Economic Impact of Engagement with Taiwan and China

A Comparative Study

EXECUTIVE SUMMARY

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Key Findings

- Economic analysis that measures relative performance after countries switch diplomatic relations to China shows that they tend not to experience a significant long-term boost in growth, although they often enjoy an initial increase in loans and investment.

- Countries that sign up for the BRI and other Chinese trade and investment drives similarly experience only limited effects in terms of GDP figures.

- In establishing diplomatic ties with China, a country may experience increased exports but also a surge in imports that leads to a significant trade deficit. The effectiveness of Beijing's use of economic coercion depends on the extent of the targeted country's dependence on China. To avoid being a potential victim of such pressure, trade diversification is a high priority.

- The impact of China's coercive measures may not be as powerful as expected: in some cases, total exports from targeted countries to China increase regardless of trade restrictions in specific sectors. Even in the targeted sector the impact can be conditioned by strong demand for the product in China.

- Substantial amounts of Chinese aid can undermine democratic development, rule of law, freedom of expression and gender equality, and lead to an increase in corruption.

- In Pacific island states and African countries, China has come to be seen as an alternative to the existing powers in the region rather than a threat. Its promotion of "non-interference" as a doctrine has proved attractive to opinion makers and some national leaders.

- Siding with Taiwan remains an economically reasonable choice for small island states in the Pacific that rely heavily on fisheries. Larger countries that depend on resource extraction are heavily reliant on China as an export destination.

- Chinese financing and FDI in infrastructure and manufacturing have not led to a structural transformation in African countries, at least in the near term. Ties with China can also encounter political opposition when they fail to meet often-inflated expectations.

Introduction

China has in recent years stepped up its efforts to isolate and subjugate Taiwan, fueling a confrontation that undermines regional stability and threatens potential conflict with the United States.

Countries engaging with the People's Republic of China (PRC) have always had to take account of the Taiwan factor. Beijing's insistence on the "One China Principle" means that it won't countenance relations with any state that recognizes Taiwan - officially the Republic of China (ROC) - as a separate national entity. But China's emergence as an economic and military giant, and its growing belligerence on the international stage, is focusing the minds of policy makers around the world and forcing a rethink on priorities over Beijing and Taipei.

This report assesses the economic ramifications of engagement with China and Taiwan, focusing on four regions of the world: Africa, Latin America and the Caribbean, Central and Eastern Europe, and Oceania. It outlines the cost that countries face for defying China over Taiwan and other sensitive issues. It also highlights the potential perils of too close an economic relationship with China, especially for small states that are vulnerable to economic coercion.

The report uses economic data to assess the impact on countries that get caught up in the contest for diplomatic recognition between China and Taiwan and those that engage with one of China's multilateral economic initiatives: the Belt and Road Initiative (BRI) launched in 2013, the first Summit of the Forum on China-Africa Cooperation (FOCAC) held in 2006, the 16+1 framework established in 2012 and the first China-Pacific Island Countries Economic Development and Cooperation Forum (China Pacific Forum) held in 2006. It supplements the data with analytical assessments to ask whether countries can prosper by trading diplomatic relations for economic gain. It also asks how far countries can go in establishing trading and other relationships with Taiwan without suffering damaging reprisals from China.

The stakes have never been higher, with China now challenging the global dominance of the United States, and Taiwan consolidating its critical position in supply chains for semiconductors. The picture is complicated by ideological considerations, as democracies struggle to confront challenges to the global order from authoritarian states. Taiwan increasingly bases its appeals for international acceptance and recognition on its status as a democratic island confronted by an autocratic and expansionist neighbor.

The report confines itself to the economic impact of engagement with China and Taiwan, an area which has received little scrutiny, while taking account of the broader geopolitical context. It finds that countries that switch diplomatic recognition from Taiwan to China, or sign up for Beijing's international initiatives, rarely enjoy the long-term economic boost that is often anticipated by local populations. Short term gains are sometimes noted but these can be offset by high debt burdens and trade imbalances.

Countries that receive substantial amounts of Chinese aid and loans can likewise receive a temporary boost, but they also risk negative repercussions, such as the bolstering of autocratic leaders and a weakening of the rule of law. States, on the other hand, that defy China over Taiwan or other of its core interests, tend to suffer economic retaliation from Beijing. This sometimes succeeds in forcing concessions but is more often unsuccessful and the economic impact of Chinese measures is often short-lived.

The struggle over Taiwan's status looks set to remain a geopolitical flashpoint in the coming years, with Beijing making clear it intends to achieve unification with the island before 2050, by force if necessary. There's a growing understanding in world capitals that China's squeeze on Taiwan amounts to far more than a regional gambit by the leadership in Beijing. The dispute is now recognized as an issue that goes to the heart of China's sense of identity and view of its place in the world.

Ever since its foundation in 1949, the PRC has emphasized that it can never accept recognition of Taiwan as an independent entity. Beijing sees Taiwan as an integral part of China that happens to be temporarily separated from the mainland by a political dispute; an internal struggle that must be settled to achieve full sovereignty. Beijing denounces any move by third countries to bolster Taiwan's de facto independence as hostile interference in its internal affairs.

Xi Jinping has used his standing as China's most powerful leader since Mao Zedong to inject more urgency into the drive for unification. He portrays Taiwan's separation from the mainland as a legacy of China's "century of humiliation" at the hands of colonial powers. Taiwan was occupied by Japan for half a century after 1895 and became a refuge for the fleeing nationalist government in 1949. It survived as a rival Chinese state in the years that followed largely because of the power of the U.S. fleet to deter an invasion.

Xi therefore sees unification with Taiwan as an essential element in China's return as a global power and as a central pillar of his vision for the "great rejuvenation of the Chinese nation". He has signaled his determination by stepping up military flights and naval activity in the airspace and waters around Taiwan and building up China's capacity for a potential invasion. Xi has also increased efforts to deprive Taiwan of its remaining diplomatic partners and block any official role for it in international organizations - an area of fundamental importance for Beijing. Any forceful seizure of Taiwan will be presented to the world as the resolution of an internal conflict and not an attack on a sovereign state.

These efforts, combined with China's growing economic might and its frequent resort to economic coercion against trading partners, have put added pressure on states that wish to forge stronger links with Taiwan. Taiwan has struggled for diplomatic recognition and international participation ever since the adoption of United Nations General Assembly Resolution 2758 in 1971, which stated that the PRC was the only legitimate government representing China. Since then, Taiwan has lost diplomatic recognition from forty countries, including the United States. China has consistently sought to undermine Taiwan's efforts to maintain ties with third countries and participate in international organizations and forums. Fierce diplomatic rivalry rages on, especially in traditional Taiwanese strongholds such as Latin America and the Caribbean and Oceania. Taipei is attempting to hold on to its existing diplomatic partners and to establish new ties, while Beijing is encroaching on these relationships with promises of aid, trade, and investment.

Bringing together lawyers, econometricians, political economists, political scientists, anthropologists and electronic engineers, this study investigates the experiences of countries in four regions of the world as they engage with Beijing and Taipei. It outlines China's use of economic coercion as it seeks to enforce compliance over Taiwan and other sensitive issues and examines China's use of economic aid to increase its diplomatic and economic leverage over developing countries.

The study contains a section on Taiwan's central position in global supply chains for computer chips and how this increases its importance to third countries that are contemplating stronger ties. It includes suggestions for policy responses for countries that are considering switching diplomatic relations between Taiwan and China, and for those that feel threatened or intimidated by attempts at economic coercion and the erosion of their sovereignty.

China's Use of Coercion as a Tool of Economic Statecraft

In parallel with its surging economic and military power, China has increasingly sought to use coercive economic measures to increase its influence in the world and intimidate perceived opponents and critics (Nephew, 2019). The evidence shows that Beijing has succeeded in imposing its will on some countries, usually smaller states that depend heavily on trade and investment with Beijing, but more often the impact of such economic coercion is limited or short-lived.

China resorts to coercive measures when it feels its self-defined "core interests" are threatened. It uses economic threats and sanctions in an attempt to internationalize its "One China Principle", which demands global recognition of Taiwan as an integral part of Chinese territory. Beijing has also used coercion to defend what it calls the principle of "non-interference" and to resist criticism of repression in Hong Kong, Tibet, and Xinjiang. Economic coercion is also used to help shape a favorable international environment for China (Macikenaite, 2020).

China may rely on its consumer market, one of the largest in the world, as the source of coercive leverage.

Beijing's exercise of economic statecraft has a number of distinctive features. Much of the economic pressure is not explicitly launched by the Chinese government. Rather, China may rely on its consumer market, one of the largest in the world, as the source of coercive leverage. Specifically, China can manipulate several tools, such as restrictions on tourism, popular boycotts, protests or even riots by Chinese civilians, to increase pressure on the targeted country (Reilly, 2012, p. 124).

Even when economic coercion is employed directly by the government, China rarely acknowledges that the punitive measures are a response to infringements of its national interests. Instead, informal or extralegal measures are used, enabling China to label its actions as legitimate regulatory measures and retain the flexibility to escalate or de-escalate the level of retaliation. For instance, China can selectively apply food safety regulations on products imported from targeted countries. The Chinese government can also suspend targeted companies' operations on the grounds of public safety concerns (Harrell et al., 2020, p. 23).

> *Most of the countries targeted in this way are democratic states. China has tended to rely on economic inducements to consolidate ties with its authoritarian partners, but such an approach is considered less likely to succeed with democracies. Consequently, China uses measures to target critical products or key enterprises in the hope that the economic damage will sway democratically elected leaders who feel responsible for the welfare of their citizens (Harrell et al., 2020, p. 23).*

One way to measure the effectiveness of China's use of coercion is to assess how trade volumes are affected and whether policy concessions are extracted from targeted countries. In recent years, China has singled out a growing number of countries for punitive action because of perceived slights and actions said to hurt the feelings of the Chinese people: against Norway when the Nobel Peace Prize was awarded to the human rights activist, Liu Xiaobo; against Japan and the Philippines over territorial disputes; in response to the reception of the Dalai Lama by the Mongolian government; in retaliation for the detention of the Huawei CFO, Meng Wanzhou, in Canada; and in response to Australia's call for an independent investigation into the outbreak of the COVID-19 pandemic. In other cases, China cut the flow of tourists to the Pacific island state of Palau and exports from Lithuania in response to the two countries' engagement with Taiwan.

Statistical analysis shows that the effectiveness of China's actions is often limited or qualified, at least as far as the trade impact is concerned.But sometimes it appears to succeed in forcing direct concessions, such as when Mongolia agreed not to host the Dalai Lama again and the Philippines backed off over a territorial dispute in the South China Sea.

Statistical analysis shows that the effectiveness of China's actions is often limited or qualified, at least as far as the trade impact is concerned.

China put restrictions on the import of Norwegian salmon, Philippine bananas, and Australian coal and barley. However, in each case the targeted sectors managed to compensate for their losses in the Chinese market by increasing exports to other countries, severely limiting the impact of the sanctions. Norway, Canada, and Australia also saw an increase in overall exports to China despite the bans imposed on the targeted sectors.

In the case of Canada, China blocked the import of canola seeds but eventually reversed the ban because of high demand for the product in domestic markets. Beijing attempted to punish Japan by restricting the export of rare earths, which enjoy high demand from Japan's high-tech industries. However, collective action by Japan and its partners at the WTO Dispute Settlement Body (DSB) succeeded in overturning the ban.

Diversifying exports and avoiding over-reliance on the Chinese market are the keys to any policy that seeks to build resilience against Chinese pressure.

Such a legal recourse against Chinese coercion is shown to be an effective deterrent, as China now presents itself as a responsible member of the international system and a faithful supporter of UN-centered multilateralism. Beijing risks reputational damage if it ignores rulings from such bodies. Diversifying exports and avoiding over-reliance on the Chinese market are the keys to any policy that seeks to build resilience against Chinese pressure. International cooperation to challenge China legally and increase imports from targeted sectors is also shown to be effective. Beijing learned from its ban on Canadian canola seeds that it is also constrained by the demands of its domestic economy.

Mongolia, the Philippines, and Norway all suffered a significant decrease in exports to China due to punitive action, and these three countries decided to restore their relationships with Beijing, either by offering a public apology or accepting the Chinese government's demands. Coercive measures have proved more effective when used against China's smaller neighbors. Larger and richer countries, as would be expected, have a stronger capacity to withstand pressure.

As has been shown, while the trade restrictive measures did result in visible decreases in the export or import of targeted products from Canada, Australia, and Japan, these countries employed policy measures to mitigate the effects, enabling them to resist making concessions. While China is an important market for them, such developed economies are also likely to control critical supply chains of high-tech products or fundamental raw materials that are indispensable for China's economic development. Escalating confrontations with such countries might also further damage the confidence of foreign enterprises in the Chinese business environment (Harrell et al., 2018, p. 15; Patey, 2021).

Other political or diplomatic factors, of course, are also at play and can help nudge countries towards compliance or resistance (Harrell et al., 2018, p. 30). China's attempt at economic coercion against Lithuania is one illustration. Whereas Lithuania's exports to China significantly decreased after it made overtures to improve links with Taiwan - and European or foreign enterprises operating from Lithuania were also affected - the economic costs did not produce policy changes. Any retreat by Lithuania would have had geopolitical implications, signaling an erosion both in European solidarity and in transatlantic partnerships, given the support offered by Washington.

Some policy implications can be drawn:

> *Countries should be aware of the dangers of being economically dependent on China and the potential threat to policy autonomy. Like-minded countries can also demonstrate their solidarity and safeguard fundamental values and principles underpinning the international order. Despite its limitations, action at the WTO can have a deterrent effect by naming and shaming states that try to coerce and intimidate their trading partners.*

The Perils of Chinese Aid

China's emergence as a major foreign aid donor has done much to enhance its standing in the developing world, but the aid, often given to friendly governments without conditions, has also undermined democratic reform and accountability in recipient countries. Beijing allocates its aid strategically to fulfill various political goals (Dreher et al., 2018), one of which is the luring of Taiwan's diplomatic partners to switch diplomatic recognition to Beijing. It has a policy of not offering foreign aid to countries that maintain formal diplomatic relations with Taiwan.

Eight countries switched ties to Beijing between December 2016 and December 2021, largely because of the prospect of economic gain: São Tomé and Príncipe (2016), Panama (2017), the Dominican Republic (2018), Burkina Faso (2018), El Salvador (2018), the Solomon Islands (2019), Kiribati (2019) and Nicaragua (2021).

To assess the impact of Chinese aid, we took advantage of internationally renowned datasets, including the World Development Indicators, Worldwide Governance Indicators and the AidData and V-Dem projects to empirically investigate the perils of Chinese aid. We conducted two-way fixed-effects regression models to analyze the data of 117 developing and underdeveloped countries that received Chinese aid between 2000 and 2017. The findings are robust to doubts about cause and effect.

Our research finds that Chinese aid often has negative political, economic and social consequences in recipient countries. The data from 119 recipient countries shows that Chinese aid, which is usually given to governments on an unconditional basis, tends to undermine levels of democracy and the rule of law.

Traditionally, countries of the Organization for Economic Co-operation and Development (OECD) offer aid in the form of official development assistance (ODA), which is usually concessional and conditional. Recipient countries need to adopt policy reforms or structural adjustments to ensure future inflows. China, on the other hand, offers much of its aid without hard conditionalities on political or economic reforms.

> *Our statistical analysis shows that Chinese aid erodes freedom of expression, increases levels of corruption and holds back gender equality in national legislatures. It is also shown to have an adverse effect on enrollment rates in primary schools and on female employment. Countries receiving substantial Chinese aid are also shown to experience no improvement in public health outcomes compared to similar countries that don't, a result that is reflected in figures for life expectancy and annual death rates. There is also no relative increase in male employment.*

The reason for such outcomes is largely political. Unconditional Chinese aid strengthens national leaders without giving them any incentive to promote democratic change or enhance transparency and accountability. Such aid can help free unscrupulous politicians from the budget constraints that inhibit their actions.

It effectively gives political elites an opportunity to bypass financial restrictions on their power. When aid does not mandate anti-corruption initiatives, politicians in recipient countries are given greater opportunities to engage in rent-seeking and tend to offer fewer public goods, such as public health care and primary education.

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Freedom of expression is adversely affected because recipient countries are incentivized to cooperate with Beijing's desire for positive media coverage of China. There is a tendency to censor negative or objective reporting, either through direct Chinese pressure, or a desire by aid recipients to keep their benefactors happy. Lastly, countries that receive substantial aid from China become less dependent on aid from democratic countries. This means less incentive to pursue democratic reform, implement anti-corruption initiatives or develop programs to improve gender equality.

China has become a major lender as well as an aid donor, and the impact on developing countries has also been substantial. As of the end of 2021, it was the leading trade partner of more than 120 countries and an important aid provider for over 93 emerging-market countries. A growing share of Chinese financing comes in the form of commercially oriented debt-based financing. China launched the BRI and the Asian Infrastructure Investment Bank (AIIB) in the mid-2010s to expand and deepen its economic engagement with other countries (Yu, 2017). The participants in these initiatives include countries that are unsatisfied with the US-led international economic order (Broz et al., 2020).

One hundred and forty-five countries have signed up for the BRI since its launch in 2013. Its aim is to generate vast Chinese investment in infrastructure projects around the world. The objective is to give form to the "China dream" by creating a "Sino-centric network of economic, political, cultural and security relations" that can "re-constitute the regional order – and eventually global order" (Callahan 2016, 226). Specifically, China offers loans to countries that participate in the BRI to build their infrastructure and generate economic growth. The BRI has been described as "China's Marshall Plan" for developing countries in the 21st century (Shen and Chan 2018). Many democracies have chosen to steer clear of the BRI despite the financing opportunities on offer, for fear of becoming overly dependent on Beijing (Balding 2018).

The AIIB is an international financial institution that has the stated intention of following international standards (Chen, 2020). However, projects under the BRI are not transparent and have led to allegations of corruption, most notably in high profile cases in Malaysia and Sri Lanka. Some BRI projects have led to fears of unsustainable debt burdens and enforced debt-for-equity swaps when borrowers face insolvency.

Switching Diplomatic Ties and Close Economic Engagement with China

China has redoubled its efforts to isolate Taiwan diplomatically since President Tsai Ing-wen was first elected in 2016. It has accused her of pursuing a pro-independence agenda and has offered economic incentives to Taiwan's remaining diplomatic partners to encourage them to break away. President Tsai's response is that Taiwan has no need to declare formal independence because "we are an independent country already and we call ourselves the Republic of China, Taiwan."

Economic analysis that measures relative performance after countries switch diplomatic relations to China shows that they tend not to experience a significant long-term boost in growth, although they often enjoy an initial increase in loans and investment. Countries that sign up for the BRI and other Chinese trade and investment drives similarly experience only limited effects in terms of GDP figures.

We use the Difference-in-Differences (DID) econometric method to measure the performance of selected countries after they either switch diplomatic recognition from Taiwan to China or engage with one of China's global economic initiatives. The basic idea of the DID method is to assess the impact of a given event at a certain turning point. In our study, we compare the average change over time in GDP per capita for a treated country with that of a similar country – the control country. The control countries are chosen based on region, income level, size of population and cultural considerations. The "breaking year" from which the trend is measured is the year when the treated country switched diplomatic allegiance or experienced another significant moment in relations with Beijing or Taipei.

The results indicate that among the African countries observed, switching ties from Taiwan to China did not lead to improved economic performance in every case. For example, Malawi lost its economic momentum after switching to China, although there are many factors that may have contributed to this. Similarly, our analysis shows that Senegal, which broke diplomatic ties with Taiwan on 25 October 2005, experienced economic downturns that were statistically significant. South Africa was another of China's diplomatic partners that experienced economic downturns in the years after the China-Africa summit in 2006, despite a sharp increase in Chinese trade and investment in Africa. Burkina Faso, Sao Tome and Principe and the Gambia, which recognized Taiwan at the time, meaning they were ineligible for funding from China, also experienced downturns.

Of the 16 countries in Central and Eastern Europe tested, five - Croatia, the Czech Republic, Hungary, Montenegro and Slovenia - did not enjoy stronger growth than their control country, Turkey, after the launch in 2012 of the 16+1 initiative, which was designed to boost cooperation between the region and China. This appears to have contributed to frustration with the initiative and complaints that it had not delivered on its promise of growth.

Of the 33 countries in Latin America and the Caribbean that were considered, most did not grow more strongly than their control countries after 2013, when China launched the BRI. This casts doubt on China's assertions that the BRI brings great economic benefits to its partner countries. It was also observed that Costa Rica, Dominica and Grenada did not perform better than their control countries after switching recognition to China.

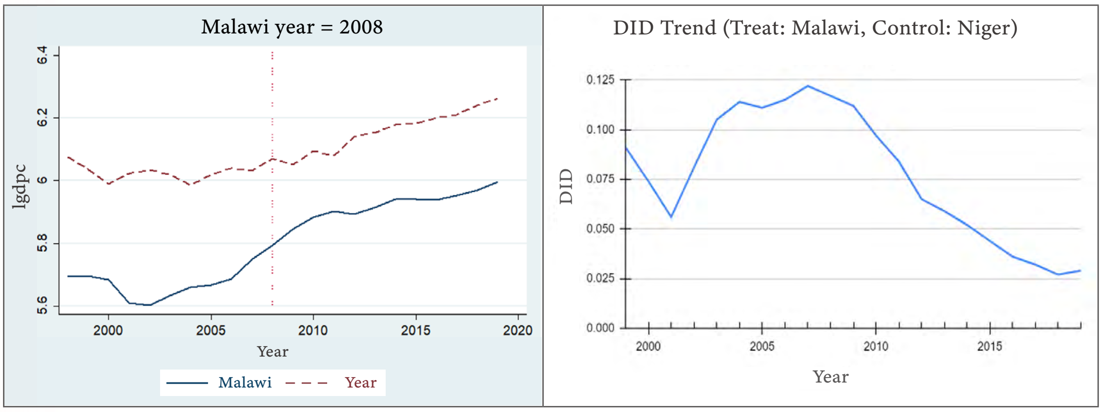
Of the 10 Oceanic countries examined, six - Fiji, the Federated States of Micronesia, Palau, Papua New Guinea, the Solomon Islands and Vanuatu - did not see better economic performance than their controls after 2006, when the first China Pacific Forum took place. During the same observation period from 1970 to 2020, Tonga, which switched recognition to China in 1998, has still not shown a relative economic improvement, while Taiwan's ally, Tuvalu, has enjoyed a positive trend.

Economic Growth after Switching Diplomatic Ties

Based on a comprehensive analysis of those countries which switched their diplomatic relations, we produce a table of DID results below. This table excludes recent cases such as Panama (2017), Dominican Republic (2018), El Salvador (2018), Burkina Faso (2018), the Solomon Islands (2019) and Nicaragua (2021) given the insufficiency of data for appropriate analysis and the abnormal case of Liberia in view of its internal conflicts. We do not include the ambivalent cases of Vanuatu and Papua New Guinea since their diplomatic relations with Taiwan were short-lived and arguably not formalized. Among the countries under investigation, only two switched from Beijing to Taipei against the general trend of embracing China: the Marshall Islands (1998) and Saint Lucia (2007). The economic impact is rather mixed but overall recognizing China cannot be said to lead to better economic performance.

Malawi outperformed Niger for the first six years, but the economic momentum was not sustained during the following period, 2015- 2019.

Chad and Malawi experienced stronger growth whereas Sao Tome and Principe and South Africa did not. In addition, even though Malawi performed better than its control country, Niger, after switching to China in 2008, it is not so straight forward. Malawi outperformed Niger for the first six years, but the economic momentum was not sustained during the following period, 2015 - 2019. This is illustrated by the DID trend.



The above figure shows the treated country, Malawi, alongside its control country, Niger, during the period 1998 to 2019. The DID trend from 2002 to 2007 increased and was statistically significant, meaning that Malawi's economic growth rate was greater than Niger's in this period. By contrast, in the period from 2008 to 2014, the DID trend decreased and was statistically significant throughout this interval, suggesting that whereas Malawi's growth rate was stronger than that of Niger, its magnitude was decreasing. Moreover, during this period, the economic performance of Malawi began to slow down. From 2015 to 2019, DID results are statistically insignificant.

> *Therefore, a closer look at the DID trend reveals that before Malawi's diplomatic switch in 2008, its economy was catching up with its peer as shown by the upward trend. After the diplomatic switch in 2008, the DID upward trend reversed after reaching its peak in 2007, indicating that whereas its economic growth rate continued to be higher than Niger's, the momentum for high economic growth faded.*

Costa Rica, Dominica and Grenada experienced economic downturns after switching to Beijing, although Saint Lucia did not enjoy better economic growth after establishing diplomatic ties with Taiwan in 2007 either. Our DID results in these cases all reach statistical significance and show that switching ties from Taiwan to China was followed by slower economic growth.

> *A sharp contrast can be drawn by a comparison between the Marshall Islands and Tonga that switched between Taiwan and China in the same year of 1998. The Marshall Islands experienced better economic growth, albeit statistically insignificant, compared to its control country, the Federated States of Micronesia, a long-term diplomatic partner of China; in contrast, Tonga experienced economic downturns, compared to its control country, Tuvalu, a long-term diplomatic partner of Taiwan.*

In the 1980s and 1990s, Tonga's economy was stronger than Tuvalu's. However, the gap between the two narrowed after Tonga switched recognition to Beijing. Using 1998 as the break year, DID analysis shows that Tonga did not perform as well as Tuvalu after the switch. Two additional factors might also have contributed to the decline in Tonga's economy: a cyclone in 2018, and riots in 2006. Tonga's economic growth is now approaching that of Tuvalu. However, Tonga has high levels of debt while Tuvalu has maintained healthier national finances.

DID Results for Countries Switching Diplomatic Relations

Treated country	Year	Control countries	DID	P > | t |
Chad	2006	Guinea-Bissau	0.358	0.000***
Central African Republic	1998	Madagascar	0.020	**0.574**
Gambia	2013	Guinea-Bissau	-0.135	0.000***
Malawi	2008	Niger	0.117	0.000***
Sao Tome and Principe	2016	Ghana	-0.121	0.076*
Senegal	2006	Zambia	-0.300	0.000***
South Africa	1998	Botswana	-0.108	0.009***
Costa Rica	2007	Panama	-0.195	0.006***
Dominica	2004	Dominican Republic	-0.146	0.008***
Grenada	2005	Panama	-0.283	0.000***
Saint Lucia	2007	Guyana	-0.19	0.000***
Marshall	1998	FSM	0.013	**0.869**
Tonga	1998	Tuvalu	-0.327	0.067*

Inference: *** p<0.01; ** p<0.05; * p<0.1

China and Taiwan in Latin America and The Caribbean

Most of Taiwan's remaining diplomatic partners - eight out of thirteen at the time of writing, in May 2022 - are in this region. The region has long been an area of stiff diplomatic competition between Beijing and Taipei. Fifteen countries broke their ties with Taiwan and recognized China between 1971 and 2000. Only one country, Nicaragua, moved in the opposite direction and recognized Taiwan in the same period. During the Chen Shui-bian administration (2000-2008), Taiwan rebuilt diplomatic ties with Saint Lucia in 2007, but lost relations with Dominica (2004), Grenada (2005), and Costa Rica (2007).

While there was no dramatic change in Taiwan's diplomatic relations in the region under the "diplomatic truce" policy of the Ma Ying-jeou administration (2008-2016), China resumed fierce competition with Taiwan after President Tsai was elected in 2016. From 2016 to 2021, Taiwan's partners in the region dropped from twelve to eight. The countries that switched to China were Panama (2017), the Dominican Republic (2018), El Salvador (2018), and Nicaragua (2021). As of May 2022, Taiwan maintains official diplomatic relations with 14 countries, with eight of them in the LAC region: Belize, Guatemala, Haiti, Honduras, Paraguay, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines.

China's diplomatic success in the region is largely due to its growing economic presence. Its trade with Latin America and the Caribbean grew 26-fold in the two decades after 2000. Unlike most creditors, China was willing to provide conditional loans to countries. These were accepted even though the interest rates were semi-concessional or non-concessional and the agreement provisions were strict and arguably unfair to the borrower (Ray et al., 2021). Further, many of those that have abandoned Taiwan were attracted by Chinese promises related to the Belt and Road Initiative (Shattuck 2020), which was adopted in 2013. Anticipated economic gains from China are a crucial motivation for a small state to break with Taiwan and recognize Beijing.

One previous study of nine countries that cut relations with Taiwan from 2000 to 2013 shows that they received immediate and significant economic benefits from China (Chen 2018). This led to arguments that Taiwan-aligned countries have to pay a "Taiwan cost" through the absence of aid, investment, and credit from China. Estimating the opportunity cost of not recognizing China, econometric analyses suggest that if a Taiwan-aligned country switched recognition from Taiwan to China, Chinese investment could be expected to grow seven-fold, and Chinese loans by a factor of 122. Such arguments have been persuasive for many countries considering switching ties from Taipei to Beijing.

> *El Salvador is an example of one country that make the switch in relations largely because of the promise of large investments in infrastructure projects that would only be available if it signed up for the BRI. Nevertheless, trade and investment make up only part of total GDP and any growth in exports to China is usually outweighed by much higher imports. DID results show that switching ties from Taiwan to China did little to help countries in the region achieve faster growth, despite increased loans and investment from Beijing. The results show that during the observation period of 2000-2017/18, Costa Rica, Dominica and Grenada actually experienced slower growth after establishing official ties with China compared to their Taiwan-aligned neighbors - Panama and the Dominican Republic, which also later recognized Beijing, in 2017 and 2018 respectively.*

Some countries appeared to take more account of factors other than economic benefits, such as US policy in the region and the attraction of the higher relationship status offered by Taiwan when considering a switch in relations. Taipei's lack of many formal diplomatic partners means that it gives elevated status to the small and often poor countries that choose to recognize it instead of China. DID analysis show that seven out of eleven countries were willing to maintain diplomatic relations with Taiwan even though similar countries, with Beijing ties, performed better after 2013, when the BRI was launched.

What explains these countries' diplomatic behavior? First, it is possible that they understood the economic risks of building formal relations with China. For instance, the BRI has been criticized for cost overruns and saddling participants with large debts, as well as a lack of transparency and negative environmental and socio-economic consequences (Gransow, 2015). Moreover, the Chinese send their own workers to recipient countries for BRI projects, leading to negative effects on local employment (Cooke et al., 2018). Second, it is also possible that the enactment in the US in 2019 of the Taiwan Allies International Protection and Enhancement Initiative Act (TAIPEI Act) might have had an impact. It states that the US Government should consider "altering its economic, security, and diplomatic engagement with nations that take serious or significant actions to undermine the security or prosperity of Taiwan." This stipulation implies potential countermeasures by the US if countries break formal ties with Taiwan.

The case of Costa Rica helps illustrate how countries that switch ties to Beijing do not necessarily enjoy stronger economic growth than those that remain with Taiwan, despite all the ostensible benefits on offer from the relationship. In June 2007, Costa Rica established formal diplomatic relations with Beijing. A memorandum of understanding (MoU) on the day of transition was revealed in 2008 showing that in return for its prompt closure of the Taiwanese embassy China promised to buy Costa Rican bonds worth $300 million and donate $130 million in aid (Tico Times, 2008). A free trade agreement between Costa Rica and China entered into force on August 1, 2011 and Costa Rica joined the BRI as one of its emerging market countries in 2018.

In 2008, one year after the switch, Costa Rica's trade balance with China changed from positive to negative.

However, after building formal ties, a trend of trade imbalances became increasingly clear. In 2008, one year after the switch, Costa Rica's trade balance with China changed from positive to negative. From 2010 through 2015, Costa Rica's trade deficit with China was second only to its deficit with the United States. By 2016, China had become Costa Rica's largest trading partner, and also the country with which it maintained the largest trade deficit. As previous studies have demonstrated, an overall deterioration in the trade balance resulting in a current account deficit has a negative impact on economic growth, given that GDP, is the sum of consumption, investment, government expenditures and net exports. From 2016 to 2019, Costa Rica's trade deficit with China accounted for about 40% of its total trade deficit. Therefore, it is possible that the imbalance in trade relations may have hampered Costa Rica's economic performance after the switch in ties.

A number of countries that joined the BRI later suffered from "buyer's remorse," a phenomenon highlighted by the suspension or cancellation of some previously agreed projects.

A number of countries that joined the BRI later suffered from "buyer's remorse," a phenomenon highlighted by the suspension or cancellation of some previously agreed projects. Costa Rica is one of the most affected countries, with troubled projects valued at $889.3 million (Malik et al., 2021, pp. 73-74). For example, the widening project of the national highway between San José and Limón has consistently fallen behind schedule (Rico 2021). The $485 million project was also contracted to use Chinese rather than local workers (Arias, 2014).

In another troubled project, Costa Rica and China's state-owned oil companies formed a joint venture in 2008 and the China Development Bank (CDB) offered a $900 million loan to build an oil refinery in Limon; however, the refinery project was suspended after an environmental impact investigation and the project was cancelled in 2016.

Notwithstanding such problems, Taiwan's remaining diplomatic position in the region remains under threat from the ever-larger Chinese presence. Our survey found Taiwan could strengthen its position by contributing more to the economies of its remaining diplomatic partners. This could be accomplished by increasing the role of its state-owned companies in regional investments and working more closely with the United States to help countries integrate with existing free trade agreements in the region.

Diplomatic Competition in Africa

Beijing's drive for influence and economic engagement with Africa in recent years has done much to isolate Taiwan on the continent, leaving it with just a single diplomatic partner by early 2022, namely Eswatini. Taiwan, meanwhile, has managed to maintain contacts on the continent through economic engagement and people-to-people ties despite its loss of formal diplomatic ties. Its policy of applying retributive actions against countries that break formal links, however, is shown to be counterproductive. Taiwan could count on more goodwill and sympathy if it did not resort to cutting aid projects and scholarships when countries make the switch to Beijing.

Taiwan and China have both used diplomatic relations with African countries to bolster their own global standing. During the 1960s, concerned about waning support for Taiwan's presence on the UN Security Council, the US encouraged it to deepen agricultural development cooperation with newly independent African states (Liu, 2013).

China, which was excluded from the UN and facing potential conflict with the Soviet Union, built relationships with newly independent African states and liberation movements, providing military training and development assistance. In 1971, Beijing prevailed over Taipei at the UN with the support of African countries.

During the 1990s, Taiwan made something of a diplomatic comeback on the continent by offering some of the poorest African states generous development aid in exchange for diplomatic recognition (Taylor, 2002). Since the late 1990s, however, China has successfully reduced Taiwan's gains from its peak of 10 diplomatic partners in 1997.

Beijing's diplomatic and economic offensive was relaunched with the Forum on China-Africa Cooperation (FOCAC) in 2000. The forum was held as a full summit in Beijing in 2006, involving 41 African heads of state. Specific commitments were made, including US$5 billion in financing, a pledge to double aid by 2009, the establishment of a China-Africa Development Fund with $5 billion in capital and expanded infrastructure commitments (Grimm, 2012). This led to a sharp increase in trade and investment between China and Africa, and economic relations have deepened further since.

Attendance at the forum and eligibility for financing and aid are premised on acceptance of the One China Principle, so countries that recognize Taiwan are excluded - although China did initially extend invitations to Taiwan's diplomatic partners to be "observers". Burkina Faso cut ties with Taiwan in 2018 just before that year's FOCAC and China expressed hopes that Eswatini would also one day "join the China-Africa family" (Gao, 2018).

Our findings show that many countries have not experienced the economic boost they anticipated from closer ties with Beijing. Other factors were found to have a more significant effect on overall economic performance.

Establishing diplomatic ties with Beijing usually does lead to an increase in exports to China, but with the exception of resource dependent countries such as Angola, such increases are small compared to the surge in imports from China.

Chinese financing and investments in infrastructure and manufacturing have not led to the structural transformations that were hoped for either, at least not in the short term. Such disappointments can make ties with China politically vulnerable, as they are often heralded by inflated expectations for increased prosperity and associated social benefits.

African countries appear to have made the diplomatic switch to China in an effort to boost their economies. However, many factors affect economic performance, and closer diplomatic relations with China don't automatically lead to measurable growth even if changes can be detected in levels of trade, FDI, aid and finance.

The effects of trade between China and underdeveloped countries have been extensively debated. On the one hand, China's exports of manufactured goods have been associated with a decline in African manufacturing (Giovannetti & Sanfilippo, 2016; Marukawa, 2017). On the other hand, China's demand for raw materials contributes to rising commodity prices, improving the economic performance of raw material exporters (Taylor, 2015). However, these are indirect effects through the global market rather than the direct effects of diplomatic relations. Establishing diplomatic relations with China may increase the volume of a country's exports to China, but it can seriously unbalance overall trade.

More attractive is the prospect of substantial investment and financing opportunities. Chinese FDI has been concentrated in construction and manufacturing (Sun et al, 2017; Marukawa, 2017). Capital goods, like machinery, are also a significant component of Chinese imports, contributing to local manufacturing industries (Munemo, 2013; Wolf, 2017). The financing of infrastructure projects with Chinese loans has been more controversial because it has contributed to an unsustainable debt burden in some countries. Long-term expectations are often not met and there have been disappointments, putting political pressure on leaders who had promised lucrative rewards from their engagement with Beijing.

For example, shortly after Malawi broke ties with Taiwan to recognize China in 2008, President Bingu wa Muratharika said the country would not only benefit from aid but also from China's rich experience. He said the relationship would help turn Malawi from poverty to riches (Mweninguwe, 2017). However, Malawi's subsequent economic performance did not live up to such high expectations. Based on DID analysis, comparing GDP per capita growth trends vis-à-vis Niger (the control country for the analysis), Malawi's economic growth was slower in the six years after the switch. The first effect was increased trade volume, with exports to China doubling between 2007 and 2010, according to the Malawi Ministry of Trade (Ndzendze, 2019), a clear gain.

Before 2008, Malawi had a smaller trade deficit with China than Niger - $24 million per year versus $51 million – but after establishing formal relations with Beijing, the deficit grew to over $100 million in 2009 and $500 million in 2019.

But as in so many other cases, Malawi also experienced a surge in imports from China. Before 2008, Malawi had a smaller trade deficit with China than Niger - $24 million per year versus $51 million – but after establishing formal relations with Beijing, the deficit grew to over $100 million in 2009 and $500 million in 2019. For all that, China remains a relatively small trading partner for Malawi and the overall impact on growth has been small.

Chinese FDI to Malawi increased after 2008, although not to the same level as in Niger. Still, it did lead to increased jobs in manufacturing, generating 13,796 jobs between 2005 and 2012. The data suggests that other factors played a larger role in Malawi's declining economic performance. In 2011, several major Western donors suspended aid to Murtharika's government on the grounds of corruption. This contributed to an economic crisis, which in turn led to anti-government demonstrations in which Chinese traders were targeted.

Despite such sentiments and China's often limited impact on overall growth, China remains attractive to many African leaders and populations because it is an example of a formerly poor country that successfully industrialized. President Muratharika argued that diplomatic relations with China would benefit Malawi because it could learn from China's experience and maybe even emulate it. African leaders have also shown an interest in other East Asian states such as Singapore, Malaysia, South Korea and Taiwan for similar reasons.

Exaggerated reporting of the hoped-for benefits of ties with Beijing can undermine such hopes. Investment pledges in Tanzania, to give one example, were reported in the media as done deals, and private investment plans were portrayed as projects supported by the Chinese state. In Malawi, at the time of the switch from Taiwan, many NGOs and government agencies approached the Chinese embassy directly asking for financial support, prompting the ambassador to reply that China was not a "miracle performer." (Nkhoma, 2020, p 694). In a ten-year retrospective of relations with China, Mweingure (2017) noted that "the country has since remained poor."

The lesson is that decisions to recognize China are often not based on straightforward guarantees of economic growth but the extent to which they can deliver visible signs of development for politicians to show their constituents in the shorter term.

Another area where Taiwan and China have competed is medical diplomacy. In Malawi, one of Taiwan's biggest projects was the establishment of the Rainbow Clinic, an HIV/AIDS clinic at Mzuzu Central Hospital, which was funded and run by Taiwanese institutions. Following the break in ties between Taiwan and Malawi in 2008, Taiwan's medical team was withdrawn. China then stepped in and provided its own team (NHC, 2013). However, the Taiwanese were invited back when the Chinese medics proved unable to provide adequate care for AIDS patients. They were permitted to work alongside Chinese doctors on a non-governmental basis, albeit in a separate ward.

Competition between China and Taiwan in the Pacific

Of Taiwan's 14 diplomatic partners, four are in the Pacific – the Marshall Islands, Nauru, Palau and Tuvalu. The last to switch to Beijing were the Solomon Islands and Kiribati in 2019. A number of island states in the Pacific have received an economic boost from Chinese aid and loans. They include Samoa and to some extent Tonga, however in many cases the growth is not sustained, and island countries have accumulated heavy debt burdens.

Countries that rely on resource extraction, such as Papua New Guinea and the Solomon Islands, tend to be heavily dependent on the Chinese market. Their position is made more precarious by China's pursuit of the BRI and the growing involvement of Chinese state-owned and state related companies in mining and infrastructure, which give Beijing a commanding presence in the region.

> *Maintaining ties with Taiwan is shown to be an economically reasonable choice for small island states that rely heavily on the fishing industry. They can remain on an economic par with neighboring states that choose to recognize Beijing. The economic involvement of Taiwan and China in the region follows very different paths. Taiwan's trade and investment is limited, except in fisheries, while China has mass volume in trade and infrastructure investment.*

Taiwan's overall trade with Oceania, though smaller than that of China, South Korea, Australia and Japan, is at a similar level to that of the United States ($1.2 billion in 2017). However, Taiwan's trade concentrates mainly on fisheries and LNG from Papua New Guinea. The small size of the market and the cost of transportation have held back further engagement despite efforts by the Taiwanese government to encourage more business activity.

By contrast, China's economic engagement with the region has grown manyfold in the past two decades, overtaking Australia to be the largest trading partner of most island countries. China moved to expand its sphere of influence in Oceania in 2000 when it set up the China-Pacific Island Forum Cooperation Fund and a Pacific Islands Forum trade office was opened in Beijing. A significant landmark was reached in 2006 when the then Chinese premier, Wen Jiabao, attended the first meeting of the China-Pacific Island Countries Economic Development and Cooperation Forum in Suva, Fiji. It was the first time such a senior Chinese leader had visited the region.

Attended by eight Oceanian countries - Cook Islands, Federated States of Micronesia, Fiji, Niue, Papua New Guinea, Samoa, Tonga, and Vanuatu - the forum aimed to strengthen cooperation between the business communities of China and the island countries, and to increase Chinese aid. After the second forum was held in Guangdong in 2013, the goals became more ambitious: to support major infrastructure projects, increase exports to China, and tap the Chinese tourism market. The third one took place in Apia, Samoa, in 2019, with the Solomon Islands and Kiribati also attending after they both switched diplomatic recognition to Beijing a month before. China at this stage moved to incorporate Pacific island states into the BRI and extend cooperation in multiple sectors.

During the debates in the Solomon Islands over the switch in diplomatic ties from Taiwan to China in 2019, the disparity of trade volumes was raised as an important argument to support the decision. China imports large amounts of natural resources (logs, fish, minerals and gas) from the Pacific; at the same time, Chinese companies have invested in extractive industries. In addition, Chinese merchants have dominated the retail business for decades and have especially benefited from their access to supply chains of cheaper Chinese-made consumer products. They also tend to have better capital levels and profit management. This has resulted in some local resentment and has sometimes developed into tension and riots, as shown in the recent disturbances in Honiara (Nov. 2021) and previous trouble in the Solomon Islands as well as Tonga and Papua New Guinea.

Samoa is a country that does appear to have benefitted from its long-term diplomatic relationship with Beijing, with China funding a lot of its infrastructure. However, the aid and investment has lately produced limited returns in terms of economic growth compared to Tuvalu and the Marshall Islands, which have both maintained ties with Taiwan. All three countries have a similar GDP per capita, ranging between $4000 and $5000.

Samoa's economy grew strongly after 2000 and overtook the other two in 2004-2006. It is likely that aid from China in the period contributed to this development. However, after the peak in 2006, Samoa's economy slowed down and stagnated for 10 years. While China continues to contribute resources, the effect on the economy has been weak in recent years. The new Samoan prime minister canceled a wharf project proposed by China in 2021 because of concerns about its economic viability.

China's rapidly growing presence in the Pacific forms part of its ambitious global agenda, as exemplified by the launch of the BRI in 2013. It has adopted an approach to the region distinct from the US-led framework, which is based on security, stressing that it has no wish to interfere in the internal politics of island states.

Facing the challenge, the United States, Australia, and New Zealand announced new foreign policy initiatives explicitly or implicitly designed to counter China's growing presence. The US adopted the framework of the Indo-Pacific during the Trump administration in November 2017. Australia asserted its interests through the Pacific Step-Up initiative in 2017 and New Zealand announced a "Pacific Reset" in March 2018. These initiatives are supported by financial commitments to deepen strategic cooperation with island countries. As tensions grew, Australia, the United Kingdom, and the US announced the 'AUKUS' pact to counter Chinese influence in the Indo-Pacific in September 2021.

Much debate in the Pacific is focused on two contrasting perspectives that present China as either an economic and strategic threat, or as an opportunity - an alternative that could give island states more leverage in their dealings with the traditional powers in the Pacific. Regional scholars and some political leaders have come to favor the latter view, dismissing criticism that they're taking Chinese rhetoric at face value and ignoring Beijing's strategic ambitions in the region.

Beijing presents itself in the Pacific as a fellow developing country, interested in such formulas as 'South-South' dialogue and 'non-interference' in the activities of sovereign states. It backs this up by often offering aid and assistance packages without strings. However, China's non-negotiable insistence that its partners accept the "One-China Principle", and its efforts to block diplomatic engagement with Taiwan, suggest that its claims of non-interference have their limits. As the second largest economic entity in the world and a growing military power, China's attempt to portray itself as a developing country is also becoming harder to sustain. Its growing belligerence in international affairs and sweeping global ambitions, as manifested by the BRI, are also giving some in the Pacific pause for thought.

Taiwan's engagement with Oceanian countries has received little scrutiny and is often discussed only as a sideline to the broader geopolitical picture and the rise of China. It could strengthen its standing by pursuing a more culturally sensitive diplomatic approach, taking more account of regional initiatives and prioritizing the threat from climate change.

China and Taiwan in Central and Eastern Europe (CEE)

All states in the region recognize Beijing and there have been no diplomatic switches from Taipei, although some countries have shown an interest in developing closer links with Taiwan, notably the Czech Republic and Lithuania. In 2012 China signaled its growing interest in the region with the launch of the 16+1 initiative, a framework for cooperation between China and 16 CEE countries in political, economic and social arenas.

The relationships have distinct characteristics. China is a relative newcomer to the CEE region, often building its relations with political and economic elites from scratch and is perceived by some regional scholars as lacking understanding of the local environment (Turcsanyi 2020b). China entered the region with more vigor following the global economic and financial crisis in 2008, when Beijing began to see CEE as a gateway to the rest of the EU market (Szunomár 2018). CEE countries also began reconsidering their predominantly west-bound orientation and exploring possibilities elsewhere, including China. Although almost all CEE countries toyed with the idea of strengthening economic relations with China in order to enhance their economic development, this commitment was rather cautious and hasn't proved lasting in most cases.

Companies from both China and Taiwan have been attracted to the region by macroeconomic factors, including market access to the EU, relatively low factor costs, a well-qualified labor force and good industrial relations.

Good political relations with individual countries were found to play an important role for Chinese companies when making investment decisions, as shown by their interest in Hungary and Serbia, both of which are friendly to Beijing.

Taiwanese multinational companies, on the other hand, tend to act in a largely pragmatic manner, taking little account of political ties. Most of the big Taiwanese firms were also found to have significant connections with China, often with large manufacturing bases on the mainland, and tend to play down their country of origin. Both Chinese and Taiwanese companies began to show interest in CEE countries after the region's transition to democratic rule and a market economy. Some smaller companies began investing early in the 1990s, while medium sized and larger companies began to make inroads after 2000.

Our research found that Taiwanese companies' strengths in high-technology, innovation, and R&D, were highly attractive to CEE countries, and stronger political links can be expected from more Taiwanese focus in these areas. Most investment to date has been in manufacturing and assembly.

While China has not had to battle Taiwan for diplomatic recognition in CEE countries, it has reacted sensitively to moves by various states to build closer links with Taipei. The new democracies in the region tended to show genuine sympathy to anti-communist Taiwan after their own transitions and saw opportunities in its dynamic economic performance. Almost all CEE countries opened representative offices in Taipei, and Taiwanese representative offices were established in their capitals. (Turcsanyi, 2020a). However, they were aware that even lower levels of cooperation with Taiwan could provoke China and as a result there was some hesitation about engaging much further.

The recent decision by Lithuania to allow the opening of a Taiwanese Representative Office in Vilnius led to strong protests from Beijing and moves to block Lithuanian imports. In response, the European Parliament expressed support for Vilnius's decision and encouraged closer EU-Taiwan political ties, including upgrading the name of its office on the island, from the European Economic and Trade Office

(EETO) in Taipei to the European Union Office in Taiwan – a move certain to aggravate Beijing with its acute sensitivity to nomenclature and anything that could suggest the trappings of sovereignty. The European Commission also proposed the establishment of a retaliatory mechanism, known as the Anti-Coercion Instrument, to protect member states from such attempts at coercion.

The Czech Republic, Poland and Hungary have proved the most attractive destinations for Chinese investment. But, of the three, the Czech Republic was most wary about engagement with China from the beginning, while Poland has tempered its earlier enthusiasm with more caution recently.

Hungary and China, by contrast, have developed their own 'special relationship'. Hungarian governments have been working on developing relations with China for over two decades. The Hungarian prime minister, Victor Orban, launched a new foreign economic policy in the spring of 2012 aiming to diversify foreign economic relations: the "Eastern opening policy". The main objective of this policy has been to reduce Hungary's economic dependence on trade and investment with the West. Besides promoting economic relations with China, Orban's government has backed China on sensitive issues. Hungary was the first EU member country to sign a memorandum of understanding with China on the Belt and Road Initiative. This came during the visit of the Chinese Foreign Minister, Wang Yi, to Budapest in June 2015. The Hungarian government was also keen to promote the Budapest-Belgrade railway, a long- negotiated construction project under the BRI umbrella. When signing the construction agreement in 2014, Orban called it the most important moment for cooperation between the EU and China (Keszthelyi, 2014).

Supporting China's infrastructural endeavors is, however, not the only field where Hungary has been distinctive. In 2016, Hungary and Greece prevented the EU from backing a court ruling against China's expansive territorial claims in the South China Sea (The Economist, 2018). In 2018, Hungary's ambassador to the EU was alone in not signing a report that criticized the BRI for benefitting Chinese companies and Chinese interests, and for undermining principles of free trade through its lack of transparency in procurement (Sweet, 2018). Although the background rationale behind the strong Hungarian commitments toward China was economic in the early 2000s, recently Hungary has used the 'China card' for political reasons (Turcsányi, 2020) to increase its leverage with Western partners.

For all China's diplomatic efforts, however, its economic presence in Central and Eastern Europe remains relatively limited. Its investments are still dwarfed by, for example, those of German multinationals. When calculating percentage shares, we found that Chinese FDI is around or below one per cent of total inward FDI stock in the Czech Republic, Poland and Hungary. It is above one per cent only in the case of Hungary. Western European investors are still responsible for more than 70 per cent of total FDI in CEE, while companies from the United States or Japan and South Korea are typically more important players than those from China. Taiwanese FDI stock is less significant than Chinese but has also been increasing.

Foreign Investment by Taiwan's High-Tech Sector

Taiwan's leading semiconductor producer, Taiwan Semiconductor Manufacturing Company (TSMC), is the world's largest and dominates global production of the most sophisticated chip designs. It has been dubbed the island's "silicon shield" in the hope that its importance to global supply chains will encourage international support for Taiwan and even deter Chinese aggression.

Taiwanese investment was found to have contributed to exports and employment in CEE countries since 2002. Investment by Taiwanese companies in South and Southeast Asia has also boomed recently thanks to the growing struggle between the US and China over trade and technology. It has also been boosted by the Taiwanese government's New South Bound Policy, which supports the island's economic penetration of the region. Nonetheless, China's role as the "world's factory" is unlikely to be challenged in the near term, given that supply chain restructuring presents a major challenge for electronics companies.

Taiwan, however, could help build ties with other governments if it gave more support to the electronics sector and backed its ambitions to build industry clusters in various parts of the world. The government could also help initiate the joint development of science-based industry parks.

The Taiwanese semiconductor industry's position is well established and likely to be maintained for the foreseeable future given the strength of its highly efficient local cluster in Taiwan. The industry has traditionally been cautious about foreign investments. However, there have been two recent investments – in the US and Japan – which suggest a more outward looking approach is developing. The industry is looking for clear indications of foreseeable demand, operational efficiency and substantial incentive programs as it contemplates future investments overseas. At the same time, China will build its own semiconductor ecosystem, spurred on by US restrictions on the export of chips and chip-making equipment that use US designs and technology. However, Chinese technology still lags behind that of the world leaders.

TSMC now controls 84% of the market for chips in the most advanced semiconductor manufacturing technologies, which provide the smallest and most efficient circuits for the world's biggest technology brands, from fast communication networks to cloud computing. It may not be an easy task for Samsung, the only other player with available advanced processes, to gain market share from TSMC. The nearest other challenger is Intel. Intel would first need to demonstrate to its customer base that it is capable of providing industry-leading process technology. The largest Chinese foundry company, SMIC, has fallen behind the competition by at least one generation.

Recommendations

- Whereas the danger of heavy debt burdens through engaging with China is highly publicized, the perils of economic dependence and surging trade deficits are less well known. The international community could do more to highlight the possible adverse effects of too close an alignment with Beijing.

- When China resorts to economic coercion, democratic countries could respond more effectively by encouraging increased imports from targeted countries. Concerted action by sympathetic countries at the WTO would also put pressure on Beijing.

- Countries intending to engage closely with China should carefully consider the potential risks, given Beijing's growing tendency to resort to diplomatic and economic coercion.

- The Taiwanese government could contribute more to the economies of its diplomatic partners by strengthening the role of state-owned companies in such relationships.

- Taiwan would help promote goodwill and people-to-people relations in Africa and elsewhere if it abandoned its policy of retributive actions against former diplomatic partners.

- Taiwan should devote more resources and diplomatic efforts to promote cooperation with Pacific island countries, where its role is often marginalized. Collaborative efforts with like-minded partners and potential synergies should be considered.

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About IEAS, Academia Sinica

Institute of American Studies, Academia Sinica was established in July 1974, with its predecessor, Center for American Studies founded two years earlier. The Institute expanded and renamed as Institute of European and American Studies in response to the increasing importance of European Union in August 1993. Academia Sinica is the most prestigious academic institution in Taiwan and the IEAS is mandated to advance Taiwan's research on European and American studies and deepen the local community's understanding in that regard.

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