translated by the author)

⁹ Ibid.

¹⁰ <https://proactivo.com.pe/pedro-castillo-plantear-nacionalizar-los-yacimientos-mineros-gasiferos-y-de-hidrocarburos-pdf/> (translated by the author)

¹¹ Ibid.

¹² <https://gestion.pe/peru/politica/pedro-castillo-vamos-a-ser-respetuosos-de-esta-constitucion-y-sus-instituciones-hasta-que-el-pueblo-lo-decida-elecciones-2021-segunda-vuelta-nndc-noticia/> (translated by the author)

¹³ <https://elcomercio.pe/economia/peru/peru-libre-pedro-francke-afirma-que-se-impulsara-la-inversion-privada-para-generar-empleo-pedro-castillo-nndc-noticia/> (translated by the author)

¹⁴ <https://elcomercio.pe/economia/peru/francke-afirma-que-se-reunio-con-grupos-empresariales-para-responder-a-retos-del-pais-nndc-noticia/> (translated by the author)

¹⁵ <https://rpp.pe/economia/economia/pbi-economia-peruana-cayo-11-en-el-2020-segun-informe-del-inei-noticia-1321007> (translated by the author)

¹⁶ <https://knoema.es/atlas/Per%C3%BA/Tasa-de-desempleo> (translated by the author)

¹⁷ <https://boletines.expertemos.pe/recursos/boletin/resultados-exportaciones-peru-2020.pdf>

The Peruvian Congress as a Constraint

The Peruvian Congress is made up of 130 seats and is heavily fragmented with ten political parties represented.¹⁸ Castillo's party, *Peru Libre*, currently has 37 seats, and through alliances with another leftist party, *Juntos por el Perú*, has the support of 42 seats.¹⁹ This is woefully short of the majority needed to establish a constitutional assembly required to amend the constitution, or to pass any of the adventurous proposals articulated by Castillo during his election campaign.²⁰ The remaining seats in Congress are occupied by conservative and right-wing parties, who support the business sector in the country, and are unlikely to vote for redistributive reforms that significantly enhance the power of the state. Therefore, to address the aftermaths of the COVID-19 pandemic and stimulate the Peruvian economy, Castillo will have to negotiate with the right-wing parties in Congress and find a working compromise with the business sector.



Even if we have misjudged Castillo's real intentions, or he feels pressured to implement anti-market measures advanced by the likes of Vladimir Cerrón, the radical leader of *Peru Libre*, the Peruvian Congress may not play along. The Peruvian Congress has recently shown its willingness to remove presidents out of step with its wishes. If Castillo fails to negotiate and receive support from congressional members, he could face Vizcarra's fate of being unceremoniously removed. This is yet another incentive for Castillo to seek moderate reforms and govern from the center.

Recent Peruvian political history has shown that governments tend to implement center and center-right policies once in office. For example, in 2011, when Humala was elected president, he ran on a leftist platform and was publicly supported by Venezuela's then president, Hugo Chavez, which vexed the Peruvian and international business communities. Commentators and the business community voiced concerns that Peru was being sucked into the *pink tide* and ebbing towards socialism. Nevertheless, once in office, Humala maintained neoliberal policies and kept Peru a solidly business-friendly destination.²¹ He implemented a fiscal adjustment plan to reduce public spending, continued to promote free trade policies by participating in the negotiation and signing of the European Union Free Trade Agreement with Colombia and Peru,²² and supported Peru's participation in the Trans-Pacific Partnership trade agreement.²³ Humala's term in office once again demonstrates that in Peru candidates tend to run on more radical platforms to energize the lower socioeconomic base, but once in office, they seek more moderate policies.



¹⁸ <https://andina.pe/agencia/noticia-congreso-diez-partidos-politicos-estaran-representados-el-parlamento-20212026-848567.aspx> (translated by the author)

¹⁹ <https://www.economist.com/the-americas/2021/06/10/pedro-castillo-is-on-the-verge-of-becoming-perus-president>

²⁰ Ibid.

²¹ <https://journals.sagepub.com/doi/10.1177/0094582X17705867?icid=int.sj-abstract.similar-articles.1&>

²² <https://www.telesurtv.net/news/Colombia-y-Peru-ejemplos-de-politicas-economicas-neoliberales-20151028-0038.html> (translated by the author)

²³ http://www.desco.org.pe/recursos/site/files/CONTENIDO/29/04_Vidarte_PHj16.pdf

Specific Business Concerns

Castillo's election has also brought up a series of specific concerns for foreign investors and international businesses. Two core issues, the future of Peru's anti-corruption agenda and the new government's potential impact on the framework for disputes and arbitration, are vital concerns for international businesses who seek legal protections and long-term security for their investments.

Peru's Anti-Corruption Agenda and Ongoing Investigations

In 2020, Peru ranked 94 in the Corruption Perception Index,²⁴ with a score of 38, below the average of 43 in the Americas region. However, Peru marginally improved by two points compared to 2019, which was attributed to *"investigations of corruption cases and the recent approval of crucial anti-corruption laws."*²⁵ In recent years, Peru has undertaken significant steps to implement legislation in order to reduce corruption in the country's business environment, specifically by increasing the accountability of companies in corruption cases.²⁶ In addition, Peru has successfully engaged in cross-border cooperation for investigating and resolving cases, most recently during the infamous Odebrecht scandal.²⁷ During the Odebrecht scandal, Peruvian judicial authorities issued arrest warrants against former presidents, including Alejandro Toledo, Ollanta Humala, and PPK.²⁸ The fact that judicial authorities in Peru opened investigations and sought to hold high level government officials accountable for their actions is an important signal. But it is unclear what steps Castillo will take towards – or possibly away from – Peru's recent anti-corruption efforts.

During his campaign, Castillo stated that his administration *"will fight all types of corruption."*²⁹ During presidential debates, he vilified his rival, Keiko Fujimori, for the

corruption accusations against her and was visibly buoyed by the Peruvian prosecutor's office charging her in March 2021 with money laundering.³⁰ Keiko has already served a one year preventive sentence for corruption allegations, and if convicted, could serve up to 31 years in prison.³¹

Another high-profile corruption case involves the leader of *Peru Libre*, Vladimir Cerrón, who has been at the center of a number of corruption scandals in Peru. Cerrón was barred from participating in the 2021 presidential elections as a candidate because of a corruption conviction. Yet, in June 2021, a court controversially overturned this ruling, which has generated more attention around Cerrón's alleged involvement in illicit affairs.³² As of June 2021, the prosecutor's office in Peru has 20 investigations open against Cerrón, all related to corruption allegations.³³

To-date, as president-elect, Castillo has not spoken about his new government's views around corruption, or about Keiko's or Cerrón's legal cases. These matters are incredibly delicate for a new president. The freedom he gives prosecutors to bring cases based on the merits against his political rival and his political ally will go a long way in signaling Castillo's approach to corruption cases. It is very likely that any indication of political interference resulting in disparate treatment between these two cases could be damaging to Castillo's reputation and his commitment to the equal application of the rule of law. These two matters would serve as an early litmus test for the Castillo government.

Impact on Disputes and Arbitration in Peru

For international investors, one of the unsettling issues during Castillo's presidential campaign was his commentary on certain international agreements, including dispute resolution instruments. Castillo's campaign plan stated that Peru *"loses more than 90% of the arbitrations in the State Contracting Supervisory Body (OSCE) to the clear benefit of*

²⁴ The Transparency International Corruption Perception Index measures and ranks 180 countries/territories by their perceived levels of public sector corruption.

²⁵ <https://www.transparency.org/en/news/cpi-2020-americas>

²⁶ <https://thelawreviews.co.uk/title/the-anti-bribery-and-anti-corruption-review/peru>

²⁷ <https://www.jota.info/especiais/cooperacion-internacional-en-el-caso-odebrecht-peru-29052019> (translated by the author)

²⁸ <https://www.opendemocracy.net/en/democraciaabierta/alan-garc%C3%ADAs-suicide-in-peru-and-the-odebrecht-scandal/>

²⁹ <https://elperuano.pe/noticia/121158-pedro-castillo-combatiremos-a-la-corrupcion-de-toda-talla> (translated by the author)

³⁰ <https://www.reuters.com/article/peru-politics/peru-prosecutor-charges-presidential-hopeful-keiko-Keiko-with-money-laundering-idUSL1N2L921O>

³¹ <https://cnnespanol.cnn.com/2021/06/21/keiko-fujimori-no-prision-preventiva-orix/>. There are those that believe Keiko ran for president to gain immunity from prosecution as president, but her desire for power is real.

³² <https://www.aljazeera.com/amp/news/2021/6/13/as-castillo-nears-victory-peru-prepares-for-what-comes-next>

³³ <https://elcomercio.pe/politica/justicia/corrupcion-mas-de-20-casos-contra-cerron-estan-paralizados-en-la-fiscalia-y-el-poder-judicial-de-junin-noticia/>

the private businessmen,” alleging that these poor results for the Peruvian government were caused by corruption in the system and specifically by corrupt arbitrators.³⁴ This viewpoint was reinforced by arbitral cases involving Odebrecht in Peru, which involved accusations of corruption against arbitrators that ruled in favor of the Brazilian company involving amounts in controversy of approximately USD 281 million.³⁵ Similarly, Castillo delved into conspiratorial Marxist rhetoric by suggesting there were numerous mechanisms of “commercial legal control”³⁶ over Peruvian sovereignty such as the International Center for Settlement of Investment Disputes (ICSID), the UN International Court of the Hague, and the UN Commission on International Trade Law (UNCITRAL). As a result, he proposed the creation of the Dispute Resolution Center of the Union of South American Nations (UNASUR) as a seat for arbitration. Castillo’s campaign proposal aims to find a forum for international arbitration outside of those mentioned above in order to avoid the “control” of the United States and of other world powers, and instead use the current dispute resolution center of UNASUR as an arbitration center. We believe this is unlikely to gain any serious traction.

The Peruvian Comptroller General’s Office prepared a report analyzing all the cases in which the country participated in international arbitration.³⁷ It concluded that Peru loses 70% of the cases, which is not an alarming figure in comparative regional experience and concluded that *“arbitration is an adequate system. The problem is not in the arbitrator but in the state player.”* The report’s results were studied by Alfredo Bullard who concluded that, in reality, Peru often loses arbitration matters because Peruvian representatives defending the country in complicated matters were subject to poor contract management by public entities, lack of training for officials, inferior experts, logistical errors, and poor methodology for selection processes.³⁸ He stated: *“Many times we lose because the State arrives at the arbitration in a very bad position. In addition, the State’s defense capacity is weak.”*³⁹



These considerations are important because it is precisely these potential failures and missteps by the Peruvian state that foreign companies and investors choose international arbitration over national courts as a dispute resolution mechanism in the first place. It is the confidence in these international dispute resolution mechanisms that creates one of the conditions that allows investments and international projects to flow into Peru.

International arbitration has been a great alternative for investors in Latin American countries, including Peru, and will continue to be so, particularly within the new political panorama.⁴⁰

Peru is currently a party to the international conventions of New York and Panama, by which it is bound to support international arbitration and to enforce arbitral awards. To be able to withdraw from those, or any other international conventions, Castillo would need Congressional approval, since the constitutional text explicitly states that it is required for the denunciation of international treaties, and as stated already, the Congress will be tilted in favor of conservative powers. Unless additional factors emerge, we believe that Castillo will likely complain about any individual losses in arbitrations, but will be unwilling or unable to alter the dispute resolution procedures for foreign investment in Peru.

³⁴ <https://gestion.pe/peru/politica/pedro-castillo-las-politicas-anticorrupcion-que-propone-en-su-plan-de-gobierno-noticia/>

³⁵ <https://elcomercio.pe/politica/justicia/todo-lo-que-debes-saber-sobre-el-caso-arbitrajes-de-odebrecht-caso-odebrecht-caso-arbitrajes-odebrecht-noticia/>

³⁶ <https://gestion.pe/peru/politica/pedro-castillo-la-revision-de-los-tlc-y-otras-medidas-de-comercio-exterior-de-su-plan-de-gobierno-noticia/> (translated by the author)

³⁷ “El arbitraje en las contrataciones públicas durante el período 2003-2013” elaborado por la Contraloría General de la República

³⁸ <https://elcomercio.pe/opinion/columnistas/vida-da-sorpresas-alfredo-bullard-370436-noticia/?ref=ecr>

³⁹ Ibid.

⁴⁰ <https://www.bilaterals.org/?cerro-verde-to-open-icsid-case>



Conclusion

We believe that commentators fearing a “Venezuelan scenario” in Peru are misreading the situation. The greater immediate concern for Peru is not the implementation of anti-market reforms, but the obstinacy from the right and the Keiko camp in accepting the election result.

Keiko has taken a page from Trump’s playbook⁴¹ and lodged legal action to annul votes in rural regions where Castillo won by a strong margin.⁴² Keiko’s current unwillingness to accept the results has created uncertainty in much of Peru, including protests led by Keiko and Castillo supporters.⁴³ The legal jeopardy she faces makes it almost certain that she will continue to wage a campaign seeking to overturn the election. The rule of law and electoral independence of Peru could be tested by powerful vested interests. A scenario where Keiko successfully overturns the popular vote would be harmful for Peru and create wide-ranging instability, as well as triggering protests from the majority of the population that elected Castillo.

In the same way we predicted the Castillo win, we think the most likely scenario for Peru in the upcoming weeks will consist of Keiko not being able to overturn the vote in her favor. However, even if Keiko is unable to overturn the vote, the governability of Castillo depends on Fujimoristas not only accepting the result, but also providing a reasonable opposition. The political volatility in Peru over the last five years has been partly caused by Keiko, who widely opposed PPK until he resigned from office.⁴⁴ With Castillo’s triumph and the current polarization in Peru, if Fujimorismo does not lead the opposition from a rational stance, it will become increasingly difficult for Castillo to govern and hinder efforts to lead Peru out of one of the darkest periods in its history.

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⁴¹ Alluding to former President of the United States Donald Trump’s strategy of challenging the validity, fairness and integrity of the 2020 election in the Courts. <https://www.washingtonpost.com/elections/interactive/2020/election-integrity/> (translated by the author)

⁴² <https://www.theguardian.com/world/2021/jun/20/peru-elite-election-pedro-castillo-keiko-fujimori>

⁴³ <https://elcomercio.pe/lima/simpatizantes-de-fuerza-popular-convocan-para-este-sabado-19-de-junio-a-una-movilizacion-por-el-cercado-de-lima-keiko-fujimori-elecciones-2021-segunda-vuelta-noticia/>

⁴⁴ <https://semanaeconomica.com/legal-politica/politica/208164-ppk-vs-keiko-la-tension-bajara-pero-no-desaparecera> (translated by the author)

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