Economic Impact of Engagement with Taiwan and China

A Comparative Study

FULL REPORT

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Introduction

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 People's Republic of China (the PRC) was the only legitimate government representing China. Since then, Taiwan, with the official title of Republic of China (ROC), has lost diplomatic recognition from 40 countries, including the United States on January 1, 1979. The losses have continued for Taiwan, while the PRC has consistently sought to sabotage Taipei's efforts to maintain ties with third countries and participate in international organizations and forums. Due to China's political and economic allure and its use of coercion, the number of countries that recognize Taiwan has kept on shrinking, falling from 29 to 14 between 2000 and 2022, with Nicaragua being the most recent loss. Fierce cross-strait 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 establish new ties, while Beijing is encroaching on its relationships with promises of aid, trade, and investment.

This competition is fueled by Beijing's attempts at power projection in strategically important regions and its drive for spheres of influence. With a view to deepening and strengthening its influence in Africa, a continent which provided decisive support for China's admission to the UN in 1971, the Forum on China-Africa Cooperation (the FOCAC) was established in 2000. Ministerial meetings were held in 2000 and 2003 and declarations adopted under the framework of the FOCAC. In 2006, China issued a white paper on African policy, the first time it had produced such a policy document for a specific country or region (FMPRC, 2006). The forum was upgraded to summit level that year with the gathering of 41 heads of state from 48 African countries. The event provoked concern in Europe, and the EU responded by calling for trilateral dialogue with African countries and China, a proposal that was met with a lukewarm response from the Chinese side (European Commission 2008).

In the wake of the global financial crisis in 2008, China attempted to combine economic relations with strategic objectives in central and eastern Europe. It established a cooperation framework - the "16+1" format - in 2012. This originally included eleven EU member states and five western Balkan countries. Greece joined in 2019 following heavy Chinese investment, including its acquisition of a 51 percent stake in the Piraeus Port Authority, while Lithuania withdrew. The framework has become a key element of China's geostrategic approach to European countries and constitutes an arm of its Belt and Road Initiative (BRI), which was launched in 2013. Despite its framing as a multilateral approach, the 16+1 format has remained largely bilateral in practice according to the European Parliament Research Service (EPRS 2018).

In November 2012, Xi Jinping became general-secretary of the Chinese Communist

Party as well as president of the PRC and chairman of the Central Military Commission. Chinese diplomacy has since undergone a fundamental shift as Xi pursues his vision of the "Chinese Dream" and the PRC's rise as a great power. He has abandoned the principle laid down by Deng Xiaoping that China should "hide our capabilities and bide our time" and has pursued what he calls "the great rejuvenation of the Chinese nation".

A more confident China should not necessarily be incompatible with other countries, even those in the western world. However, Beijing's tendency to trumpet China's special characteristics and development needs — sometimes under the cover of "Asian values" — as a justification for China's deviation from international norms or universal values does pose a challenge to the liberal international order. This is highlighted by China's increasingly confident participation in international affairs and its eagerness to act as a "rule-maker" not merely a "rule-taker" (Wang 2017). The Belt and Road Initiative (BRI) and the Asian Infrastructure Investment Bank (AIIB) are illustrative examples of its ambitions.

145 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). However, the initiative has also led to warnings that some of the participants could be walking into a "debt trap" by signing up for excessive loans. Such debts could not only increase China's leverage over a given country, but also threaten its sovereignty if it's unable to repay the loan. The best-known case was Sri Lanka's deal to lease Hambantota port to a Chinese company for 99 years after it failed to repay loans (Abi-Habib 2018). It is also argued that China's BRI agreements can encourage corruption in borrower countries (Doig 2019). Accordingly, many democracies chose to steer clear of the BRI despite the financing opportunities on offer (Balding 2018).

The BRI extends to Latin American and the Caribbean through its maritime arm, known officially as the 21st Century Maritime Silk Road. On February 15th, 2022, the Argentine President, Alberto Fernandez, met with Xi Jinping and agreed to join the initiative, making Argentina the 21st of 33 LAC countries to sign up. The remaining 12 LAC countries that have not joined the BRI include Taiwan's eight diplomatic partners in the region and the three most populous countries: Brazil, Mexico, and Colombia. Panama was the first country in the region to sign up in 2017, but the BRI's expansion has slowed since the outbreak of the COVID-19 pandemic in 2020. The US government took no effective measures to hinder the BRI's growth until August 2020, when the then secretary of state, Mike Pompeo, launched the Clean Network, which aimed to purge Chinese tech companies from involvement in 5G networks. In September 2021, President Biden and G7 leaders launched the "Build Back Better World (B3W) Partnership," which plans to counter the BRI by addressing the multi-trillion-dollar shortfall in infrastructure investment in developing 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 opened a Pacific Islands Forum trade office 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. There is a wide consensus in the field of Pacific studies that China has significantly increased its economic presence and aid engagement in the Pacific since the launch of this cooperation forum. The second forum was held in Guangdong in 2013, attended by the same partner countries. The goals became more vigorous: 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.

The BRI aims to strengthen links from China to Europe via Central Asia through its terrestrial arm, known officially as the Silk Road Economic Belt. This ambitious Eurasia connectivity plan has aroused concern among EU countries, some of which are wary of what they see as China's "divide and rule" strategy. China's investment in key infrastructure projects and its acquisition of critical assets has increased concern about the continent's economic security. With some hesitation, the EU responded to the BRI with its own connectivity strategy unveiled in 2018 (European Commission 2018). It was expanded and strengthened by the Global Gateway initiative announced by the President of the European Commission, Ursula von der Leyen, on December 1, 2021 (European Commission 2021). The EU also adopted an investment screening regulation in 2019, mirroring the Committee on Foreign Investment already established in the United States. With the outbreak of COVID-19, supply chain security, technological sovereignty and strategic autonomy had become major issues for the EU.

While China was promoting the BRI, Taiwan's new government unveiled its New Southbound Policy (NSP) in 2016 with the aim of improving cooperation and exchanges with 18 countries in South Asia, Southeast Asia and Australasia. SNP was billed as "new" to differentiate it from its predecessor, the Southbound Policy, which was adopted in the 1990s. Both policies had the aim of reducing Taiwan's economic dependence on China by increasing economic, social and cultural exchanges with other Asian countries. The NSP, however, goes beyond its predecessor's focus on Taiwanese exports and emphasizes policy areas based on values, with initiatives described as "people-centered" and designed to enhance "bilateral reciprocity."

As Taiwan's target countries overlap with the BRI, the NSP has been seen as an attempt to counter the Chinese initiative. According to Yang (2018), the NSP also facilitates Taiwan's engagement with the world, a process that has been dubbed "international socialization". By helping to shape Taiwan's international identity and increase its visibility, the NSP also helps Taiwan resist China's attempts to marginalize it. Chen (2020) further argues that the NSP signals to the US that Taiwan is pursuing a moderate foreign policy that aligns with its "Free and Open Indo-Pacific Strategy" (FOIPS), a drive to strengthen Washington's economic and security relations with the region in response to the BRI (Tan 2020). In other words, China's BRI has faced a response from both Taiwan and the US in East and Southeast Asian Countries.

Since its accession to the WTO in 2001, China has reaped substantial benefits from the world trading system. It has also actively sought free trade agreements and bilateral investment treaties wherever it can, ranging from Southeast Asia, Oceania and Latin America to Africa and Europe. In 2015, Australia became one of the first western countries to conclude a free trade agreement with China, while the EU concluded a comprehensive agreement on investment with China in 2020. In addition to bilateral free trade agreements, China also actively participates in mega-regional trade agreements, including the Regional Comprehensive Economic Partnership, which was concluded in 2020 and came into force on January 1, 2022. Over the past two decades, the volume of China's international trade has soared and so has its trade surplus with the rest of the world. This has resulted in uneven trade and sometimes undue economic dependence on China, giving Beijing scope for the use of economic coercion, an approach sometimes linked to its increasingly strident diplomacy.

China's attempts at economic coercion are most frequently employed over Taiwan, visits by the Dalai Lama, or criticisms of China's human rights violations. The recent decision by Lithuania to allow the opening of a Taiwanese Representative Office in Vilnius, which led to strong protests and sanctions from Beijing, is a case in point. In response to China's actions, the European Parliament adopted its first-ever report on EU-Taiwan political relations. It expressed support for Vilnius's decision and encouraged closer EU-Taiwan political ties, including changing the name of its office in Taipei, from the European Economic and Trade Office (EETO) in Taipei to the European Union Office in Taiwan, to reflect the broad range of relations. The European Commission also moved to counter future threats to member states by proposing the establishment of a retaliatory mechanism, known as the Anti-Coercion Instrument.

The competition between Taipei and Beijing for diplomatic partners, and Beijing's efforts to undermine Taiwan's diplomatic relations, should also be viewed against the background of Taiwan's internal politics. Both the succession of Xi Jinping in 2012 and the election of President Tsai Ying-wen in 2016 marked crucial junctures in the contest for diplomatic recognition. Under the previous Taiwanese administration of Ma Ying-jeou from 2008 to 2016, political relations with Beijing were much better than under either its predecessor or successor. They were marked by the signing of the Cross-Strait Economic Cooperation Framework Agreement (ECFA) in 2010 and Ma's meeting with Xi in Singapore in 2016. The Ma administration's favorable approach to China led to a truce in the diplomatic competition. When Gambia cut off diplomatic relations with Taiwan in 2013, China held off establishing ties with the African country until after the Tsai administration came to office in 2016.

With the signing of the ECFA, the Taiwanese and Chinese economies became increasingly integrated; however, the signing of a new agreement in June 2013, the Cross-Strait Services Trade Agreement, led to a backlash, with popular protests culminating in the Sunflower Movement in March 2014. The protesters feared that overdependence on China economically would eventually undermine Taiwanese sovereignty. The Sunflower Movement prepared the ground for the governing Kuomintang's defeat in the local elections at the end of 2014 and finally in the presidential election of 2016. China imposed economic sanctions after the Tsai administration took office, citing its refusal to recognize the "1992 consensus" on cross-strait relations, a vague and ambiguous understanding that had nonetheless helped preserve the status quo. The measures included restrictions on Chinese tourist visits and a ban on the import of Taiwanese fruit. China also persuaded several countries to switch diplomatic relations from Taipei to Beijing to signal its anger.

China's assertive diplomacy and its global ambitions have caused alarm in Washington and threaten to undermine US interests in Asia and beyond. Various policy initiatives have been tried, including the US "pivot to Asia" under the Obama administration and the current Indo-Pacific Strategy. France, Germany and the EU as a whole have also drawn up their own Indo-Pacific strategies since 2018. Taiwan's security is now a key consideration for all players as tensions continue to rise in the region. Taiwan was high on the agenda at the G7 summit, the Quad leaders' summit, as well as at the US-Japan summit and bilateral security consultations between Tokyo and Washington.

The competition between Taipei and Beijing for diplomatic partners should be seen within the context of the wider contest between Washington and Beijing. The Taiwan Allies International Protection and Enhancement Act (TAIPEI Act), which was passed by the US Congress in 2019, illustrates Washington's growing acknowledgement of Taiwan's importance in the struggle. The Biden administration has shown increasing support for Taipei's presence in the UN system, although it has preserved the concept of "strategic ambiguity" over the extent of its willingness to defend the island in the event of attack. On October 26, 2021, the Secretary of State, Antony Blinken, urged "all UN Member States to join in supporting Taiwan's robust, meaningful participation throughout the UN system and in the international community, consistent with the "One China policy".

With such geopolitical considerations in the background, this study aims to isolate the economic dimension of the diplomatic competition between China and Taiwan and assess the benefits and risks that third countries can expect from engaging with either. We will assess whether China delivers on the often lavish promises it makes when encouraging countries to break off ties with Taiwan and investigate the economic and social impact on states that switch ties. This project is an attempt to vet and verify China's claim that significant economic benefits arise from switching diplomatic recognition to Beijing. By offering evidence with empirical, quantitative and qualitative analyses, this study sheds light on the policy making of third countries that are considering such a switch. By exploring the social ramifications for countries that make the change we help to weigh any economic gains against the political and social costs. Moreover, as China relies heavily on economic coercion in its diplomacy, this study helps to ascertain its effectiveness and explores possible policy responses.

We use statistical analysis to assess the impact of China's threats of economic coercion against countries that challenge it over Taiwan and other issues. We also investigate the social perils that can accompany close economic ties with China, such as restrictions on freedom of speech and the undermining of gender equality. We provide case studies from Latin America, Oceania and Africa, where the competition between Taipei and Beijing has been intense. We also investigate three central European countries - Poland, Hungary and the Czech Republic - where Poland and the Czech Republic are strengthening their relations with Taiwan, and Hungary is a firm supporter of China within the EU. Additional attention is paid to Taiwan's high-tech sector, including electronic manufacturing services and semiconductor production, in the light of the ongoing restructuring of global supply chains.

This study starts by identifying China's use of economic coercion and evaluating its effectiveness. It assesses the impact on the export volume to China of the targeted sectors, the export volume to the rest of the world, and the impact on the total trade volume of the targeted country with China. Finally, it analyses the responses of targeted countries and their policy options. The effectiveness of China's attempts at coercion is highly erratic, depending on a country's relative strength, its trade dependence, and the vagaries of Chinese demand for the products or sector being targeted. The capacity of countries to diversify their markets, and the level of solidarity shown by other countries, are also important factors. We argue that China's readiness to use economic coercion stems partly from the leverage it wields over countries that rely heavily on the Chinese market, and partly from the weakness of the WTO dispute settlement system. The WTO's inability to award compensation undermines deterrence. The problem can be addressed by collective action from countries that rally to the support of those caught in Beijing's sights.

Chapter 2 then assesses the perils associated with Chinese foreign aid, as aid is Beijing's key policy instrument for extending its influence in the developing world. Recent studies suggest that Chinese aid can generate short-term economic growth in recipient countries (Bluhm et al., 2020; Dreher et al., 2021), but its aid diplomacy is accused of being inconsistent with international norms, such as those laid down by the OECD Development Assistance Committee. We map Chinese foreign aid to third countries and examine evidence through statistical analysis of its potential adverse effects. The findings show that Chinese aid tends to erode institutional quality in recipient countries, with a negative effect on democratic development, rule of law, freedom of expression, and gender equality in politics. This process fosters regime corruption. Such aid can also have negative social consequences, such as lower enrollment rates in primary schools and lower gender equality in employment. The findings are robust to alternative statistical models that address the issue of cause and effect. One key implication of this chapter is that China's foreign aid may continue to be detrimental unless Beijing adopts the international norms and standards that are associated with official development assistance (ODA) from OECD countries.

Chapter 3 is a quantitative chapter that uses the econometric method to trace changes in economic growth when a country switches diplomatic recognition from Taipei to Beijing or vice versa. We also track the impact on growth of other Chinese initiatives. These include the introduction of the Belt and Road Initiative to Latin American and the Caribbean in 2013, the first Forum on China-Africa Cooperation (FOCAC) summit held in 2006, the establishment of the China-Pacific Islands Economic Cooperation Forum in 2006, and the launch of the 16+1 format in Central and Eastern Europe (CEE) in 2012. We examine whether these landmarks had a significant impact on growth and whether the effect was positive or negative. The results of this chapter lay down the foundations for further analysis in subsequent chapters. The methodology we use is the Difference-in-Differences formula to assess whether a policy change has made any difference to growth.

The remaining chapters use the DID methodology, supplemented by qualitative analysis that employ methods from the social sciences and anthropology, to assess the broader impact on economies and society. Diplomatic competition between Beijing and Taipei has been particularly fierce in Latin America and the Caribbean, Oceania and Africa. In Central and Eastern Europe, where there have been no switches in diplomatic recognition, there has nonetheless been a significant change in atmosphere. Poland, the Czech Republic, Slovakia, and most recently Lithuania, have all made sympathetic overtures towards Taiwan and backed closer cooperation, while continuing to adhere to the EU's One China policy.

Chapter 4 turns to Latin America and the Caribbean where the diplomatic competition between Taipei and Beijing remains intense. We supplement a study of the numbers with an analysis based on interviews and secondary literature. The quantitative analysis shows that the switching of diplomatic relations from Taipei to Beijing does not necessarily lead to stronger economic performance. In the case of Costa Rica, the economy did grow steadily after switching ties from Taipei to Beijing in 2007, but growth was slower than for neighboring Panama, which remained with Taiwan until 2017. In addition, after building formal ties with China, a trend of trade imbalances became increasingly clear. By 2016, China had become Costa Rica's largest trading partner and also the country with which it maintained the largest trade deficit. However, the prospect of faster growth is not the only factor at play. Some small countries opt to reject Beijing for the higher relational status they get from Taiwan, "a feeling of being accepted and respected." This, however, should not be overstated and economic incentives are often decisive. We thus argue that the Taiwanese government needs to work harder to contribute to the economies of its diplomatic partners.

Chapter 5 investigates Africa, once the scene of intense competition between Taiwan and China, but where Eswatini is now the only country to still recognize Taiwan. We find that the economic impact of ties with Beijing is complex, and China is often far from the decisive factor affecting economic performance. Malawi switched ties to Beijing in 2007 and its exports to China increased but so did its trade deficit (to over US$100 million in 2009 and to a peak of $500 million in 2019). The change has had only a limited impact on its economic performance. Switching relations to Beijing often creates expectations of an economic boost that Chinese and African leaders are unable to deliver. Chinese diplomats, African leaders, and journalists frequently talk up investment pledges and project proposals that never materialize. While China has chalked up a diplomatic victory on the African continent, Taiwan has come to depend increasingly on people-to-people relations, an area that has not received serious study. Taiwan, however, has also tended to apply the principle of reciprocity to countries that break diplomatic relations or challenge its interests, a response that is often counterproductive. Taiwanese private actors have occasionally stepped in to preserve contacts after diplomatic breaks. On occasion, African students in Taiwan, cut off from Taiwanese government support, have been offered help with tuition and living costs. In another example, the Pingtung Christian Hospital in Taiwan stepped in to fund and operate the Taiwanese built Rainbow AIDS clinic in Malawi after Taipei cut support. Such steps are unlikely to generate a lobby for the reestablishment of formal relations, but they can create a constituency of people well-disposed to Taiwan who can help in other ways.

Chapter 6 addresses the diplomatic competition in Oceania against the backdrop of a dynamic geopolitical picture. We first consider the divergent regional perspectives under such headings as "China as an alternative" or "China as a partner" as opposed to "China as a threat." We find that arguments advocating China as an alternative to the traditional regional powers, or as a partner, tend to forego scrutiny of the reality behind China's rhetoric and its repetition of such concepts as "non-interference" and "South-South" engagement. As the world's second largest economy and a growing military influence in the region, China cannot be called a developing country in the same category as the Pacific island states. China's claims of non-interference in the region also need careful examination. We then analyze the economic performance of selected countries using results from the DID method and dig deeper into key economic sectors. It often makes economic sense for small island economies to side with Taiwan. This can present them with economic opportunities and doesn't put them at a disadvantage compared to neighbors that align themselves with China. On the other hand, Chinese aid and loans often boost economic performance for a period, but the gains can be short-lived, as experienced by Samoa. Both Samoa and Tonga are now heavily in debt to China, while Taiwan's remaining partners suffer no such burden. Larger countries whose revenue depends on resource extraction tend to rely heavily on China as an export destination, which makes them vulnerable to political pressure from Beijing. Diversification of import and export markets is identified as an important step in increasing resilience against potential Chinese pressure and maintaining sovereign control over foreign policy.

Chapter 7 addresses Central and Eastern Europe, where Taiwan and China compete for influence even in the absence of any switches in formal ties. We focus on Poland, the Czech Republic and Hungary (the CEE3) and examine the trade and investment activities of Taiwanese and Chinese enterprises. We find that accession to the EU in 2004 and the launch of the 16+1 initiative in 2012 gave new impetus to CEE3 relations with China. However, trade has remained unbalanced. Whereas Chinese exports into the CEE3 have increased substantially, the growth of the CEE3's exports to China remained modest after 2012, and even decreased slightly for a few years after 2014, leading to wider trade deficits. Trade relations between Taiwan and the CEE3 are more balanced. Between 2002 and 2020, imports from Taiwan nearly doubled, while exports to Taiwan tripled. Chinese investments, meanwhile, are still dwarfed by, for example, German multinationals' (MNEs) investments into these countries, with Chinese FDI stock barely accounting for one per cent of total inward FDI stock. Taiwanese investment in the CEE3 is even less significant in percentage terms. One less expected discovery was that most Taiwanese multinational companies with a presence in the CEE3 also have a connection with China: either a subsidy from the Chinese mainland or cooperation at the global level. We also find that for Chinese enterprises, political relations between the home and the host country are of critical importance. Taiwanese enterprises are less concerned about the level of diplomatic cooperation, although political relations do count to some degree. If Taiwan wishes to translate its economic links with the CEE3 countries into diplomatic gains, then investments in more advanced sectors and technologies appears to be the key rather than restricting itself to electronics manufacturing.

Chapter 8 stands alone in this study as it does not focus on state activities. Instead, it investigates the behavior and strategies of Taiwanese technology enterprises, and examines what possible spill-over effect they may have on the political domain. To this end, we chose two industries where Taiwan holds a strong position: electronics manufacturing services (EMS) and semiconductor foundry services. We focus on two regions and one country, Southeast Asia, Central Europe and India, where

Taiwanese enterprises are in the process of relocation, diversification or investment, and where Taiwan appears to be making incremental diplomatic gains. Investments by Taiwanese EMS companies in South and Southeast Asia have been surging lately. They have been fueled by the trade and technology contest between the US and China and the launch of Taiwan's New South Bound Policy, although China's entrenched role as the "world's factory" appears unlikely to be challenged in the near term. In addition, the strategic importance of Taiwan's semiconductor industries has been further affirmed by the current chip shortage crisis and disruptions to supply chains. We argue that the Taiwanese government should align its strategies and policies with the private sector to support the global expansion of Taiwanese high-tech enterprises. This would yield added diplomatic benefits at a time of rising economic nationalism in a way that is distinct from China's system of state capitalism. We further propose the joint development of science-based industry parks, the promotion of digital infrastructure projects through foreign aid, and the establishment of a global semiconductor alliance as practical steps for Taiwan to raise its profile. Such opportunities are on the rise given the growing trade and tech rivalry between the US and China. Any partnership and synergy between the Taiwanese government and Taiwan's high-tech enterprises can only be mutually beneficial.

Key Findings

- Switching ties from Taiwan to China does not necessarily help a country achieve faster economic growth.

- 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' trade 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 the trade restrictions in specific sectors. Even in the targeted sector the impact can be conditioned by strong demand for the product in China.

- Based on data from 117 recipient countries, our models show that Chinese aid can undermine democratic development, rule of law, freedom of expression, and gender equality in the legislative branch, and lead to an increase in corruption. These findings are robust to alternative model specifications that address the issue of reversed cause and effect.

- The case of Costa Rica shows that its economic growth was slower, after switching ties from Taipei to Beijing, than that of a Taiwan-aligned neighbor.

- The "China as an alternative" narrative has taken hold in influential circles in Oceania. However, scrutiny of the reality behind Chinese rhetoric is often lacking, including Beijing's promotion of such concepts as "non-interference" and "South-South" engagement.

- Siding with Taiwan is 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. A diversified import/export market increases economic resilience against Chinese pressure and helps countries preserve independent foreign policies.

- A closer diplomatic relationship with Beijing does not automatically translate into economic growth for African countries. This is because economic links with China are only one of many factors at the local and global levels. In addition, whereas diplomatic relations can help increase exports to China, the growth is often small compared to a surge of Chinese imports, except in the case of heavily resource dependent countries such as Angola.

- 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 become politically vulnerable when they fail to meet the often inflated expectations that tend to accompany initial pledges.

- Taiwanese EMS (Electronics Manufacturing Services) companies' investments began as early as 2000 in Central and Eastern Europe and have had a substantial economic impact on exports and employment. Taiwan's strength in technology is in line with CEE countries' industrial strategies that are aimed at a transformation from manufacturing to research and development.

- Taiwan's semiconductor industry, referred to by some as the "silicon shield" because it's thought to bolster Taiwan's geopolitical position against China, has a highly efficient local cluster and has been cautious about foreign investments. Its two recent investments in the US and Japan have started to change that pattern. Given its new investment plan and leading manufacturing technology, Taiwan Semiconductor Manufacturing Company looks set to continue as the platform leader and a key element in the global semiconductor ecosystem.

Here are some recommendations for the international community, including countries that are considering establishing or strengthening diplomatic relations with China, as well as for the Taiwanese government and business community.

- Whereas the danger of falling into a debt trap through engaging with China is highly publicized, the perils of economic dependence and surging trade deficits are less well known. The international community should highlight these possible adverse effects of too close an alignment with Beijing.

- When China resorts to economic coercion, democratic countries should demonstrate their solidarity diplomatically and economically by encouraging increased imports from the targeted countries. Concerted action by sympathetic countries at the WTO would put pressure on Beijing.

- Countries intending to engage closely with China should be mindful of the potential dangers they face given Beijing's tendency to resort to diplomatic and economic coercion.

- The Taiwanese government should work harder to contribute to the economies of its diplomatic partners by strengthening the role of state-owned companies, such as Taiwan Agricultural Investment and Development Co. Ltd and Mitagri Co. Ltd. in such relationships.

- The Taiwanese government should empower its two state-owned companies to work with the US International Development Finance Corporation to make effective investments in countries that recognize Taiwan.

- The quality of economic and people-to-people relations between Taiwan and African countries plays a greater role in the maintenance and enhancement of ties than government-to-government relations, so Taipei's policy of retributive actions against former partners should be reconsidered.

- There are limited studies on Taiwan's engagement with Oceanian countries. Taiwan's contribution in the region is undervalued and is often discussed only as a sideline in the discussion of geopolitics and China's rise. The international community as well as the Taiwanese government should devote more resources and pay more attention to Taiwan's role in the area.

Here are some suggestions for future research:

- In addition to its shrinking number of diplomatic partners, Taiwan's participation in international organizations is also under continuing threat. The conventional formula of "meaningful participation" that falls short of full membership may no longer suit today's international landscape. How Taiwan can participate in international relations, including the UN system, in what format, and on what legal basis, remains under-researched. This is an area of compelling importance.

- In view of the current restructuring of global supply chains and threats to supply chain security arising from the US-China trade war and COVID-19, as well as the global shortage of computer chips, Taiwan's central role in the sector requires new strategic thinking and further research.

- Dual-use products or technologies play a key role in the technological race. How to prevent critical components or technologies from being diverted to entities or uses beyond their intended scope constitutes a key challenge facing democratic countries, including Taiwan. How to integrate Taiwan into the regulatory framework for advanced technology, whether the Wassenaar Arrangement or the new framework that surfaced from recent discussions between the US and Japan, is a critical issue that deserves more research.

Notes

[1]"1992 consensus" is a vague, ambiguous and controversial concept that may evolve further. It refers to the idea that both Taiwan and the Chinese mainland agree that there is only one China. Whether each side is entitled to decide which China the formula refers to is subject to dispute, as is the question of how China should be represented diplomatically.

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CHAPTER 1
The Threat of China's Economic Coercion

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This chapter examines the characteristics of China's use of economic coercion and assesses its effectiveness. We use four key indicators: policy changes or other responses to the measures; the trade volume between China and the targeted sector; the total volume of trade between the targeted country and China; the trade volume of the targeted sector with the rest of the world. We find that the effectiveness of Chinese economic coercion depends on a number of factors: power asymmetry; trade dependence; the elasticity of China's demand; and the capacity of the targeted sector or country to swiftly diversify export markets. We argue that trade diversification is the first essential step to avoid economic dependence on China and becoming vulnerable to coercive measures. A collective response by like-minded countries also plays a critical role in helping targeted sectors and countries. Joint action can be undertaken to challenge the legality of China's coercive measures at forums such as the WTO dispute settlement system. The EU's recently adopted countermeasure – the Anti-Coercion Instrument - also serves as a good example for countries considering legislation to deter China.

1.1 Introduction

In the past few decades, the People's Republic of China (PRC) has maximized its efforts to isolate Taiwan from international relations. One of its policy instruments is the use of economic statecraft, which aims to lure Taiwan's diplomatic partners with economic benefits or coerce them to behave in a given manner for diplomatic and strategic purposes. China may offer economic benefits, such as foreign aid and trade preferences, with a view to persuading states that recognize Taiwan to switch diplomatic relations. On the other hand, it may resort to economic coercion in order to change their behavior and shape the direction of policy making. Whether the promise of economic benefits materializes, or whether coercion is effective, demands careful analysis.

This chapter complements following chapters that examine in more depth the economic impact on countries that switch diplomatic relations or establish representative offices in Taipei. It aims to illustrate how China uses its economic power to pursue strategic and diplomatic objectives by shaping the behavior of third countries, and in some cases competing with Taiwan for diplomatic partners. The chapter first examines the policy instruments available for China's economic statecraft in general, and assesses its use of economic coercion in particular, and then highlights their characteristics. The chapter then considers the effectiveness of China's use of economic coercion based on four indicators: the trade volume of the targeted sector into the Chinese market; the total trade volume of the targeted country with China; the trade volume of the targeted sector with the rest of the world; and finally, the responses of countries that have been targeted in terms of changed behavior. After assessing the effectiveness of China's use of economic coercion and examining the response of the targeted sectors/countries, this chapter offers suggestions on how to ameliorate the impact of Chinese coercion and how to preserve policy autonomy.

1.2 Policy Instruments for China's Economic Statecraft and their Characteristics

1.2.1 China's Evolving Attitude toward Economic Statecraft

Economic statecraft is understood as the use of economic tools or measures by countries to advance their national and strategic interests (Baldwin, 2020). Scholars have illustrated how the expansion of a country's economic and diplomatic power can lead to much more vigorous use of such methods (Norrism, 2016; Macikenaite, 2020, pp. 108-109). Economic statecraft can be exercised either to entice targeted countries with incentives, or to employ economic coercion to compel a given response (Blanchard & Ripsman, 2013). The available policy tools, national objectives, and the effectiveness of economic coercion or inducements over targeted countries, are all observed indicators and constitute the primary focus for us to examine China's economic statecraft.

China has been described as a master of economic statecraft. However, its use of such foreign policy tools began relatively recently (Suettinger, 2000, p. 15). For decades after the PRC was established in 1949, the Chinese government constantly stressed its commitment to "Five Principles of Peaceful Coexistence", which highlighted anti-hegemony as a fundamental foreign policy goal (Ministry of Foreign Affairs, 2021).[1]

During the Cold War, China repeatedly criticized the US and Soviet Union for using their economic and military power to bully the developing world (Li, 2017; Levine, 1975; Van Ness, 1993). However, since 1980, in line with its growing economic, military and political power, China has increasingly resorted to economic coercion to pursue its national interests (Nephew, 2019). Illustrative examples include an attempt to internationalize the "One China Principle", which requires recognition of Taiwan as an integral part of Chinese territory, and to insist on the principle of non-interference regarding Beijing's control over Hong Kong, Tibet and Xinjiang (Macikenaite, 2020, p. 118).

1.2.2 Economic Statecraft with Chinese Characteristics

China has employed ever more diverse economic tools to further its interests as its economic and diplomatic powers have increased. Positive economic instruments were once favored, including the allocation of foreign aid, investment by state-owned enterprises and foreign development assistance programs for the least developed countries (Li, 2017). In 2018, with a view to coordinating its once fragmented foreign aid administration, the "China International Development Cooperation Agency" was established, representing the first structural change in China's institutional evolution of foreign aid allocation (Rudyak, 2019). This, combined with the Belt and Road Initiative,[2] has led to a more systematic use of positive economic statecraft.

Turning to negative economic statecraft, studies find that China is increasingly resorting to coercive measures from its foreign policy toolbox. They are used to retaliate against countries that challenge China's sovereignty, pose a threat to its national security, or stand against its foreign policy objectives (Li, 2017, p. 18). While being employed more frequently, commentators note that China's use of coercion is usually not long-lasting and not aimed at crippling targeted countries' economies; instead, it is designed to express China's anger and to encourage changes of policy (Macikenaite, 2020, p. 119). China's ambitious agenda now includes attempts to shape the international system through economic coercion (Economy, 2018, p. 186).[3] Its expanding use of such measures can also be understood as a component of a more aggressive foreign policy. China has expanded its self-defined "core interests" and insists on its own interpretations of international law and understanding of international relations.

Beijing's exercise of 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).

1.3 A Review of China's Use of Economic Coercion in Recent Decades

This section uses descriptive statistics to demonstrate quantitatively the effect of economic coercion against other countries. We assess the impact on the following countries that have been targeted in various ways: Norway, Japan, the Philippines, Mongolia, Canada, Palau, Australia and Lithuania. We measure the effectiveness of China's use of economic coercion through four indicators: (1) the value of the targeted product(s) exported to China; (2) the value of the country's total exports to China; (3) the value of the targeted product(s) exported to other countries; and (4) any policy changes undertaken by the targeted country. We aim to offer empirical inputs by displaying the trade effects or policy changes caused by the coercive trade measures.[4]

1.3.1 Economic Coercion against Norway (2010-2016)

China is Norway's largest trading partner in East Asia and one of the most important markets for Norwegian salmon (Chen & Garcia, 2016, p.31). However, in 2010, China-Norway relations suffered a severe setback when the Norwegian parliament-appointed Nobel Committee awarded the Nobel Peace Prize to Liu Xiaobo, a human activist detained by China on charges of endangering national security (The Nobel Peace Prize, 2010). After the announcement, the Chinese government condemned Norway for disrespecting its judicial sovereignty and accused Norway of damaging relations (BBC, 2010). China further declared that stricter inspections would be carried out on Norwegian salmon due to food safety concerns.[5] Lengthy and complicated border inspections resulted in long delays, which were devastating for a fresh product such as salmon. Moreover, in 2015, China announced a full import ban on Norwegian salmon after allegedly detecting infectious salmon anemia, a viral disease (Xinhua, 2015). Relations finally improved in 2016 after China received a formal apology from Norway and the two countries signed a joint communiqué to normalize their relations.[6] The salmon trade resumed soon afterwards.

In this case, China's coercive measures had a significant impact on Norwegian salmon exports (Chen & Garcia, 2016). The import values of Norwegian salmon to China rose and fell according to the scale of the confrontation (Figure 1.1). After the Nobel Prize was awarded to Liu, the export value of salmon to China fell sharply from \$145 million to \$84 million in the next quarter. A sharper decrease followed in 2015 Q1 to Q3, while the import ban was in place. While seriously influenced by Chinese economic measures, Norway successfully increased salmon exports to other markets. The huge surge in the export value of Norwegian salmon in 2013, in the midst of the dispute, supports such an observation. Additionally, notwithstanding the tension between the two countries, China did not cut off all trade relations with Norway. Figure 1.2 also shows that the overall value of Norway's exports to China increased from 2013 Q1 to 2014 Q4 while the salmon restrictions were in place. In brief, even though China expressed its dissatisfaction with Norway with punitive measures on one of its vital exports, the Chinese government did not completely suspend bilateral interaction. However, Beijing's actions were successful since Norway yielded to its demand for an apology, and relations were normalized with the issue of a joint communiqué 2016.

Figure 1.1 The Export Value of Norwegian Salmon to China

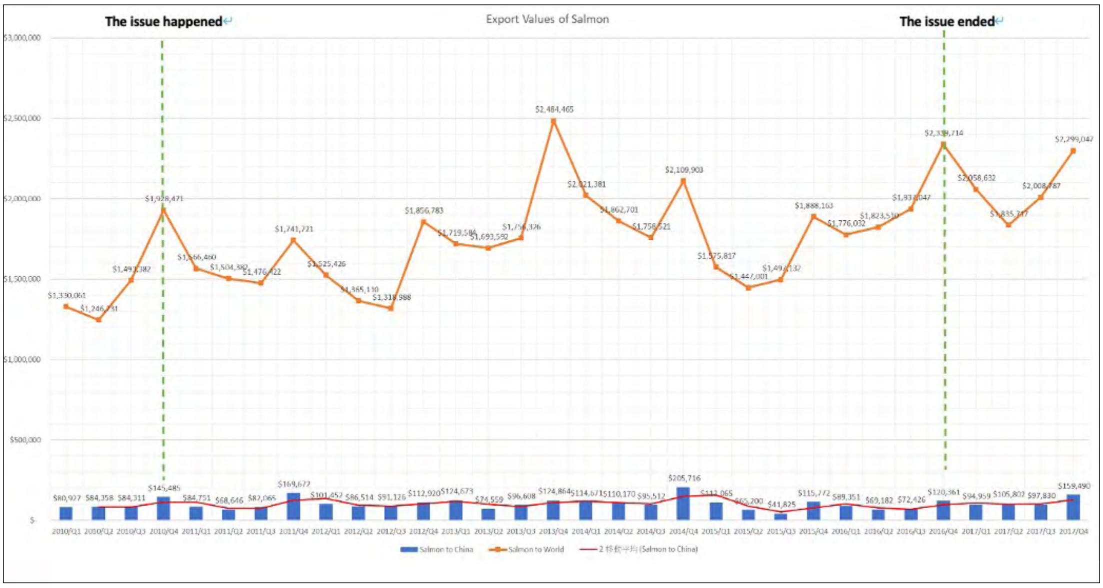
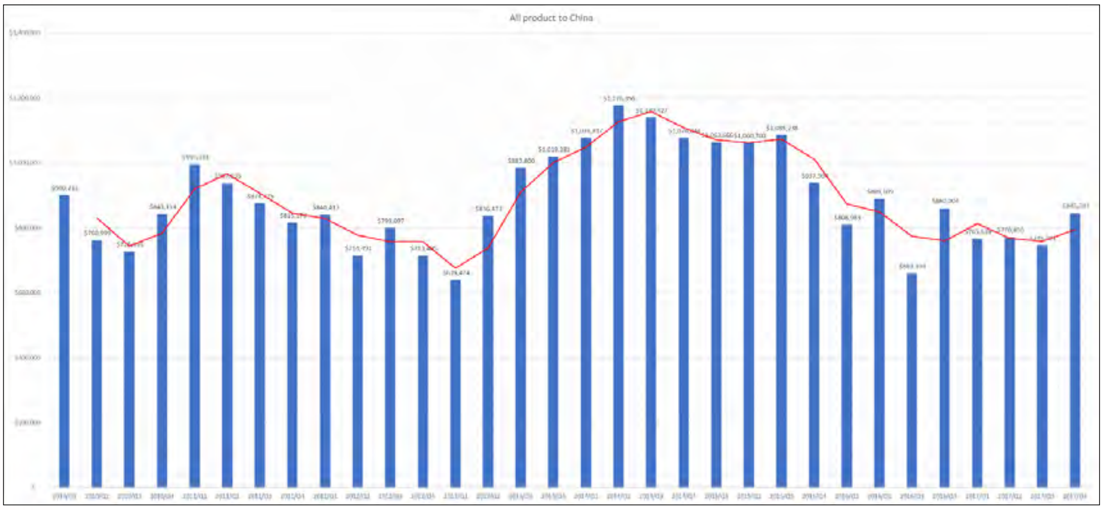


Figure 1.2 Total Export Values from Norway to China

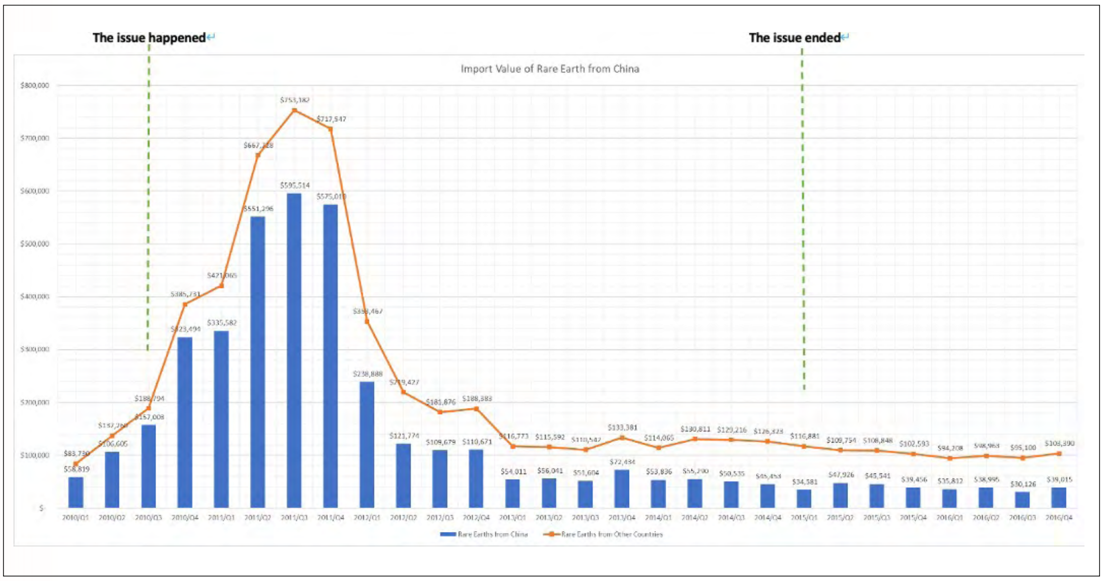


1.3.2 Economic Coercion against Japan (2010-2015)

Japan and China have a close but complicated relationship due to geographical, economic, historical and cultural factors. The territorial and maritime dispute arising from their competing sovereignty claims over the Senkaku/ Diaoyu islands is a fundamental source of tension (Fravel, 2010, p. 144). In 2010, a Chinese fishing vessel collided with a Japanese coast guard patrol boat in the disputed sea area of the uninhabited islands. The Chinese trawler was seized by Japan for illegally entering Japanese controlled waters and unduly interfering with the Japanese coast guard (McCurry, 2010). The Chinese government strongly protested and took steps to halt the export of rare earths globally. While the export ban did not explicitly mention Japan, Tokyo was widely seen as the intended target and Japanese manufacturing suffered severe repercussions given China's control of 97% of global rare earths production (Japantimes, 2010; Jha, 2010). Japan responded by uniting with some of its trade partners to challenge the legitimacy of the Chinese move at the WTO. The claimants won the case in 2014. The Dispute Settlement Body (DSB) of the WTO ruled that China shall lift the export ban and export quotas that were hampering the export of rare earths.[7]

Figure 1.3 shows the import values of rare earths from China and other countries to Japan. While China had begun to cut overall export quotas of rare earths in 2006 because of its own national industry policy (Morrison & Tang, 2012, p. 12), it further restricted the volume of rare earths exports to Japan to retaliate over the territorial dispute. The export restrictions caused the value of rare earths to jump to a historical high in 2011. This phenomenon can be explained by shortages in supply chains that resulted in rocketing prices. Japanese industries managed to reduce their demand for rare earths and cut imports in response. Furthermore, after the WTO ruled that China's export ban was not in line with WTO rules, the import value of Chinese rare earths to Japan stabilized. Thus, Japan did not yield to China's demands, perhaps due to the highly sensitive nature of the territorial dispute. It had successfully collaborated with the US and other countries to challenge the legality of export bans and quotas.

Figure 1.3 The Import Values of Rare Earths from China and other countries to Japan



1.3.3 Economic Coercion against the Philippines (2012-2016)

The Philippines and China have long clashed over their overlapping territorial and maritime claims in the South China Sea (Storey, 1999). After 2012, tension escalated when both sides dispatched coast guard vessels to the waters surrounding the Scarborough Shoal, a chain of reefs off the west coast of the main Philippine island of Luzon, resulting in a prolonged standoff. The tension intensified when the Philippines initiated international arbitration against China's territorial claims under the United Nations Convention on the Law of the Sea and challenged China over the historical rights it claimed in the area (Reed & Wong, 2017).[8] Shortly after these events, China imposed strict phytosanitary controls on bananas imported from the Philippines. While neither the Chinese nor Philippine governments overtly connected the trade restrictions to the South China Sea dispute, the restrictions were imposed at about the same time as the territorial confrontation (Higgins, 2012). Bilateral relations improved in 2016 after the newly elected president of the Philippines, Rodrigo Duterte, sought to restore friendly relations. He agreed to set aside the 2016 arbitral award that had favored the Philippine position (Kreuzer, 2018, pp. 16-23).

The effect of the phytosanitary measures on Philippine bananas can be found in Figure 1.4, which shows that the export value of bananas from the Philippines to China decreased and remained low after 2012 Q1. Nevertheless, exports bounced back in 2014. While the value dropped again in 2015, this was attributed to a drought that significantly reduced the quality and volume of banana production (FAO, 2015-16). Interestingly, the export value of bananas to other countries increased significantly during the period of China's import restrictions (from 2012 Q1 to 2014 Q2), which indicates that the Philippines successfully diverted its banana exports to other markets. Moreover, after President Duterte was elected and decided to mitigate the tension between the Philippines and China, total export values to China significantly increased (Figure 1.5, 2016 Q2-Q4). Political considerations clearly played a critical role in affecting bilateral trade relations. In view of Duterte's decision to set aside the South China Sea arbitration, China was successful in changing the targeted country's behavior.

Figure 1.4 The Export Value of Philippine Bananas to China

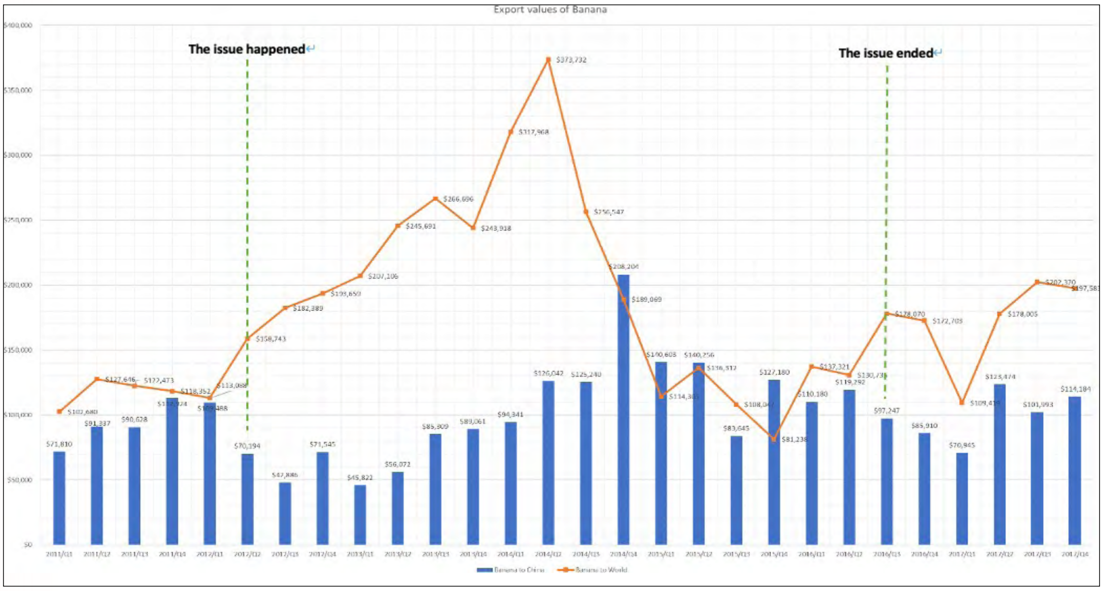
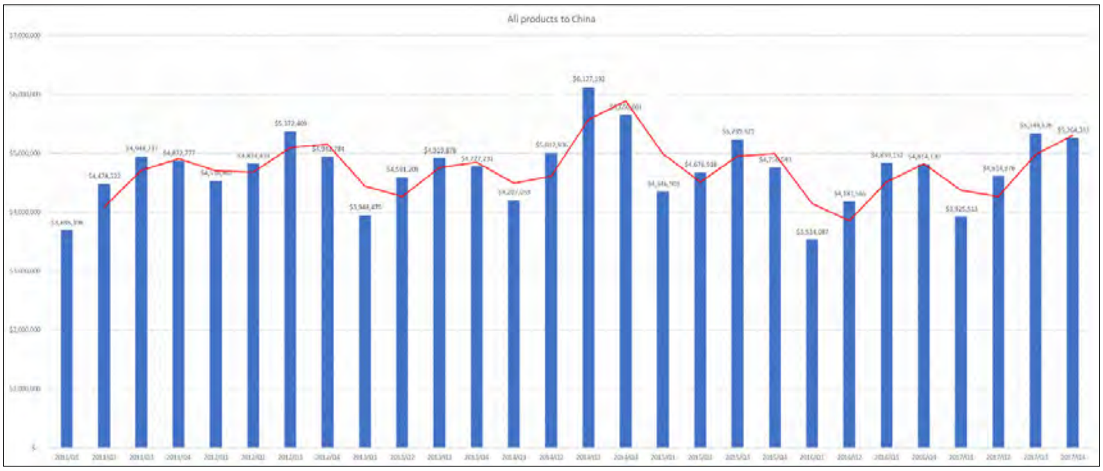


Figure 1.5 Total Export Values from the Philippines to China



1.3.4 Economic Coercion against Mongolia (2016)

China is Mongolia's largest trading partner. Some 89% of Mongolian exports of goods are destined for China.[9] Overall, the relationship between Mongolia and China is smooth and close. Nevertheless, when the Dalai Lama, whom China regards as a dangerous separatist, visited Mongolia in 2016, China asserted that hosting or meeting with the Dalai Lama was a major offense against China's sovereignty and the sentiment of the Chinese people. A week after the Dalai Lama's visit, China raised fees on mining product imports (mainly copper ore) from Mongolia and created delays at various border crossings (AL JAZEERA, 2016). China also announced it would call off ongoing financial assistance negotiations with Mongolia (Aldrich, 2016). While China did not explicitly connect these measures with the visit by the Tibetan spiritual leader, it stated that the "Dalai Lama's furtive visit to Mongolia brought a negative impact to China-Mongolia relations (Reuters, 2017)."

The effect of China's trade disruptive measures is disclosed in Figure 1.6, which displays the export value of copper ore from Mongolia to China. The data show that it declined in December 2016 compared to October and November. Shortly afterwards, the Mongolian government expressed regret at the negative impact caused by its reception of the Dalai Lama and reassured China that it would not invite him back in the future (Caiyu & Tao, 2016). All the indicators in Figure 1.7 have bounced back since 2017. China's use of economic coercion against Mongolia was successful both in terms of curbing the country's exports to China and Mongolia's subsequent change of policy.

Figure 1.6 The Export Value of Mongolian Copper to China and other countries [10]

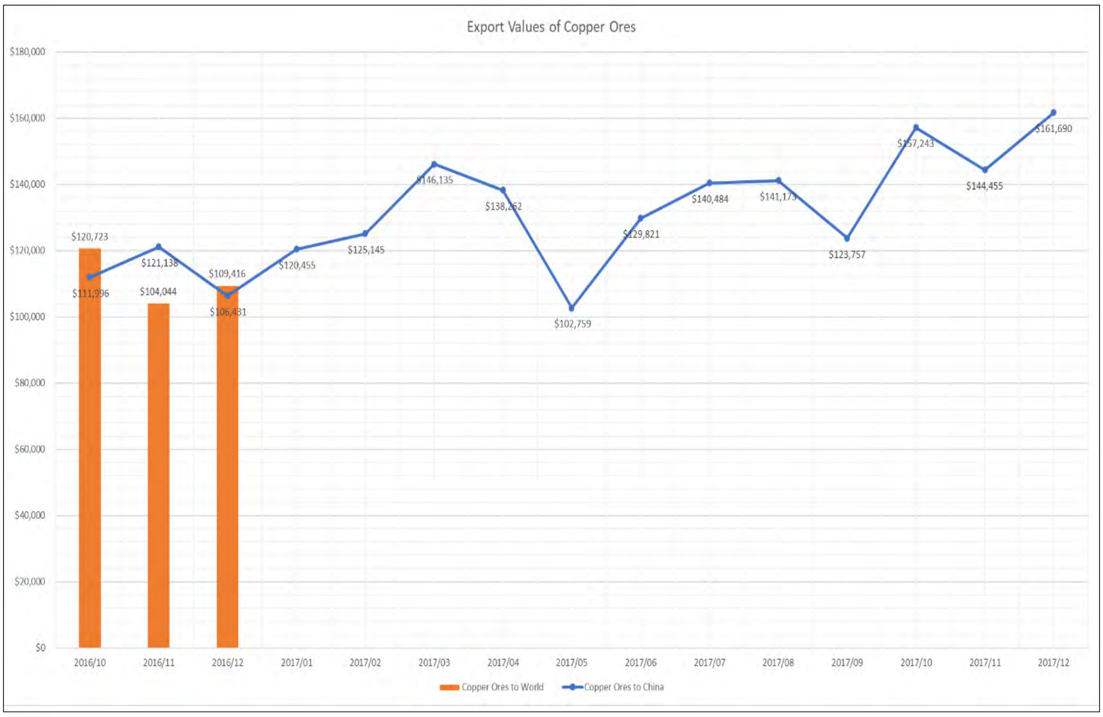
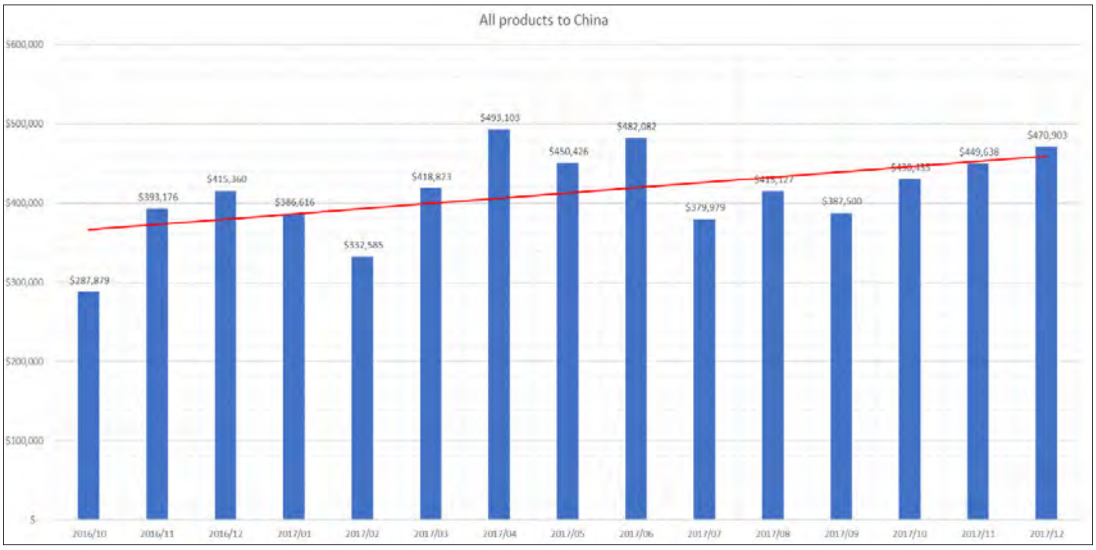


Figure1.7 Total Export Values from Mongolia to China



1.3.5 Economic Coercion against Canada (2018-)

In late 2015, when Justin Trudeau became prime minister, the China-Canada relationship became more cooperative, and trade and investment grew (Blanchfield, 2015). However, Ottawa's relations with Beijing deteriorated shortly after 2018. The turning point was the arrest of Meng Wanzhou, the chief financial officer and deputy chair of Huawei (Wakabayashi & Rappeport, 2018). A few days after her arrest, unilateral economic measures were adopted by the Chinese government to increase pressure on the Canadian government. The targeted product in this case was canola seeds. China accounted for 40% of Canada's exports of the product (Johnson, 2019). It imposed trade restrictions alleging that the seeds carried diseases and were contaminated with insects and weeds that threatened human, animal, and plant health.[11] In response, Canada took its case against China to the WTO and initiated a consultation procedure.

The value of canola exports from Canada to China steadily decreased after January 2019 (Figure 1.8). According to the Canola Council of Canada, canola seed exports to China "were down approximately 70 per cent in 2019 due to trade disruptions, resulting in an estimated $1 billion in lost revenue from canola (Lester, 2021)." However, the value of canola exports to other countries increased after the import ban thanks to Ottawa's drive for new markets to mitigate the impact (Patey, 2021). Nevertheless, as the Meng case dragged on, Canada's canola exports to China steadily rebounded, and in June 2021 they reached $220,637,000, 95.6 percent of the level before Meng was arrested. Also, whereas it is undeniable that overall diplomatic relations between Canada and China have been undermined, Canada's total exports to China first decreased but have grown again since February 2020. They had reached the same level as before the dispute by July 2021 (Figure 1.9). The Meng dispute finally came to an end on 24 September 2021 when Meng and the US Department of Justice reached a settlement and the Canadian court concluded that there was no need for an extradition ruling.

The effectiveness of China's attempt at economic coercion against Canada cut both ways because of the complexity of the case. Meng was arrested because of an extradition request by the US. The move was seen by China as part of Washington's attempt to constrain Huawei's expansion into global 5G networks, a key element in the US-China trade war and technological competition. On the face of it, China succeeded in its aim to get Canada to release Meng. However, her release was in effect the result of a settlement between Meng and the US Department of Justice. Canada's actions came against the backdrop of China's resort to hostage diplomacy. Two Canadian citizens were detained in China on national security charges (BBC, 2019b) and two were executed after convictions on criminal charges (BBC, 2019a). Therefore, the effectiveness of China's economic sanctions must be seen in the light of the broader diplomatic context. Canada's exports of canola continued to increase despite the measures, while China was forced to import canola oil from third countries, much of which derived from Canadian canola seeds, because of its huge demand for the product. China's goal of hitting Canadian exporters had backfired, and Chinese consumers paid the price. Total exports from Canada to China, meanwhile, continued to increase regardless of the dispute. The case provided further evidence that China's high demand for raw materials can stymie its attempts at economic coercion.

Figure 1.8 The Export Value of Canadian Products Targeted by China

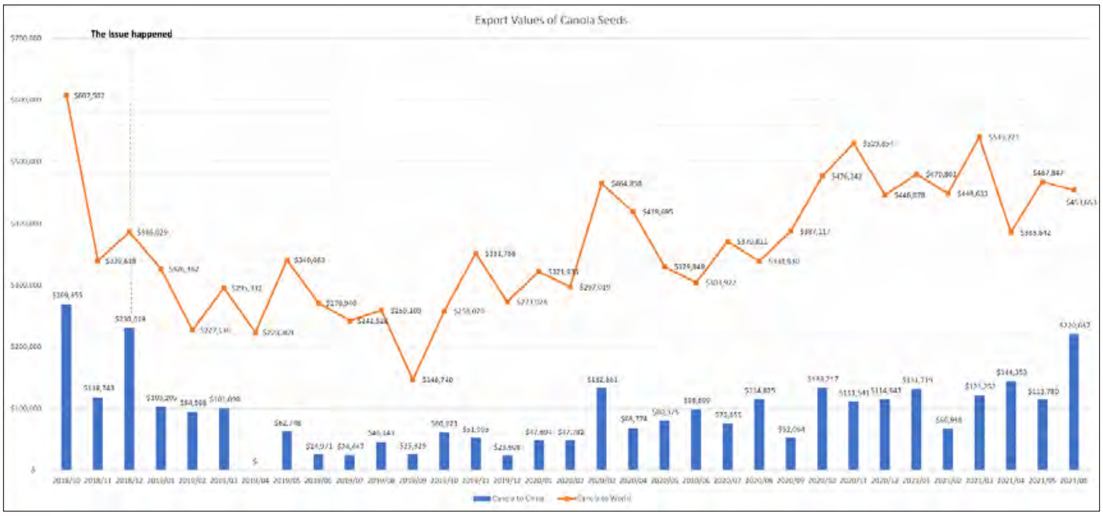
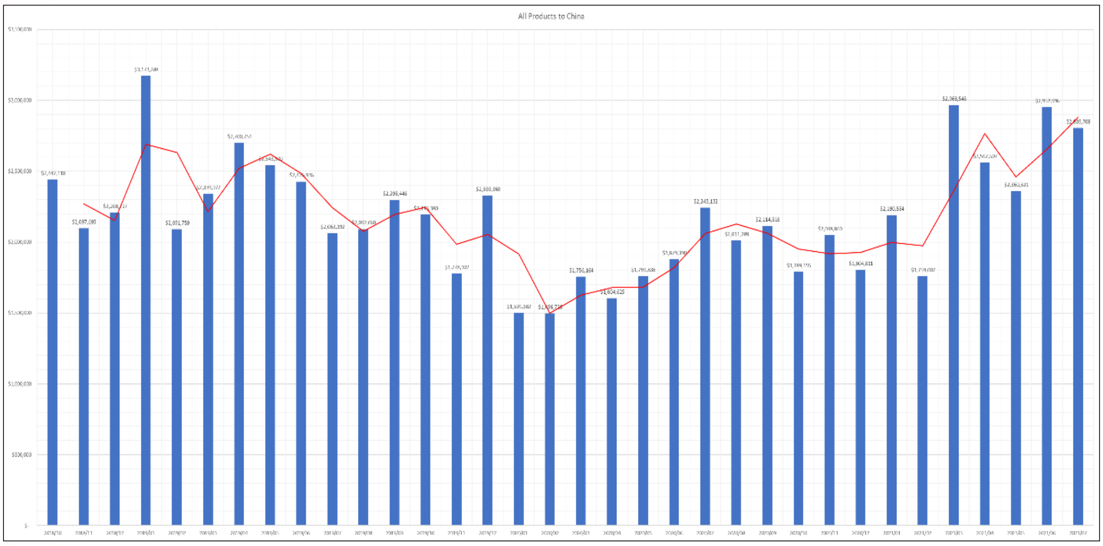


Figure 1.9 Total Export Values from Canada to China

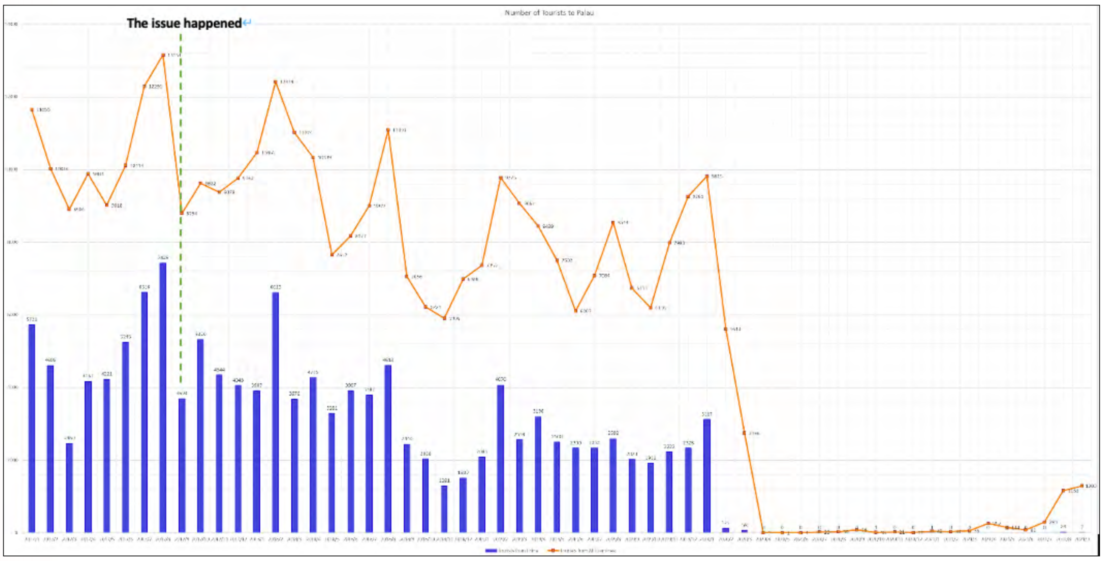


1.3.6 Economic Coercion against Palau (2017-)

Palau is a Pacific nation and one of Taiwan's 14 remaining diplomatic partners. The two countries established diplomatic relations after Palau achieved independence in 1994. Tourism is Palau's main industry, accounting for over 50% of its GDP before the pandemic. Some 50% of the tourists come from China, especially on package tours which constitute a major part of Palau's tourism market (Beldi, 2018). Hence, China has a strong hand in the economy of Palau and Chinese tourists have been weaponized by China to serve its foreign policy – namely to lure and to threaten Palau to shift its diplomatic recognition from Taipei to Beijing. The carrot and the stick have both been used. China's attempt at coercion focused on the use of its Approved Destination Status (ADS) system, which permits state-run tour agents to operate package tours only to listed countries (Arita et al., 2012). In other words, China can punish any country that challenges its national interests simply by removing it from its ADS list and prohibiting operators from sending tourists to that country. This was applied to Palau at the end of 2017 when the Chinese government designated Palau an illegal destination, and banned tourist groups from visiting, because it refused to sever diplomatic relations with Taiwan (Master, 2018).

Figure 1.10 shows the fluctuations of tourist arrivals from China and from the rest of the world. The data[12] suggests that the travel ban imposed by China caused a sharp decline in the number of Chinese tourists, which dropped 22.7% between the third and fourth quarters of 2017. Simultaneously, the total number of tourists declined by 16% over the same period. The statistics correspond with reports and interviews which indicated that the Chinese travel ban had inflicted serious damage (Lyons, 2020). Palau's hotels experienced a substantial drop in bookings after the ban and Palau Pacific Airways announced the termination of flights to China (Master, 2018). However, this attempt at economic coercion was ineffective in its attempt to force Palau to adjust its foreign policy. Palau still maintains diplomatic relations with Taiwan and both sides built closer ties after the outbreak of the pandemic (Agence France-Presse, 2021). Overall, the effectiveness of China's economic coercion against Palau was not decisive even though it did inflict harm. Palau did not yield to China's demands and did not change its diplomatic orientation. Such an outcome highlights how bilateral trade relations are only one part of the picture when geopolitics and strategic interests are in play. Strong support from the US, including security assurances and financial support, are the primary buttresses that enable Palau to resist pressure from China (Seidel, 2018). The fact that the US ambassador to Palau accompanied the Palauan president on an official visit to Taiwan demonstrates the US's strong influence over the Pacific island and its intention to counter China's growing presence in the Pacific.

FIGURE 1.10 NUMBERS OF TOURISTS FROM CHINA AND OTHER COUNTRIES TO PALAU[13]



1.3.7 Economic Coercion against Australia (2020-)

China is Australia's largest trading partner and the relationship between Canberra and Beijing reached new heights in 2015 when the Australia-China free trade agreement was signed.[14] However, in 2020, bilateral relations sharply deteriorated due to Canberra's support for an independent investigation into the origins of COVID-19 and China's handling of the initial outbreak (Wong, 2021). In addition, Canberra expressed concern over China's implementation of the National Security Law in Hong Kong and its suspected use of forced labor in Xinjiang (Reuters, 2021). These steps antagonized the Chinese government, and it has since imposed a series of restrictions on the import of Australian goods, including barley, wine, beef, lobster, and coal. The measures have ranged from levying extra tariffs to imposing import bans and restrictions. Like Canada, Australia also brought Beijing's attempt at economic coercion to the WTO. China responded that its trade measures were applied in line with its obligations.[15]

The impact on the export of the targeted Australian products is illustrated in Figures 1.11 to 1.13. The data suggests that China's trade restrictions resulted in significant decreases in export values. We can even observe that the export of Australian wine, barley and coal were banned outright after December. However, the deterrent effect might not have been as pronounced as expected because the Australian government successfully diverted most of the targeted products to other countries. For example, overall exports of barley and wine increased in the aftermath of China's moves. Coal exports also thrived in 2021 despite China's ban. Commentators noted that "Australian coal exporters seem to have been quite successful in diverting to other markets (Tan, 2021)," and "exports to other markets initially rose as China first reduced its coal imports starting around mid-year. The trend then accelerated as China targeted Australian coal specifically starting in October 2020 (Tan, 2021)." Moreover, Figure 1.14 shows a positive trend in the total value of exports from Australia to China despite the economic measures. The data shows that while Beijing resorted to trade disruption to try to influence Canberra, it remained highly dependent on exports from Australia in other sectors.

China's attempt at economic coercion against Australia was also highly complex and touched on many sensitivities. Australia and China had originally had a close economic relationship, with Australia being one of the first countries to sign a free trade agreement with China. China also accounts for a large proportion of foreign investment in Australia and many Chinese students go to Australia for higher education. Beijing's initial move was likely fueled by anger, but the measures should also be seen in the broad context of Australia's close alliance with the US, including its role in the Indo-Pacific Strategy and subsequently the AUKUS (Australia, UK and US security pact). Trade data demonstrates that China effectively prevented the targeted products from entering the Chinese market, but that Australia overcame any losses by diverting to other markets. Moreover, Australia's total export volume to China increased despite the sanctions, due largely to China's demand for Australian iron ore. Australia did not yield to China's demands for changed policies and challenged the legality of the measures at the WTO. China's attempt at economic coercion cannot be said to have been effective or successful.

Figure 1.11 The Export Value of Australian Barley to China

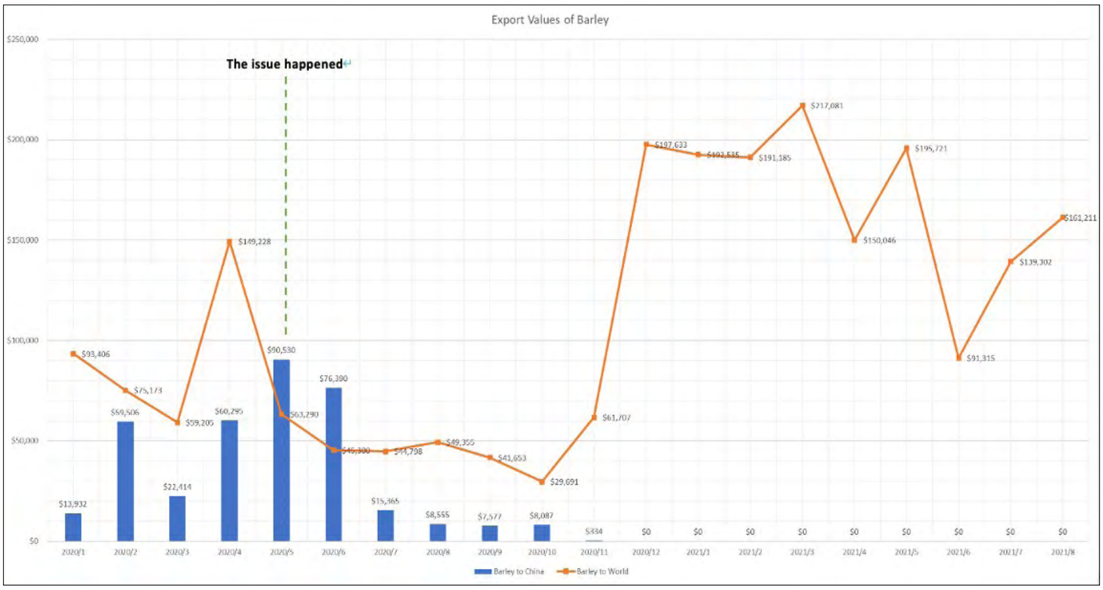


Figure 1.12 The Export Value of Australian Wine to China

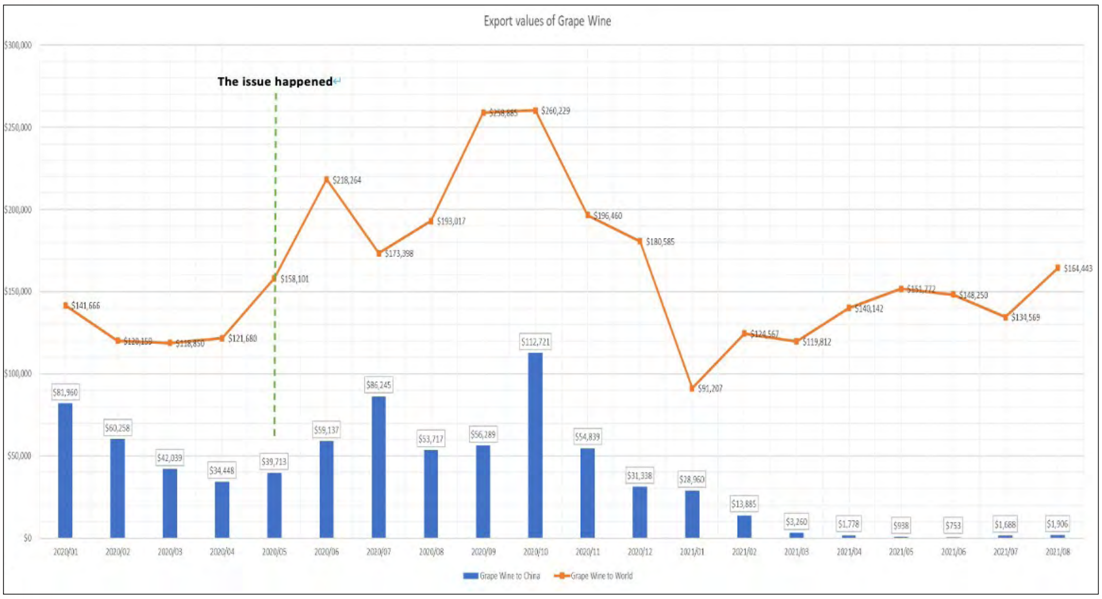


Figure 1.13 The Export Value of Australian Coal to China

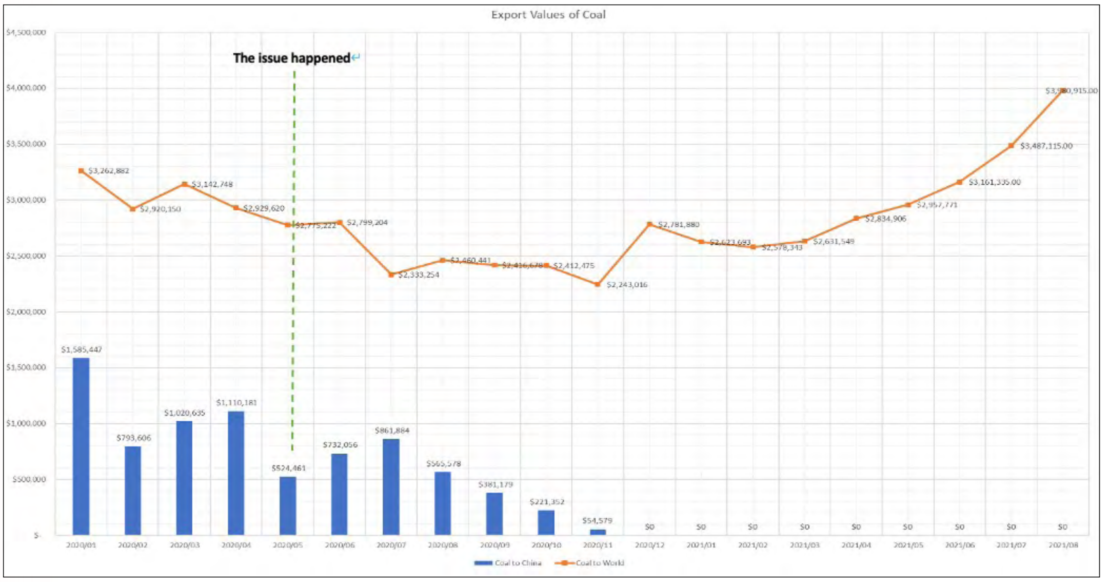
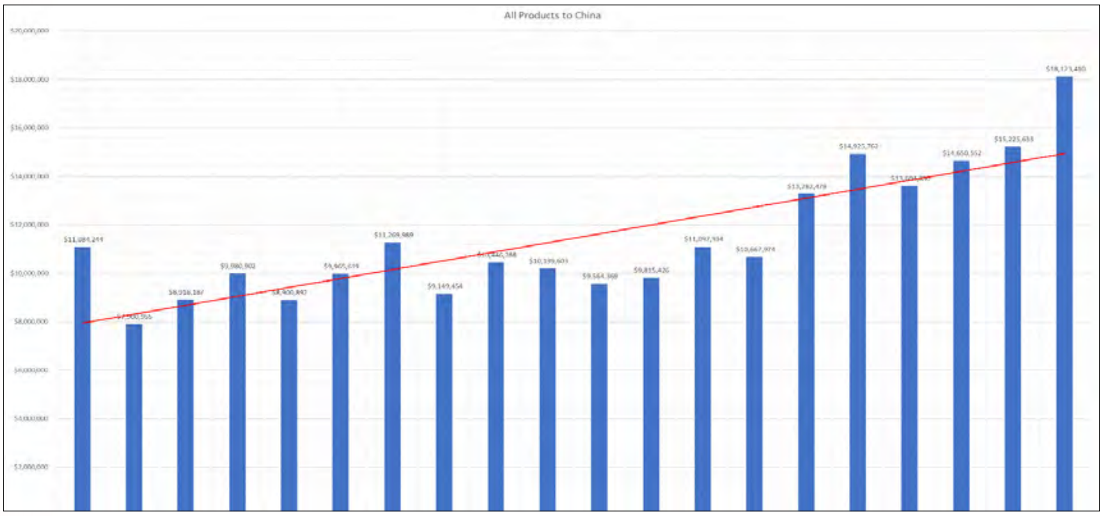


Figure 1.14 Total Export Values from Australia to China



1.3.8 Economic Coercion against Lithuania (2021-)

China and Lithuania established diplomatic relations when Lithuania achieved its independence from the Soviet Union in 1991. However, the relationship has not been easy. In 2021, Vilnius withdrew from the China-CEEC (Central and East European Countries) framework, known as the 16+1 format, because the mechanism was failing to deliver sufficient benefits. Lithuania's foreign minister further appealed to other EU countries to form a unified policy to counter threats from China (Lau, 2021).[16] The latest factor in an escalating confrontation was Lithuania's decision to allow Taiwan to open a de facto embassy in Vilnius under the name of the "Taiwanese Representative Office," in November 2021 (Huang, 2021). China accused Lithuania of undermining its sovereignty (FMPRC.GOV, 2021)[17] and downgraded diplomatic ties from ambassadorial level to that of chargé d'affaires (Lau & Momtaz, 2021). Additionally, an attempt at economic coercion was launched. Some Lithuanian enterprises reported that China appeared to be hindering economic transactions

(Davidson, 2021). Lithuanian enterprises further reported that Chinese customs authorities were blocking their exports by removing Lithuania from the Chinese customs registry system (Sytas, 2021).

Among exports from Lithuania to China, dairy products, beef and timber were reported to have faced disruption. Hence, we investigate the trade flow of these three products to explore the effects of China's measures. Figure 1.15 displays the values of Lithuanian beef, dairy products and timber exports to China from January 2021 to October 2021. We can observe that the export values of the products declined significantly after the confrontation began. There were further falls after December following Beijing's decision to remove Lithuania from its customs registry system (Figure 1.16). The Lithuanian government showed no sign of backing down and appeared robust enough to withstand the pressures from China. It further appealed to the European Commission, which raised concerns over China's unannounced sanctions at the WTO (Nardelli & Baschuk, 2021). Unlike other EU members which have significant interests in maintaining close relations with China, Lithuania's relatively few economic ties have been a shield against attempts at coercion. Given that Lithuania has little to lose from the dispute, it can stand firmly against the pressure (Lau, 2021).

China's coercive and retaliatory measures against Lithuania for allowing Taiwan to establish a representative office under its own name went beyond the expectations of the EU. The deletion of Lithuania from China's customs registry system in effect means a complete ban on Lithuanian exports to China, a blatant violation of WTO laws. In addition, China imposed secondary sanctions by pressuring European enterprises to reject intermediate goods from Lithuania (BBC, 2022), a move that undermines the fundamental principle of the EU internal market: the free circulation of goods. For these reasons, the European Commission felt obliged to challenge the compatibility of China's restrictive measures at the WTO. China's economic sanctions on Lithuania also had repercussions in the US. The EU's Vice President/ High Representative, Josep Borrell Fontelles, and the US Secretary of State, Antony Blinken, "highlighted their shared concerns about escalating political pressure and economic coercion by the People's Republic of China against Lithuania, which are impacting both U.S. and European companies." (US State of Department 2021)

China's attempt to intimidate Lithuania over its outreach to Taiwan has so far failed to effect any change in policy or behavior. In doing so, it also sought to undermine the fundamental principles of EU integration and violated the spirit of the WTO. China's sanctions cannot be said to have been effective, notwithstanding their scale and intensity.

Figure 1.15 The Export Value of Lithuanian Targeted Products to China

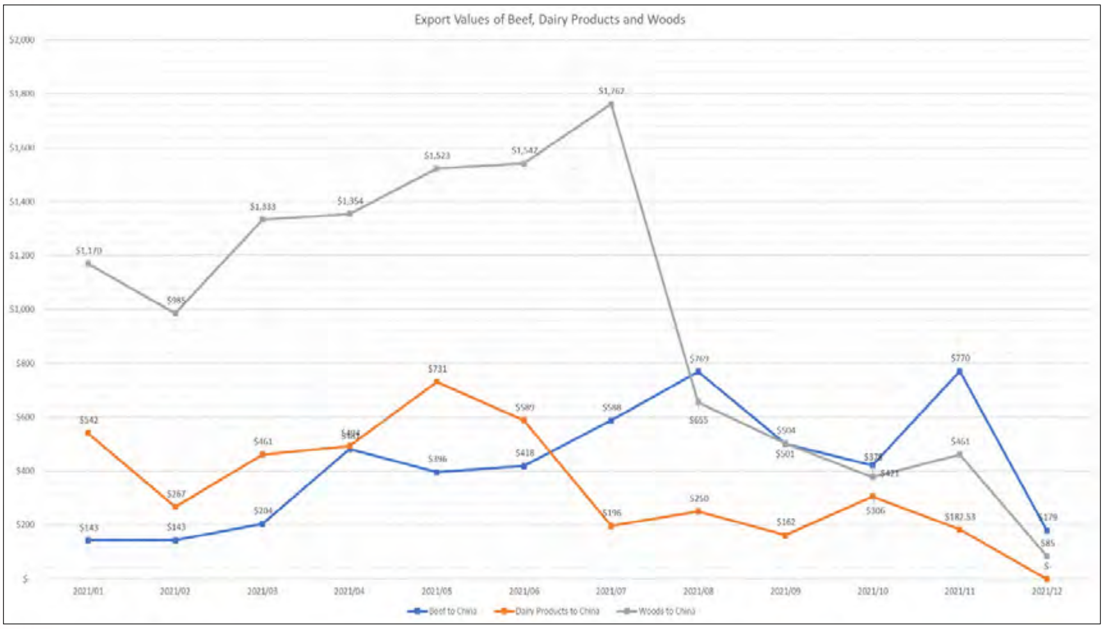
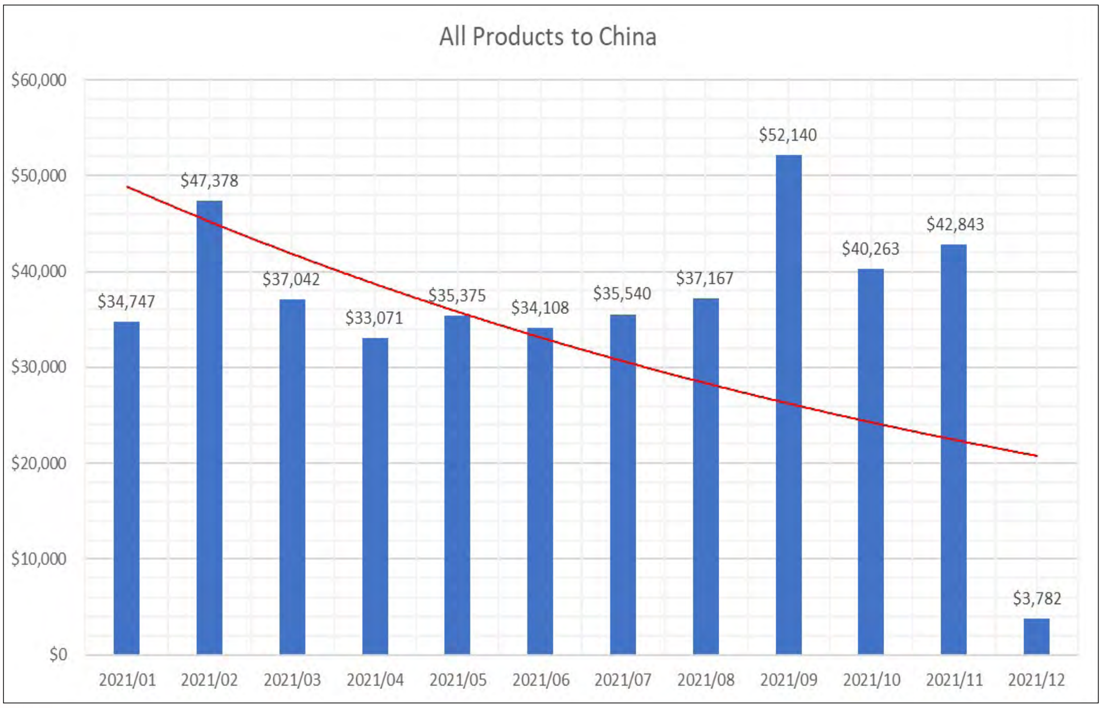


Figure 1.16 Total Export Values from Lithuania to China



1.4 The Effectiveness of China's Attempts at Economic Coercion and Legal and Policy Redress

1.4.1 New Trends and the Effectiveness of Chinese Economic Coercion

After examining China's recent use of coercive economic measures, we demonstrate that China has expanded its use of economic coercion as an important component of its foreign policy. The punitive measures have primarily been triggered when

China considers foreign countries are challenging its core interests, such as meetings with the Dalai Lama, territorial/maritime disputes, or any official engagement with Taiwan. Moreover, a recent trend seems to indicate that even relatively minor offenses against China, such as Meng Wanzhou's detention, or the appeal to China to be transparent over the COVID-19 outbreak, may also result in an economic backlash. Moreover, it seems that China no longer seeks to keep its economic counter-measures free from challenges at the WTO. This development can be understood as an example of China's growing skills at using legal weapons, and its greater confidence in standing up to Western countries in international judicial forums (Yang, 2015).

In terms of its success rate in inflicting damages and forcing policy changes, the descriptive statistics results reveal that China succeeded in some circumstances but not in others (Harrell et al., 2020, pp. 29-30).[18] Any success is at best termed as limited or qualified. Specifically, economic coercion is much more effective against those countries with the following characteristics: First, economic dependence on the Chinese market results in greater harm (Ravindran, 2012, p. 116; Reilly, 2013, p. 9; Macikenaite, 2020, pp. 110-112). For instance, for Mongolia, the Philippines, and Norway, China is an important export market. Hence, punitive action resulted in a significant decrease in exports to China, and subsequently these three countries decided to restore the relationship either by offering a public apology or accepting the Chinese government's demands. Second, power asymmetry between China and targeted countries is a critical factor (Reilly, 2013). Coercive measures are more influential against China's smaller neighbors; in contrast, larger countries have stronger leverage 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 more policy measures to mitigate the effects, enabling them to resist compromise. Moreover, while China is an important market for these countries, conversely, these developed economies also 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).[19]

In brief, we can conclude that China's use of economic coercion is less effective when China and the targeted countries maintain a highly interdependent economic relationship; in contrast, if the targeted country one-sidedly depends on China for exports, China's economic coercion is more likely to succeed. However, it must be recognized that measuring "success" or "failure" merely by examining the impact on trade may be incomplete because other political or diplomatic factors can also help nudge countries towards compliance or resistance (Harrell et al., 2018, p. 30). China's economic coercion against Lithuania best illustrates this. Whereas Lithuania's exports to China significantly decreased and European or foreign enterprises investing in Lithuania were also affected, the economic costs did not automatically produce policy changes from Lithuania. Any retreat by Lithuania would have had geopolitical implications, signaling an erosion both in European solidarity and in transatlantic partnerships.

1.4.2 Legal and Policy Redress against China's Use of Economic Coercion

1.4.2.1 Diversifying economic partnerships to reduce dependence on the Chinese market

As shown by the descriptive statistics results in the previous section, an excessive economic reliance on China renders countries deeply vulnerable to economic coercion (Mazarr & Wyne, 2020). Hence, with a view to mitigating the negative impacts arising from China's economic statecraft, diversification of economic partners is the most effective means to retain independent action and stave off China's fast-growing influence. For instance, in response to China's export ban on rare earths, the Japanese government reacted by supporting its domestic enterprises in their efforts to develop new technologies to reduce dependence on the minerals (Hui, 2021). Alternatively, strengthening a country's role in the supply chain of critical goods for China's domestic production is an effective way to deter sanctions. While China has one of the largest consumer markets in the world, it is still highly dependent on market access, investment flows and advanced technology transfers from Western countries and their allies. Hence, if targeted countries control critical items that are necessary for China's national development blueprint, such as semiconductor chips, coal, and other sources of energy, they can exert this economic leverage to pressurize China to refrain from implementing coercive measures. China's aggressive economic statecraft cannot last long if its coercive measures harm domestic industries.

1.4.2.2 Legal redress and collective responses against China's economic coercion

China's economic statecraft is aimed at challenging the international order founded by the US, in an attempt to forge a direction better suiting China's national interests (Williams, 2020). The competition between China and the US-led camp contains an increasingly important ideological component (Mazarr & Wyne, 2020). Therefore, economic coercion employed by China should not be considered as merely an example of bilateral discord between China and the targeted country. Instead, these coercive measures should be understood in the context of China's ambition to use its economic power to reshape the current rules-based international order (Ginsburg, 2020).

In response to Beijing's ever more aggressive foreign policy, we argue that the immediate priority for democratic countries is to work together and undertake joint action to confront Chinese attempts at economic coercion. To start with, an information-sharing and coordination mechanism should be established. Even though there is no doubt that China is increasingly adopting coercive measures, there has been no attempt at a systematic examination of the patterns, the triggers and the implications of Chinese actions. The primary role of any coordinating mechanism should be cooperation between democratic partners to better understand China's methods and predatory activities (Harrell et al., 2020, p. 36). Annual ministerial level meetings between like-minded countries could be held to serve as a platform for cooperation and to incorporate all possible legal and diplomatic means to build resilience against economic coercion. Ideally, democratic countries could consider the feasibility of launching an international code of conduct in response to China's growing assertiveness, with the aim of regulating the use of economic coercion as a policy tool in international relations. Recently, the EU initiated a proposal for an anti-coercion instrument (ACI), a positive step towards cooperative action (European Commission, 2021).[20]

In addition to any preventive mechanism, we propose that legal remedies under international law should also be in the toolbox available to targeted countries (Glaser, 2021). The available international forums include the WTO and the UN system such as the International Court of Justice (ICJ). Each could be employed depending on the nature of the Chinese action. Some cases could be challenged for violating the principles of non-interference and the prohibition on intervention under Article 2(4) of the UN Charter (Helal, 2019-2020, pp. 98-108). China could also be challenged when it deviates from its legal commitments under WTO agreements. Some might contend that resorting to the international legal system is unlikely to provide meaningful relief for targeted countries because China tends to tailor its measures with such potential challenges in mind (Harrell et al., p. 23; Kreuzer, 2018, pp. 7-14); nor has China consented to the compulsory jurisdiction of the ICJ.[21] Beijing can also utilize its influence as a permanent member of the UN Security Council to counter criticism of its actions. However, we believe that recourse to legal remedies through the WTO or other international judicial forums should still be seriously considered. China now presents itself as a "responsible great power" within the international system and as a faithful supporter of UN-centered multilateralism. It could pay a significant reputational cost if it declined to resolve disputes through a rule-based international judicial forum, or respond to concerns about its aggressive economic statecraft from the international community (Guzman, 2002).[22]

The strategies that Japan, the US and the EU collaboratively adopted, namely, to seek legal recourse against China through the WTO dispute settlement mechanism, could be seen as a successful model (Glaser, 2021). Trade data confirms that after the WTO Appellate Body published its report, China lifted relevant trade restrictions on rare earth exports and notified its implementation to the WTO Dispute Settlement Body.[23] Currently, Canada, Australia, Lithuania and Taiwan are seeking to, or have launched, consultation requests under WTO platforms to express their concerns over China's use of unilateral economic sanctions (Glaser, 2021; Nardelli & Baschuk, 2021). [24] If these countries can adopt a coherent position and produce legal remedies in international forums to challenge China, it would constitute a significant blow against China's ever more assertive economic statecraft.

1.5 Conclusion

After reviewing a series of cases of China's use of economic coercion, we found that while China is a trade giant, its use of economic pressure is not always effective. Its impact is limited or qualified by a number of factors. In some cases, exports from the targeted sector to China do shrink while total global exports increase, as shown in the case of Canadian canola and Australian barley. Moreover, whereas in some cases, such as Australia, the export volume of a given targeted sector to China decreases, the country's total exports to China increase. In some cases, such as over Canadian canola seeds, China eventually implicitly abandoned its import ban because of large domestic demand for the product. Therefore, if a country or a given sector is less dependent on China, it is less likely that China's attempt at economic coercion will be effective. Also, the effectiveness of China's economic coercion also depends on the elasticity of China's demand. If China is highly dependent on the targeted sector and has no access from other sources, it's unlikely to be able to sustain the pressure. Above all, collective action by like-minded countries can help deter China, whether by providing relief for the targeted sector, lending support to the targeted country, or challenging the measures in question in international forums.

Some policy implications can be drawn. Countries should be warned of the danger of being economically overdependent on China, and thus vulnerable to China's economic pressure with a consequent loss of policy autonomy. The diversification of markets is one of the highest priorities for countries aiming to shield themselves against China's economic coercion. Whilst such diversification takes time, once a country is targeted by China, like-minded countries should 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 through the naming and shaming of China's activities. The WTO's inability to adopt disciplinary measures against violations, however, is a significant shortcoming.

Finally, it is worth noting that when a third country switches diplomatic relations from Taiwan to China, Taiwan reacts by revoking or cancelling scholarships given to nationals of the country, as will be illustrated in the Africa chapter. Such action does not amount to economic coercion on the Chinese scale given the obvious difference in size and power between Taiwan and China. Nonetheless, the policy undermines goodwill and social contacts at a time when formal ties are no longer possible. Therefore, we propose an end to such punitive action.

Notes

[1] *See The Five Principles of Peaceful Coexistence*, Ministry of Foreign Affairs, https://www.fmprc.gov.cn/web/ziliao_674904/wjs_674919/2159_674923/t8987.shtml (last visited Dec. 19, 2021). The five principles are: "(1) mutual respect for each other's territorial integrity and sovereignty, (2) mutual non-aggression, (3) mutual non-interference in each other's internal affairs, (4) equality and mutual benefit, and (5) peaceful co-existing".)

[2] The BRI is a "development strategy that aims to build connectivity and cooperation across six main economic corridors encompassing China and: Mongolia and Russia; other Eurasian countries; Central and West Asia; Pakistan; other countries of the Indian sub-continent; and Indochina." See OECD, China's Belt and Road Initiative in the Global Trade, Investment and Finance Landscape, at 3, https://www.oecd.org/finance/Chinas-Belt-and- Road-Initiative-in-the-global-trade-investment-and-finance-landscape.pdf

[3] "Chinese President Xi Jinping has a stated and demonstrated desire to shape the international system, to use China's power to influence others, and to establish the global rules of the game."

[4] We collected the data from the International Trade Centre, which is the joint agency of the World Trade Organization and the United Nations. *See* International Trade Centre, https://www.intracen.org/itc/about/ (last visited Dec. 21, 2021). All the values used in the figures are in thousand US dollars.

[5] Zhonghua Renmin Gongheguo Guojia Zhiliang Jiandu Jianyan Jianyi Zongju (Central office of quality supervision, inspection and quarantine of the People's Republic of China), Guanyu jiaqiang jinkou sanwenyu jianyan jianyi de gonggao (General notice on strengthening inspection and quarantine of imported salmon), January 28, 2011, https://m.cqn.com.cn/zj/content/2011-02/10/content_1155486.htm

[6] Statement of the Government of the People's Republic of China and the Government of the Kingdom of Norway on Normalization of Bilateral Relations, https://www.regjeringen.no/globalassets/departementene/ud/vedlegg/statement_kina.pdf

[7] Appellate Body Report, *China — Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum*, WT/DS433/AB/R (Aug. 7, 2014).

[8] South China Sea Arbitration (Phil. v. China), PCA Case No. 2013-19, Award (UNCLOS ANNEX VII Arb. Trib. July 12, 2016).

[9] Mongolia Balance of Trade, Trading Economics, https://tradingeconomics.com/mongolia/balance-of-trade (Last visited Dec. 15, 2021).

[10] The export values of Mongolian Copper Ores to other countries are missing from the database.

[11] Panel established to review Chinese measures on imports of Canadian canola seeds, WTO, https://www.wto.org/english/news_e/news21_e/dsb_26jul21_e.htm (last visited Dec. 20, 2021).

[12] The data is collected from the official statistics database maintained by the Palauan government: https://www.palaugov.pw/executive- branch/ministries/finance/budgetandplanning/immigration-tourism-statistics/

[13] The number of tourists sharply decreased since February 2020 because of the outbreak of COVID-19.

[14] China-Australia Free Trade Agreement (ChAFTA), Asialink Business, https://asialinkbusiness.com.au/china/getting-started-in-china/china-australia-free-trade-agreement-chafta?doNothing=1 (last visited Dec. 20, 2021).

[15] Panel established to examine Chinese duties on imported Australian wine, WTO, https://www.wto.org/english/news_e/news21_e/dsb_26oct21_e.htm (Last visited Dec. 13, 2020). Australia initiates WTO dispute complaint against Chinese barley duties, WTO, https://www.wto.org/english/news_e/news20_e/ds598rfc_21dec20_e.htm (Last visited Dec. 13, 2020).

[16] Lithuania stressed that "it is high time for the EU to move from a dividing 16+1 format to a more uniting and therefore much more efficient 27+1."

[17] The spokesman of China's Ministry of Foreign Affairs blamed Lithuania for "brazenly violat[ing] the spirit of the communiqué on the establishment of diplomatic relations between China and Lithuania and severely undermin[ing] China's sovereignty and territorial integrity."

[18] The success or failure of coercive measures are be evaluated by several factors, including any change in behavior by third countries or any expression of formal apology or regrets, any substantial concessions or commitments, and the amount of harm inflicted on targeted countries.

[19] For instance, even after imposing export restrictions on rare earths, China refrained from escalating the confrontation with Japan for fear of jeopardizing high-tech Japanese investment. Tougher measures would have further undermined the confidence of Japanese companies in the Chinese investment environment. Similarly, hefty anti-dumping tariffs and other trade restrictive measures on Australian barley, wine, lobster and coal exports, were balanced by an increase in other Australian exports to China. These included mineral resources (i.e., iron ore) where China faces difficulties in finding replacements. The same happened in the case of Canada, where Canada, the world's largest canola exporter constrained China's ability to uphold a widespread, long-term ban. Without giving explicit notice, China resumed the procurement of Canadian canola seeds because of food insecurity caused by the pandemic. Additionally, as we have already demonstrated, total export values from Australia and Canada to China during the year when the measures were imposed were only slightly lower than the year before, which indicate that overall economic relations remained robust regardless of the attempt at economic coercion.

[20] Lithuania and other EU member states have expressed concern about the use of economic coercion and appealed to the EU Commission to establish a mechanism to deter such tactics. This led to the proposal for an EU level legislative instrument to deal with such disruption through a structured and uniform approach. According to the proposal, the concept of economic coercion is defined as "a situation where a third country is seeking to pressure the Union or a member state into making a particular choice by applying or threatening to apply measures affecting trade or investment." If one member state is targeted, the EU is empowered to respond through counter measures, including restrictions on access to the EU market. The EU stated that possible countermeasures under the ACI will be exercised only when necessary and will be consistent with international law. Most importantly, the EU's ACI proposal also emphasized the importance of creating a platform to promote international collaboration with other non-EU member states on the issue of tackling economic coercion. Such a cooperative mechanism corresponds to our policy recommendations in terms of employing a multilateral approach to deter China from using economic coercive measures as part of its economic statecraft.

[21] The Statutes of International Court of Justice, Art. 36.2.

[22] Regarding the concept of reputational costs and its relationship with international law compliance.

[23] Understanding between China and Japan regarding procedures under articles 21 and 22 of the DSU, *China - Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum*, WT/DS433/15 (May 26, 2015).

[24] Note by the Secretariat, *Committee on Sanitary and Phytosanitary Measures - Summary of the meeting*, G/SPS/R/104 (Dec. 17, 2021). *The Taiwan Mission raised specific trade concerns against China at WTO SPS Committee*, Permanent Mission of the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu to the World Trade Organization (Nov. 9, 2021), https://www.roc-taiwan.org/wto_en/post/1600.html

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CHAPTER 2
The Perils of Chinese Foreign Aid

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As China has become a major donor of foreign aid to developing and underdeveloped countries, concerns have been raised about the political and economic consequences for recipient countries. Traditionally, OECD countries offer aid to other countries in the form of official development assistance (ODA), which is usually concessional and conditional. continued aid. However, China advocates the principle of "non-interference" and often gives aid without hard conditionalities on political or economic reforms. Sometimes China also uses its aid to fulfill its political goal of isolating Taiwan, by demanding that recipient countries sever formal diplomatic relations with Taiwan. In this chapter, we argue that non-conditional Chinese aid leads to detrimental political and social consequences in recipient countries. These include the deterioration of democratic development, and an erosion of the rule of law, freedom of expression and gender equality. Poorer quality education can also result and corruption increase. Our arguments are supported by empirical data collected in 117 countries between 2000 and 2017 and by robust to alternative models addressing the issue of reversed causality. This chapter contributes to the literature on the perils of Chinese foreign aid.

2.1 Introduction

The economic growth of China in the 21st century has made it a rising global power and inspired a burgeoning literature on how China is reshaping the landscape of international relations (Beckley, 2012; Brooks & Wohlforth, 2016). For instance, China launched the Belt and Road Initiative (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). As of the end of 2021 China was the leading trade partner of more than 120 countries and an important aid provider for over 93 emerging-market countries. China also increasingly asserts itself on the international stage (Chang-Liao, 2016; Johnston, 2013), a process that accelerated after the outbreak of the COVID-19 pandemic in 2020 (Martin, 2021).

China's tremendous economic growth since the 1980s has transformed it from an aid recipient to a major donor. Dreher et al. (2021, p. 139) report that China had officially "committed, implemented, or completed" foreign development projects worth US$354 billion between 2000 and 2014. The US provided $394 billion of official financing to foreign countries during the same period. As a result, scholars have paid special attention to the motives behind China's foreign aid programs and their consequences (Bräutigam, 2011b; Dreher et al., 2021; Strange et al., 2017).

China 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 (Rich, 2009). It has a policy of not offering foreign aid to countries that maintain formal diplomatic relations with Taiwan, and it uses foreign aid to convince countries, especially less developed ones, to sever official diplomatic ties with Taiwan (Rich, 2009). Recent examples include the break-off of formal diplomatic relations between Taiwan and seven countries between December 2016 and September 2019, including São Tomé and Príncipe (2016), Panama (2017), the Dominican Republic (2018), Burkina Faso (2018), El Salvador (2018), the Solomon Islands (2019), and Panama (2019). ANNEX 2.1 illustrates that many former diplomatic partners of Taiwan began to receive aid from China after they made the switch.

China's use of foreign aid to fulfill its strategic and political goals has raised a number of questions for scholars and policymakers. OECD countries offer official development assistance (ODA) with the stated aim of promoting the economic development and welfare of developing or underdeveloped countries. Donor countries usually set conditionalities that require recipient countries to implement economic or political reforms. These often address macroeconomic mismanagement, human rights violations and corruption (Molenaers et al., 2015; Svensson, 2000). If the recipient countries fail to meet the requirements, they risk cuts in aid. However, Chinese foreign aid is usually unconditional (Li, 2017). Some scholars claim that this gives more flexibility to recipient countries to use the aid in more efficient ways (Lagerkvist, 2009). Furthermore, Chinese aid may benefit recipient countries in certain respects, such as short-term economic growth and the reduction of economic inequality (Bluhm et al., 2020; Dreher et al., 2021). Nevertheless, there is evidence that Chinese aid worsens social and political outcomes because it does not meet the real needs of recipients and is designed to serve only China's strategic goals (Naim, 2007). More importantly, the lack of conditions means no accountability (Ping et al., 2022), so political leaders in recipient countries have inadequate incentives to use the aid effectively. It is against this backdrop that we aim to investigate the political consequences of China's foreign aid with the latest "time-series-cross-national" datasets developed by several international teams.

Before proceeding, we would like to note that China has also become a major lender as well as donor. A growing share of Chinese financing comes in the form of commercially oriented debt-based financing rather than foreign aid. There is no substantive evidence that the China-led AIIB, an international financial institution that follows international standards, issues loans with conditions attached (Chen, 2020). However, it is less clear whether projects under the Belt and Road Initiative (BRI), whose loan packages are not transparent, are offered without conditions. Hurley et al. (2019) have reported that some BRI projects may include conditionalities that can result in "debt traps" or "debt for equity" swaps when borrowers face insolvency. To comprehensively evaluate how China's financial outflows influence foreign countries we focus on China's overall development finance portfolio, including aid projects, export credits and debt (Dreher et al., 2022).

In the next section, we discuss the political and social perils of Chinese aid in recipient countries and consider related hypotheses. In the empirical section, we describe our research design and test our hypotheses with empirical data. The final section discusses the implications of our findings and offers concluding remarks.

2.2 Arguments

In this chapter, we argue that China's aid, due to its frequent lack of transparency and conditionality, tends to have negative consequences in recipient countries. Although many other donors also take account of strategic considerations when allocating aid (Dreher & Fuchs, 2015; Woods, 2008), Beijing's approach has caused more alarm. As pointed out by Bräutigam (2011a), China's foreign aid programs are less transparent than ODA from OECD countries and so less accountable (Ping et al., 2022). Some researchers have even labeled its aid as "rogue" for its focus on political considerations (Naim, 2007) even if it can sometimes boost short-term growth (Bluhm et al., 2020; Dreher et al., 2021).

Based on previous studies, we argue that the lack of conditionality attached to Chinese aid leads to decreases in institutional quality in recipient countries, including their democratic development and other institutional sub-components such as rule of law, freedom of expression and gender equality. Such aid can also have negative social consequences on public health, education, and employment. We elaborate our argument below.

2.2.1 Level of Democracy

In the literature of foreign aid, it is well documented that foreign aid with conditionalities can promote democracy in recipient countries. The key mechanism underlying this aid-democracy nexus is that donors allocate aid with conditionalities that reward democratization and recipient countries respond to this incentive for democratic reform. Without the conditionalities, recipient countries can view foreign aid as a form of lucrative rent and this retards the improvement of government institutions. Using data from 122 countries between 1972 and 2011, Kersting and Kilby (2014) find that aid improves democracy in both the short and long run. Wright (2008a, 2008b) further demonstrates that the conditionalities of foreign aid are effective in facilitating democratization in autocracies when leaders expect to remain in power during a process of political liberalization. Specifically, they need to distribute resources to larger coalitions in exchange for political support. This distribution to a larger coalition increases the prospect of election victories during the process of democratization. As a result, autocrats with larger coalitions have a stronger incentive to democratize their countries in response to aid than those that rely on smaller support groups.

We argue that Chinese aid, due to its lack of conditions for the promotion of democracy, does not facilitate democratization in recipient countries. Furthermore, it can be detrimental to their democratic development because the inflow of Chinese aid as an alternative financial source reduces the incentive of political leaders to implement reforms that improve governance. As reported by Ping et al. (2022), receiving aid from China reduces horizontal accountability between judicial and legislative institutions in recipient countries. Similarly, Li (2017) demonstrates that after China became a major donor to African countries, the inflows of Chinese aid to Sub-Saharan Africa reduced the effects of OECD development aid on democratization. Meanwhile, African countries have not developed higher levels of political freedom after receiving Chinese aid. Based on these insights, we propose the first hypothesis of this chapter:

H1: Countries receiving more aid from China have lower levels of democratic development.

2.2.2 Rule of Law

According to O'Donnell (2004, p. 33), the minimal meaning of rule of law is "that whatever law exists is written down and publicly promulgated by an appropriate authority before the events meant to be regulated by it and is fairly applied by relevant state institutions including the judiciary." In other words, the essence of rule of law is that the state apparatus and its agents are subject to a set of legally based rules. As the state is constrained, citizens' political and economic rights are protected. Accordingly, political institutions that uphold the rule of law and constrain political powers will contribute to economic development because individuals are not disincentivized by potential state appropriation of their economic gains (Haggard et al., 2008; Wright, 2008a).

Previous studies have investigated the effect of foreign aid on rule of law in recipient countries. Although donors can always set conditionalities to ask recipient countries to improve the rule of law, foreign aid programs may fail in this goal because political elites in recipient countries have little incentive to completely implement institutional reforms that undermine vested interests (Erbeznik, 2011). Nevertheless, in a recent study, Dawson and Swiss (2020) analyze the data of 154 countries between 1995 and 2013 and find that foreign aid targeting security and judiciary reforms does increase the likelihood of reforms that enhance the rule of law. In other words, foreign aid, once properly designed with conditionalities, can enhance the rule of law in recipient countries (Holmes, 1999).

In this article, we argue that Chinese aid undermines rule of law in recipient countries due to its non-conditionality. When receiving aid from China, political leaders have no incentive to reform, but instead disburse Chinese aid to their inner circles to sustain their power. For instance, Dreher et al. (2019) find that the birth regions of African leaders receive more Chinese aid, especially when elections are approaching and when those elections are strongly contested. Such a bias towards leaders' birth-regions is not detected for foreign aid allocated by the World Bank. In other words, inflows of Chinese aid into developing countries enhances political elites' capacity to evade institutional constraints on their power. Accordingly, we propose the following hypothesis on the relationship between Chinese foreign aid and the rule of law in recipient countries:

H2: Countries receiving more aid from China have less adherence to the rule of law.

2.2.3 Freedom of Expression

In this article, we argue that Chinese foreign aid inhibits freedom of expression in recipient countries. Existing studies find that the influence of foreign aid on freedom of expression in recipient countries varies depending on the recipient's political system. Using data from 106 recipient countries between 1994 and 2010, Dutta and Williamson (2016) find that aid has a significant positive impact on media freedom in democracies but not in autocracies. According to Dutta and Williamson (2016), foreign aid fails to promote media freedom in authoritarian countries due to a lack of oversight, accountability, and transparency. By contrast, in democratic countries where there are checks and balances, foreign aid tends to promote media freedom through financial support and improved infrastructure. We argue that lack of conditionality makes Chinese aid more harmful than traditional ODA to freedom of expression in autocracies, because recipient countries tend also to comply with China's demands for censorship of news reports that could harm China's international image.

The political system of the recipient country and those of its trading partners are also factors when assessing the impact on freedom of expression. Gamso (2021) investigates whether the rise of China has promoted media censorship in its trading partners and whether this varies according to their political systems. He argues that countries that trade with China have increased levels of censorship because China wants to reduce negative media coverage. Specifically, China exports technology and provides economic incentives for its trading partners to seek control over their media environments. Using 163 countries between 2002 and 2014, Gamso (2021) finds that media censorship has spread from China to its trading partners, particularly in democracies that trade closely with China.

Based on these insights, we argue that Chinese aid does not promote freedom of expression in recipient countries, a result of Beijing's desire to reduce negative media coverage about China. In other words, Chinese aid is detrimental to the development of freedom of expression because the inflow of Chinese aid increases China's market power over the recipient country and impedes the flow of any information about dissatisfaction with the Chinese government. Based on these discussions, we propose the following hypothesis:

H3: Countries receiving more aid from China have less freedom of expression.

2.2.4 Gender Inequality in Politics

Foreign aid distributed in the form of ODA is sometimes tied to the condition of narrowing gender inequality. For instance, Donno et al. (2021) demonstrate that foreign aid dependence was associated with advances in women's political representation and legal equality and rights under autocracies. Specifically, autocracies enact gender-related legislation at a higher rate than democracies due to pressure from aid donors. Another way to achieve gender equality is to set gender quotas in legislatures. More female representation leads to more legislation on gender equality. Like other ODA projects, the success of foreign aid in improving gender equality via female legislative quotas depends on the donor's conditions and the recipient's willingness to accept the conditions. Edgell (2017) finds that foreign aid in general does not lead to an increase in recipient countries' gender quotas, but foreign aid from the US does. There are two mechanisms to explain this difference. On the one hand, recipient countries use gender quotas as a signal of their willingness to reform and so secure future aid flows. On the other hand, the adoption of gender quotas results from successful foreign aid interventions specifically designed to narrow gender inequality. As a result, countries are more likely to adopt gender quotas the more they rely on US foreign aid.

In this article, we show that Chinese aid does not address gender inequality in recipient countries. Instead, it widens it because political leaders in recipient countries face less pressure to share power with female political elites in their legislatures. Based on this reasoning, we propose the following hypothesis:

H4: Countries receiving more aid from China have higher levels of gender inequality

2.2.5 Corruption

It is well-documented in the literature that foreign aid can lead to corruption in recipient countries. The key mechanism underlying this aid-corruption nexus is that politicians in recipient countries engage in rent-seeking activities when they receive foreign aid (Svensson, 2000). Specifically, inflows of foreign aid not only relax government budget constraints but also lead to a decrease in the provision of public goods. Politicians have a stronger incentive to embezzle government revenue if they receive more foreign aid. However, some studies show that foreign aid can reduce corruption in recipient countries if the donors set conditionalities on anti-corruption measures (Asongu, 2012). China's often condition-free aid can therefore be lucrative but "toxic" (Naim, 2007). Therefore, we formulate the following hypothesis:

H5: Countries receiving more aid from China have more corruption.

2.2.6 Social Aspects

In this chapter we also evaluate the effects of Chinese aid on other social outcomes. We argue that the unconditional nature of Chinese aid means it makes fewer demands on governments to fund public health, education, and to tackle gender inequality. It effectively reduces incentives to divert funds to the social sector. It is widely accepted that "unearned income," such as natural resources or foreign aid, can encourage political leaders to disburse resources to their private patron-client networks. It is because of such moral hazards that conditions are normally attached to foreign aid. Therefore, we propose the following hypotheses:

H6a: Receiving aid from China has no effect on life expectancy in recipient countries.

H6b: Receiving aid from China has no effect on death rates in recipient countries.

H7a: Receiving aid from China has no effect on primary school enrollment rates in recipient countries.

H7b: Receiving aid from China has a negative effect on primary school enrollment rates in recipient countries.

Recent studies have shown that Chinese aid can lead to short-term economic growth in recipient countries (Dreher et al., 2021). China's overseas finance is often channeled into infrastructure, which may enhance employment rates. However, such projects require more male laborers than female ones. Accordingly, we propose the following two hypotheses regarding the effect of Chinese aid on gender inequality in employment in recipient countries.

H8a: Countries receiving more aid from China have higher male employment rates.

H8b: Countries receiving more aid from China have lower female employment rates.

2.3 Empirical Analysis

Data. To test our hypotheses, we utilize the latest version of the AidData project's Global Chinese Development Finance Dataset and construct a dataset of several important political and economic variables in addition to data on China's foreign aid and investment in 117 countries during the period from 2000 to 2017. In particular, the AidData team has made a tremendous effort to collect detailed data on China's international development projects, encompassing 13,427 projects worth $843 billion across 165 countries since 2000 (Strange et al., 2017). We would like to note that there are other authoritative sources of data on Chinese aid, such as the one maintained by the SAIS China Africa Research Initiative (SAIS-CARI) based at Johns Hopkins University. Yet, AidData provides the most comprehensive record in that time period (Dreher et al., 2022), so we have opted to use it in our empirical analysis.

Key Explanatory Variable. The key independent variable in this article is the total amount of Chinese foreign aid sent to other countries (in constant 2017 US dollars). We would also like to note that China's aid refers to the Chinese government's official finance to foreign countries, including aid and debt-financed projects, because China's allocation of foreign aid does not follow the standards of the OECD Development Assistance Committee (DAC).

Dependent Variables. In this article, we focus on the political and social consequences of Chinese aid. The data on these variables are taken from the V-Dem project (Coppedge et al., 2021) and other international organizations, such as the World Bank. We describe the operationalization of these variables below.

2.3.1 Level of Democracy

We use the index of electoral democracy created by the V-Dem project as a measure of democracy. The index interrogates the extent to which the ideal of electoral democracy in its fullest sense is achieved (Coppedge et al., 2021, p. 43). Specifically, this is a composite measure that investigates how responsive rulers are to citizens in the holding of elections, how freely political and civil society organizations are able to operate, whether or not elections are clean, and whether freedom of expression and media freedom allow the presentation of alternative political views between elections. Based on our discussion in the previous section, we expect that countries receiving more Chinese aid would have lower levels of democratic development.

2.3.2 Rule of Law

Our second dependent variable is the rule of law in countries receiving Chinese aid. Again, we adopt the index of rule of law constructed by the V-Dem project. In particular, this measure investigates "to what extent are laws transparently, independently, predictably, impartially, and equally enforced, and to what extent do the actions of government officials comply with the law" (Coppedge et al., 2021, p. 299). As we have set out in the previous section, we expect countries receiving more Chinese aid to have lower adherence to the rule of law.

2.3.3 *Freedom of Expression*

Recent studies have paid special attention to China's export of authoritarianism to other countries. We hypothesize that China's foreign aid plays a similar role in endangering freedom of expression in recipient countries. We rely on the V-Dem project's freedom of expression index to test this hypothesis. This index measures the level of a government's "respect towards the press and media freedom, the freedom of ordinary people to discuss political matters at home and in the public sphere, as well as freedom of academic and cultural expression" (Coppedge et al., 2021, p. 307).

2.3.4 *Gender Inequality in Politics*

To measure gender inequality, we use the V-Dem project's index on gender quotas in legislatures. It measures whether there is "a national-level gender quota for the lower (or unicameral) chamber of the legislature" (Coppedge et al., 2021, p. 157). There are four levels of gender equality recorded by this variable: (1) No national level gender quota; (2) a statutory gender quota for all parties without sanctions for noncompliance; (3) statutory gender quotas for all parties with weak sanctions for noncompliance; (4) statutory gender quotas for all parties with strong sanctions for noncompliance; (5) reserved seats in the legislature for women. We rescale this 1-5 ordinal variable into a 0-1 scale, with higher values indicative of more female political representation in a country's lower chamber.

2.3.5 *Corruption*

We also investigate whether countries receiving more Chinese aid engage in more corruption. We rely on the V-Dem project's data to measure the extent to which political actors use their position for private or political gain. As discussed in the previous section, politicians are more likely to abuse their power for private gain when foreign aid is allocated without conditionality. As most Chinese foreign aid projects are non-conditional, we expect countries receiving more Chinese to have higher levels of corruption.

2.3.6 *Life Expectancy*

We use the index on life expectancy at birth (total years), included in the World Development Indicators (WDI), which indicates "the number of years a newborn infant would live if prevailing patterns of mortality at the time of its birth were to stay the same throughout its life."

2.3.7 *Death Rate*

To measure death rates, we use the WDI index on crude death rates (per 1,000 people), which indicates "the number of deaths occurring during the year per 1,000 population estimated at midyear."

2.3.8 *School Enrollment*

We use the WDI index on the enrollment of primary education to investigate the influence of Chinese aid on education. This measure indicates "the ratio of total enrollment, regardless of age, to the population of the age group that should be in primary education."

2.3.9 *Employment*

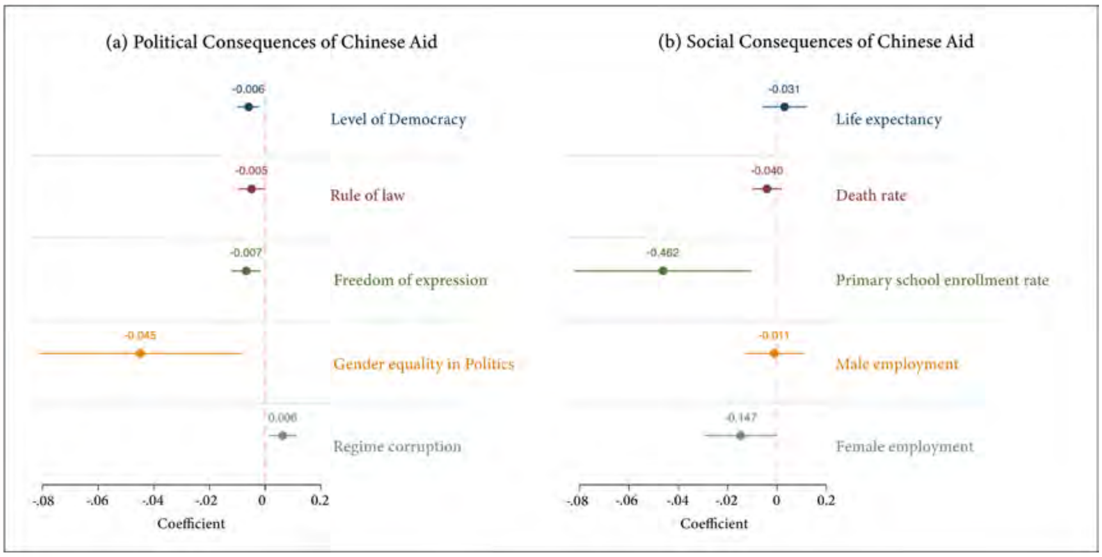
To measure the male employment rate, we use the WDI index on employment to population ratio (15+, male, %), which indicates the proportion of a country's male population that is employed. We also use a similar measure for the female population.

Estimation Results. With the variables discussed above, we estimate a series of regression models to investigate the effect of Chinese aid (the key independent variable, IV) on several political and social outcomes (dependent variables, DVs) in recipient countries. In these regression models, we estimate coefficients that describe the relationship between Chinese aid and different DVs. A positive coefficient indicates a positive relationship whereas a negative coefficient indicates a negative relationship. We also estimate standard errors of those coefficients, with larger standard errors indicative of larger uncertainty. Allowing that a country's political and social outcomes may not be solely determined by Chinese aid but other factors, such as its political stability and economic development, we include an additional set of IVs in our regression models, such as recipient countries' GDP per capita, economic growth, population size, endowment of natural resources, political stability, and ODA from other countries. We discuss the details of the operationalization of these control variables in ANNEX 2.2.

We report the full results of our estimation in ANNEX 2.3 and ANNEX 2.4. Here we mainly focus on the role of Chinese aid in shaping political and social outcomes in recipient countries. Figure 2.1 summarizes the coefficients of Chinese aid in our regression models in ANNEX 2.3 and ANNEX 2.4 with the different political and social outcomes as the DVs. The solid circles indicate the estimated relationships between Chinese aid and the DVs. A positive coefficient indicates that the relationship between Chinese aid and the DV is positive. The horizontal bar, based on the standard errors of estimated coefficients, indicates the 90% confidence intervals measuring the uncertainty of our estimation. When a horizontal bar of a coefficient overlaps with the dashed vertical line of 0, it means that the relationship between the IV and DV is statistically indistinguishable from 0. If a horizontal bar does not overlap with the dash line, the estimated coefficient can be used to represent the direction and magnitude of the relationship between Chinese aid and the DV.

Specifically, Figure 2.1(a) suggests that countries receiving more aid from China have lower levels of democracy, rule of law, freedom of expression and gender equality in politics. They also have higher levels of regime corruption. All of these relationships are statistically significant (i.e., different from 0) because their 90% confidence intervals do not overlap with the dashed vertical line. Meanwhile, Figure 2.1(b) shows that Chinese aid is negatively related to the enrollment rate of primary education and female employment in recipient countries. However, Chinese aid has no impact on recipient countries' life expectancy, death rates and male employment ratio because their 90% confidence intervals overlap with 0.

Figure 2.1 Estimates for the Political and Social Consequences of Chinese Aid

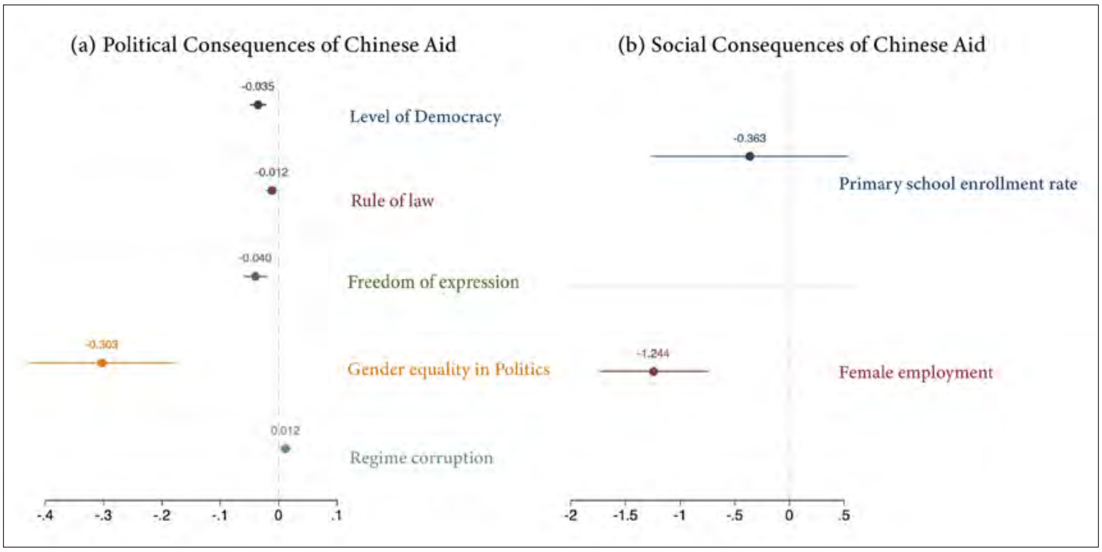


Note: Solid circles indicate the point estimates for the effects of Chinese aid on recipient countries' political and social outcomes in the regression models in ANNEX 2.3 and 2.4. A positive point estimate indicates positive effects of Chinese aid on the corresponding political or social outcome. The horizontal bars indicate the 90% confidence levels measuring the uncertainty of the point estimates. A point estimate with a 90% confidence level overlapping with the dashed vertical line of 0 indicates that the effect of Chinese aid on that political or social outcome is not statistically different from 0.

The model raises the question of cause and effect. How reliably can we say that Chinese aid was the trigger for the outcome found. For instance, it might be the case that countries with a low level of democratic development are more likely to receive Chinese aid. Similarly, corrupt politicians might be more likely to receive aid from China because conditions are less likely to be attached. To guard against this issue of reversed causality in our estimation, we follow previous studies and estimate two-stage instrument-variable (IV) regression models. The estimated results, as fully reported in ANNEX 2.5 and partially illustrated in Figure 2.2, suggest that most of our main findings in Figure 2.1 still hold, except for the model on enrollment rates for primary education.

Based on these results, we conclude that Chinese aid does result in negative political and social consequences. In addition, Chinese aid does not improve public health outcomes, such as life expectancy and death rates. In other words, most of the hypotheses are supported by empirical evidence, except H7a and H7b on primary education and H8a on male employment.

Figure 2.2 Addressing the Issue of Reversed Causality



Note: Solid circles indicate the point estimates for the effects of Chinese aid on recipient countries' political and social outcomes in the regression models in ANNEX 2.5. A positive point estimate indicates the positive effects of Chinese aid on corresponding political or social outcomes. The horizontal bars indicate 90% confidence levels measuring the uncertainty of the point estimates. A point estimate with a 90% confidence level that overlaps with the dashed vertical line of 0 indicates that the effect of Chinese aid on that political or social outcome is not statistically different from 0.

2.4 Discussion and Conclusions

As China has become a major donor of foreign aid, concern has increased about the political and economic consequences in recipient countries. Traditionally, OECD countries offer ODA with concessional and conditional terms to other countries, while China follows the principle of non-interference and offers much of its aid without conditions. Occasionally China also uses aid to pursue its political goal of isolating Taiwan by demanding recipient countries sever formal diplomatic relations with Taiwan.

We have argued that the non-conditionality of Chinese aid entrenches the power of political leaders without contributing to democratic development or accountability. Specifically, Chinese foreign aid can lift budget constraints that inhibit political leaders in the recipient countries. The unconditional nature of Chinese aid enables political elites to shake off restrictions on their power. Furthermore, without anti-corruption conditionality, political elites in recipient countries have a greater incentive to engage in rent-seeking. Recipient countries also tend to cooperate with Beijing's request that they limit any negative news reports against China, thereby inhibiting freedom of expression. Countries taking aid from Beijing also become less dependent on assistance from democratic countries and so have fewer incentives to improve gender equality in politics. Moreover, China's aid results in a deterioration in other social outcomes, such as primary education enrollment and female employment. In short, receiving Chinese aid results in detrimental political and social consequences in recipient countries.

To test our argument, 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 and suggest that Chinese aid leads to deteriorating political and social outcomes. Nevertheless, we found no empirical evidence to suggest that Chinese aid has a substantive effect on public health, life expectancy or death rates.

Although our findings shed light on the emerging literature on Chinese aid, they have some limitations. First, we could not analyze a more extended period due to data limitations because the AidData project on China's overseas development finance only covers the post-2000 period. Second, this chapter regards all Chinese aid as less (or non-) conditional, but some Chinese aid projects do conform more closely to international norms on ODA. Future studies may fill this gap by differentiating such aid from other official flows (OOF) and investigate its effects in recipient countries. Similarly, we do not analyze the heterogeneous effect of Chinese aid in different recipient countries, where different social and political conditions are in play. For instance, Chinese aid may inhibit democratic development in countries that are already less democratic. It may also increase corruption in countries that are already highly corrupt Although we have addressed the issue of reversed causality in this chapter, future studies may further explore the impact of specific country circumstances.

It has to be highlighted that our empirical analysis also suggests that the political and social effects of Chinese aid are usually the opposite to those of ODA from other donors (see detailed discussions in ANNEX 2.2). Even when other donor countries' strategic objectives are similar to China's, the effects of their aid on recipient countries still differ from China's. It appears to be the lack of transparency and conditionality that leads to such divergent political and social outcomes. One avenue of investigation is to evaluate the impact of aid on countries that cut formal diplomatic relations with Taiwan and then start receiving aid from China. However, there are challenges. First, the data on Chinese foreign aid to third countries only became publicly available after 2000. Second, Taiwan keeps secret the detailed data of its foreign aid. Advanced statistical models are needed to estimate the scale of Taiwan's foreign aid to its diplomatic partners.

The findings in this chapter provide further insights into the context of China's rise. Although some literature suggests that Chinese aid can boost economic development (Dreher et al., 2021), we show that such assistance is not a free lunch but a potential menace. Other donors should also be aware of the potential impact on their own aid when recipient countries also receive assistance from China. ODA donors should try to coordinate their aid disbursements with China in particular countries and encourage Beijing to apply internationalized recognized standards.

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CHAPTER 3

The Promise of Growth: a "Difference-In Deifferences" Analysis of the Economic Impact of Switching Diplomatic Relations Between Taiwan and China

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This chapter is the quantitative component for the research project on the economic impact of diplomatic engagement with Taiwan and China. We apply the Difference-in-Differences (DID) approach to investigate whether an event that occurred in a certain year leads to better or worse economic performance – be it the severance of diplomatic ties with Taiwan in exchange for the recognition of China, or the launch of significant Chinese investment programs in the region. According to our empirical results, South Africa's economy did not improve after it cut ties with Taiwan in 1998. Croatia, the Czech Republic, Hungary, Montenegro and Slovenia also did not perform better economically, relative to Turkey, after the launch of China's 16+1 initiative, which excluded Ankara. Results from Latin America and the Caribbean also cast doubt on Beijing's assertions that the Belt and Road Initiative (BRI) brings great economic benefits to its partners. In Oceania, Tonga, which switched recognition to China in 1998, has still not shown stronger economic performance than neighboring countries, while Taiwan's partner, Tuvalu, has enjoyed positive economic growth relative to its control country.

3.1 Introduction

Taiwan's diplomatic isolation began when it lost its right to the "China seat" at the United Nations in 1971 and was replaced by the People's Republic of China (PRC). It lost the recognition of over four dozen countries, including the US, in the years that followed, and has more recently suffered further setbacks. Seven countries cut diplomatic ties in the period from 2016 to 2019: Sao Tome and Principe, Panama, Dominica, Burkina Faso, El Salvador, the Solomon Islands, and Kiribati. In December 2021, Nicaragua also cut diplomatic ties and switched recognition to Beijing. The rapid rise of China's political and economic strength has been a decisive factor in these losses. But Taiwan is still working hard to participate in international organizations, such as the World Health Organization (WHO). It aims through trade, investment, tourism and technological exchanges to send a message to the world that "Taiwan can help".

This chapter aims to provide the empirical foundation to assess the impact of having diplomatic relations with Taiwan or China and provide results for further analytical examination. It is aided by additional data and observations in the region-based chapters that follow. We apply the Difference-in-Differences (DID) approach, an econometric technique developed by Card and Krueger (Card & Krueger, 1994), to implement data-driven comparative case studies. Under the DID framework, we investigate whether an event that occurred in a certain year – be it a severance of diplomatic ties with Taiwan in exchange for recognition of China, or the launch of Chinese investment programs in the region – leads to better or worse economic performance. The variable, GDP per capita in log form, was sourced from the United Nations (UN) Data for Oceanian countries and the World Bank's World Development Indicators (WDI) for Africa, Latin America and the Caribbean (LAC), and Central and Eastern Europe (CEE). The data are complete until 2019. The global outbreak of COVID-19 in early 2020 had such a global economic impact that data from 2020 are more volatile.

3.2 Methodology

DID is our econometric model of choice to observe the variation in economic performance between two countries. A detailed description of the development and advantages of this methodology is included in ANNEX 3.1 along with the equations used in the regression model, while a simplified example of its application is outlined below followed by an explanation of how it was utilized in this chapter.

3.2.1 DID example

When observing the impact in 2019 of a certain economic event or change of policy that occurred in 2013 in country A, now termed the treated country, the year 2013 is hereafter referred to as the "interruption year".

To conduct such an examination, we first select a "control country", referred to as country B, which ideally is located in the same region and has a similar culture, language, education level, and political and economic policies as country A. We then set an empirical period to observe, which in this example is from 2008 until 2019, in other words beginning well before the interruption year.

Figure 3.1 illustrates the trend of GDP per capita of both countries in the selected period from 2008 to 2019. The difference in GDP per capita between the two countries was US$100 in 2008, as shown in Table 3.1. This $100 gap remained fixed until the interruption year, when the treated country adopted the economic policy in question and started feeling its impact. By 2019, the difference in GDP per capita between country A and B has widened to $700. The dotted line in Figure 3.1 is the assumed parallel – the expected GDP per capita trend for country A if it had not adopted the policy, keeping the fixed $100 difference to country B. A Difference-in-Differences calculation is then carried out by comparing the average change over time in the outcome variable for the treated country to the average change over time for the control country – subtracting the differences between the two countries before and after the implementation of the new policy: $700 – $100. Therefore, the DID result is $600, which illustrates the impact of the change on country A and shows that its economic performance was better than that of the control country after the interruption year.

Figure 3.1 Difference in Differences Method

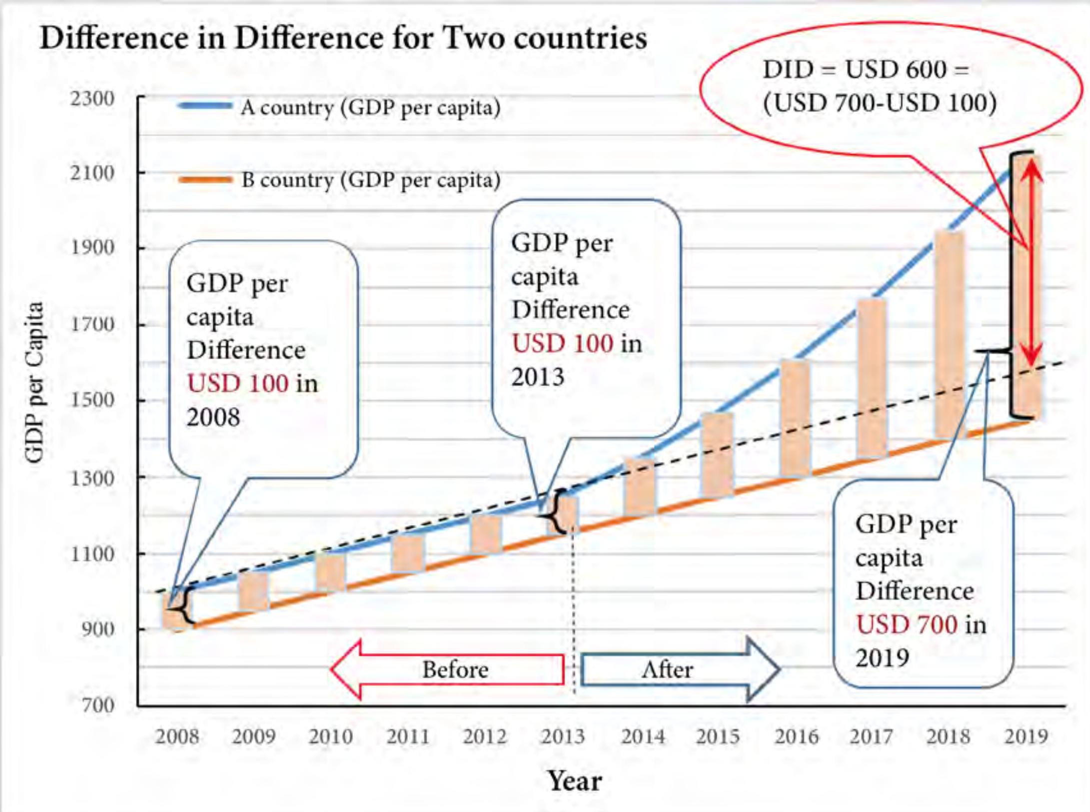


Table 3.1 Difference in Differences Method

Year	2013	2019
Country A (GDP per capita in USD)	1,250	2,150
Country B (GDP per capita in USD)	1,150	1,450
Difference	100	700
Difference-in-Differences= (700 – 100) = 600		

3.2.2 *DID application in this chapter*

In this chapter, we aim to apply the DID method to estimate the effect of an event, for example the establishment or severance of relations with Taiwan or China, on the economic performance of our treated countries. Our variable, GDP per capita in log form, was sourced from the UN Data for the Oceanian countries and the WDI for the three remaining regions.

As a chief objective of this chapter is to supply empirical results for the regional-based discussions, our selection of the treated countries is mainly informed by the contributors to those chapters. Two key considerations are relevant: whether these countries have switched their diplomatic relations from Taipei to Beijing or vice versa, or in the case of no formal diplomatic shift, whether bilateral relations have been strengthened; and the scale of trade and investment relations these countries maintain with Taiwan and China. The control countries, on the other hand, are chosen based on region, GDP per capita, income level, size of population and cultural affinity. We made our best efforts to choose a control country in the same region, if available.

The interruption years for different treated countries were either the years when they broke diplomatic ties with Taiwan in favor of China, or vice versa (also referred to as "breaking year" in these cases), or the date when China launched major investment drives in the region.

2006 was selected for the nine African countries examined, the year of the third Forum on China-Africa Cooperation (FOCAC). The importance of this event is reflected by a sharp increase in trade and investment between China and African countries in the years that followed (See Chapter 5). FOCAC was first held in 2000 and 2003 as ministerial meetings, but the 2006 event was held in Beijing as a full summit, with 41 heads of state from Africa attending. China's first policy white paper on Africa was presented in the same year, along with specific financial commitments. They included $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. The forum also set the pattern for the subsequent triannual forums.

2012 was chosen as the interruption year for the 16 CEE countries examined because it was the year the 16+1 framework was launched under the title: Cooperation between China and Central and Eastern European Countries. China's goal was to introduce the Belt and Road Initiative (BRI) into the region through the framework (see Chapter 7). China's drive for investment in the CEE countries can be seen as part of an effort to open up the European market and connect it to China through new links across Central Asia (see Chapter 7).

2013 was picked for the 33 Latin American countries examined, the year when China launched the BRI along with its branches in Latin America. Since then, China has been increasingly able to use economic statecraft, including infrastructure investment, to pursue its strategic goals (see Chapter 4). Some studies suggest that the BRI could help Chinese partners achieve stronger economic performance. Therefore, we examine whether GDP in the treated countries slowed down after 2013 compared to that of a long-term Chinese partner (also see Chapter 4).

2006 was selected for the ten Oceanian countries, the year of the first China-Pacific

Island Countries Economic Development and Cooperation Forum (hereafter referred to as "China Pacific Forum") and the visit of the then Chinese premier, Wen Jiabao. China significantly increased its economic presence and aid engagement in the Pacific after 2006 (see Chapter 6).

The interruption and breaking years divide the empirical period into the pre-breaking and post-breaking periods. By comparing the GDP per capita differences between two countries in both periods, a DID value is obtained. In addition, a DID trend graph is produced for treated countries that warrant further discussion. The DID trend is produced by treating each year in the empirical period as an interruption to yield multiple DID results, before plotting these resulting values into a curve that can better explain the economic development before and after the interruption. That is, it dynamically maps out the GDP per capita differences between the treated and control countries throughout the observed period.

3.3 Empirical Results

The four regions examined by this empirical study are Africa, CEE, LAC, and Oceania. A comprehensive result of the DID analyses is provided in the ANNEX while we focus on selected countries for detailed DID regression and trend analysis. For Africa, two out of the ten treated countries were chosen: Malawi and South Africa. In the CEE, two out of the 16 were selected: The Czech Republic and Hungary. In LAC, five out of 33: Costa Rica, Dominica, Grenada, Guatemala, and Saint Lucia. In Oceania, two out of ten: Tonga and Tuvalu. Most of these countries either switched diplomatic relations or are diplomatic or trade partners of Taiwan.

For each treated country discussed, two graphs are presented: a GDP per capita trend of both the treated and control countries on the left, and one for the DID trend on the right. The GDP trend graph outlines the paths of economic performance measured by (the log of) GDP per capita over the entire study period, with the solid line representing the GDP per capita of the treated country, and the dashed line denoting its counterpart drawn from the control country. A vertical dotted line denotes the year of the interruption.

The DID trend graph, on the other hand, shows the DID result values plotted on a curve for each year of the empirical period. That is to say, the DID trend graph dynamically maps out the GDP per capita differences between the treated and control countries throughout the observed period of time. When the DID trend goes up, the economic growth rate of the treated country is higher than that of the control, indicating stronger economic growth than the other country. When the DID trend goes down, the economic growth rate of the treated country is slower than that of the control.

3.3.1 Africa

A total of nine African countries – Burkina Faso, the Central African Republic, Chad, Eswatini, Malawi, Sao Tome and Principe, Senegal, South Africa, and the Gambia – were selected to undergo DID analysis (see ANNEX 3.2). Control countries were assigned to treated countries on the basis of similarities in GDP per capita and other relevant factors noted above. The interruption year of 2006 was applied - the year of the third FOCAC, while additional breaking years were employed for countries that had broken off ties with Taiwan: 1998 for South Africa, 2008 for Malawi, and 2016 for São Tomé and Príncipe.

The default empirical period for African countries is from 1998 to 2019. However, the WDI database lacks data for São Tomé and Príncipe before 2001, thus the empirical period 2001 to 2019 was selected for it. South Africa broke ties with Taiwan in 1998, but as 1990 was the year that saw the release of Nelson Mandela, which was swiftly followed by the end of apartheid in 1991 and subsequent revocation of sanctions, the period of 1990 to 2019 was adopted.

In the nine observed countries presented in **ANNEX 3.2**, Burkina Faso, São Tomé and Príncipe, Senegal, South Africa and the Gambia experienced economic downturns that were statistically significant after the third FOCAC took place in 2006. On the other hand, Chad and Malawi are observed to have experienced economic growth after 2006. The Central Africa Republic and Eswatini did not produce results that are statistically significant.

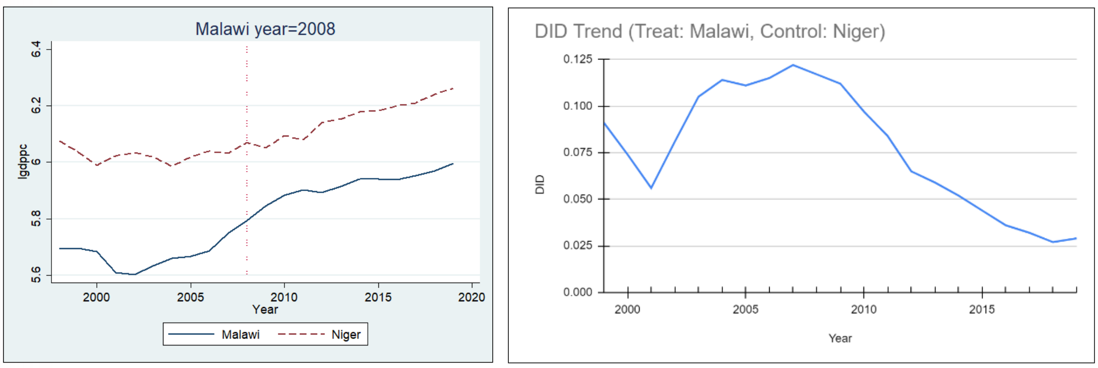
In this treated pool, two countries that switched diplomatic allegiance between Taiwan and China – Malawi and South Africa – yielded statistically significant results thus warranting additional DID trend analysis and further discussion. A table showing the DID trends for African countries is included in ANNEX 3.3.

3.3.1.1 Malawi

Figure 3.2 shows the treated country, Malawi, alongside its control country, Niger, during the period 1998 to 2019. The DID illustrates the (log of) GDP per capita trend and the breaking year, 2008, when Malawi cut diplomatic ties with Taiwan. The right graph illustrates the DID trend from 1998 to 2019 and displays all positive DID values in this period. Compared with the control country, the DID trend for GDP per capita in Malawi went down from 1999 to 2001.

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 the magnitude of its growth rate was less than that of Niger, and the economic performance of Malawi began to slow during the six years following the establishment of ties with China. From 2015 to 2019, DID results are statistically insignificant; therefore, we cannot say whether Malawi had a better or worse economic performance in this period.

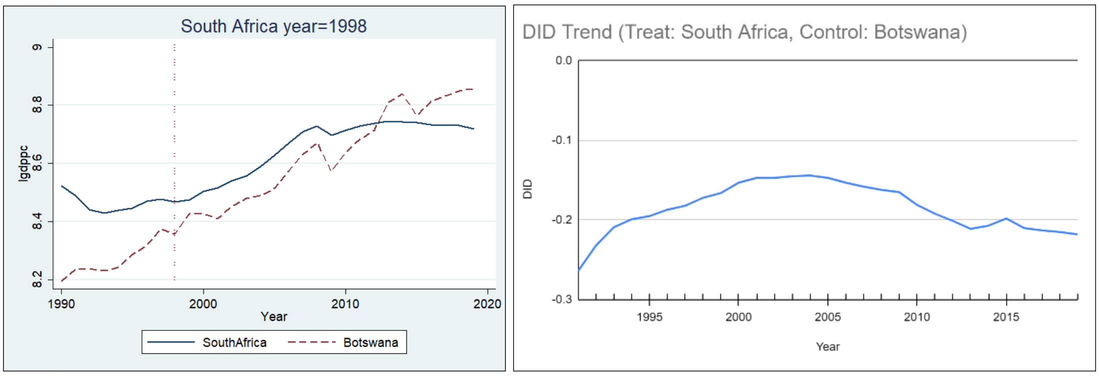
Figure 3.2 Malawi vs Niger



3.3.1.2 *South Africa*

Figure 3.3 compares the treated country, South Africa, and its control country, Botswana. The breaking year on the left graph is 1998, when South Africa cut ties with Taiwan, and the observation period is 1990 to 2019. The right graph exhibits the DID trend, showing negative and statistically significant DID values throughout the empirical period. The DID trend also starts falling from 2004, showing that South Africa's economy did not improve compared to Botswana's. Its economy remained stagnant after 2004.

Figure 3.3 South Africa vs Botswana



3.3.2 *Central Eastern and Europe (CEE)*

A total of 16 CEE countries – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Montenegro, North Macedonia, Poland, Romania, Serbia, Slovakia, and Slovenia – were selected to undergo DID analysis (see **ANNEX 3.4 DID results of Central and Eastern Europe**). Turkey was selected as the control country for the area due to its geographic proximity, its candidacy for European Union (EU) membership and its exclusion from China's 16+1 initiative, making it an ideal point of reference when exploring the economic impact of the initiative on CEE countries.

The interruption year 2012 was applied, as we wanted to examine the economic impact of the initiative against initial hope in the CEE that the 16+1 format would boost Chinese trade and investment and stimulate growth (see Chapter 7). The empirical period for the region is 1999 to 2019.

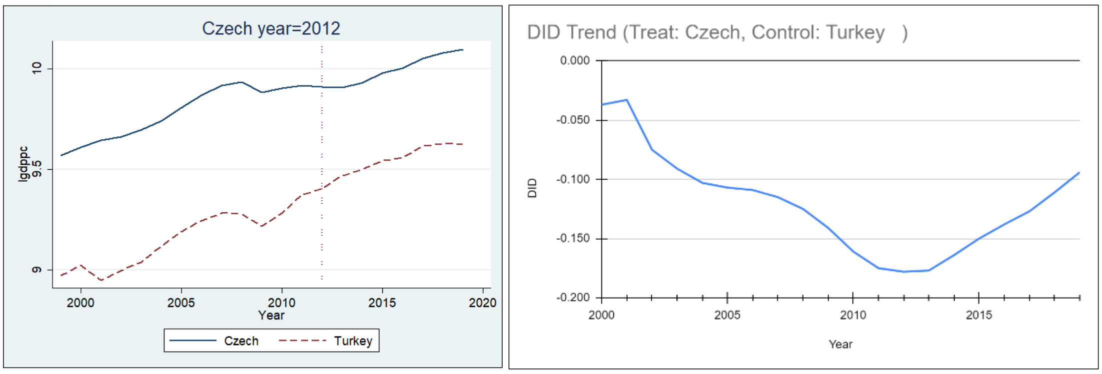
In the 16 observed countries displayed in the **ANNEX 3.4**, eleven presented negative DID result values, while five showed positive values. More significantly, Croatia, the Czech Republic, Hungary, Montenegro and Slovenia all presented statistically significant, and negative, DID result values, showing that they did not perform better than Turkey after the launch of the 2012 initiative.

In the countries that yielded statistically significant result, the Czech Republic and Hungary were chosen to undergo additional DID trend analysis and further discussion. A table showing the DID trend for CEE countries is included in **ANNEX 3.5.**

3.3.2.1 *The Czech Republic*

Figure 3.4 shows the Czech Republic as the treated country and Turkey as the control. The left graph is the (log of) GDP per capita trend with an observation period from 1999 to 2019, with 2012 as the interruption year. The right graph shows the DID result trend from 2000 to 2019, with negative DID result values presenting throughout the entire empirical period within two intervals: 2004 to 2006, and 2008 to 2018. The DID value began to drop from 2001 and stopped at 2012, showing that the magnitude of economic growth was less than that of Turkey during this period. From 2013 to 2018, the DID trend rose but still presented negative and significant DID results, meaning that while the degree of Czech economic growth was stronger than Turkey's in the period, it still experienced a slump after 2012.

Figure 3.4 The Czech Republic vs Turkey

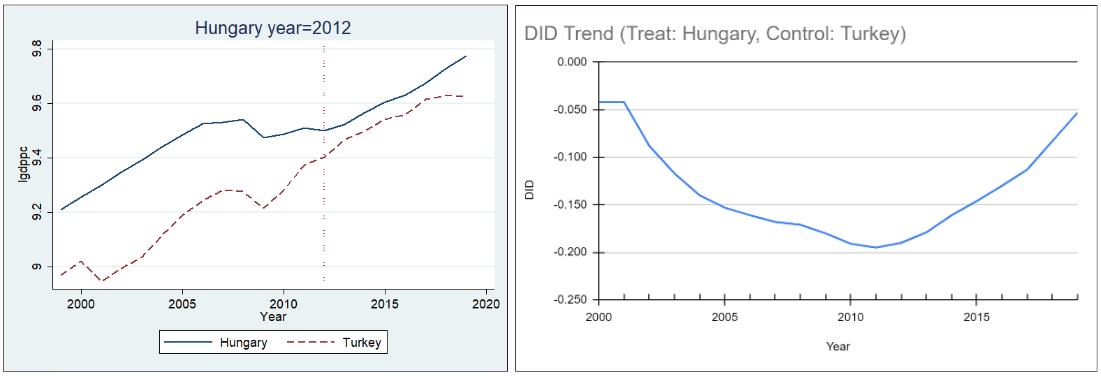


3.2.2.2 Hungary

Figure 3.5 shows Hungary as the treated country and Turkey as the control. The empirical period is 1999 to 2019 and the interruption year is 2012.

On the right, Hungary's DID trend is shown to have decreased after 2001, reaching its lowest point in 2011, denoting economic shrinkage in the period. However, the DID trend experiences an uptick from 2012 to 2019, illustrating stronger growth than Turkey.

Figure 3.5 Hungary vs Turkey



3.3.3 Latin America and the Caribbean

A total of 33 countries in the LAC were tested (see **ANNEX 3.6 DID Results of Latin American and the Caribbean**), with the default empirical period set from 2000 through 2019. In 2000, Taiwan welcomed its first transition of power after Chen Shui-bian of the Democratic Progressive Party (DPP) was elected president ending over half a century of rule by the Chinese Nationalist Party (KMT) and opening the door to a new diplomatic onslaught from China. For countries that switched ties to China recently, such as Panama (2017) or El Salvador (2018), not enough time has passed for an assessment on economic development to be conducted. Therefore, they are still treated in the model as Taiwanese partners, and alternative end years for the empirical period are used.

The interruption years for the individual countries are either the year of their diplomatic switch, or 2013, the year when the BRI was extended to the LAC. Control countries were chosen on the basis of two criteria: Similarity in the level of economic development (in this case GDP per capita), and consistency in their recognition of Taiwan or China. For further discussion of these selections, and how the empirical DID results applied to the testing of the “Switching Helps” and “BRI Attracts” hypotheses, please refer to Chapter 4: The Political Economy of Diplomatic Competition: Taiwan and China in Latin America and the Caribbean.

In the following section, Costa Rica, Dominica, Grenada, Guatemala, and Saint Lucia receive some further DID regression and trend analysis. A table showing the DID trend for LAC countries is included in **ANNEX 3.7.**

3.3.3.1 Costa Rica

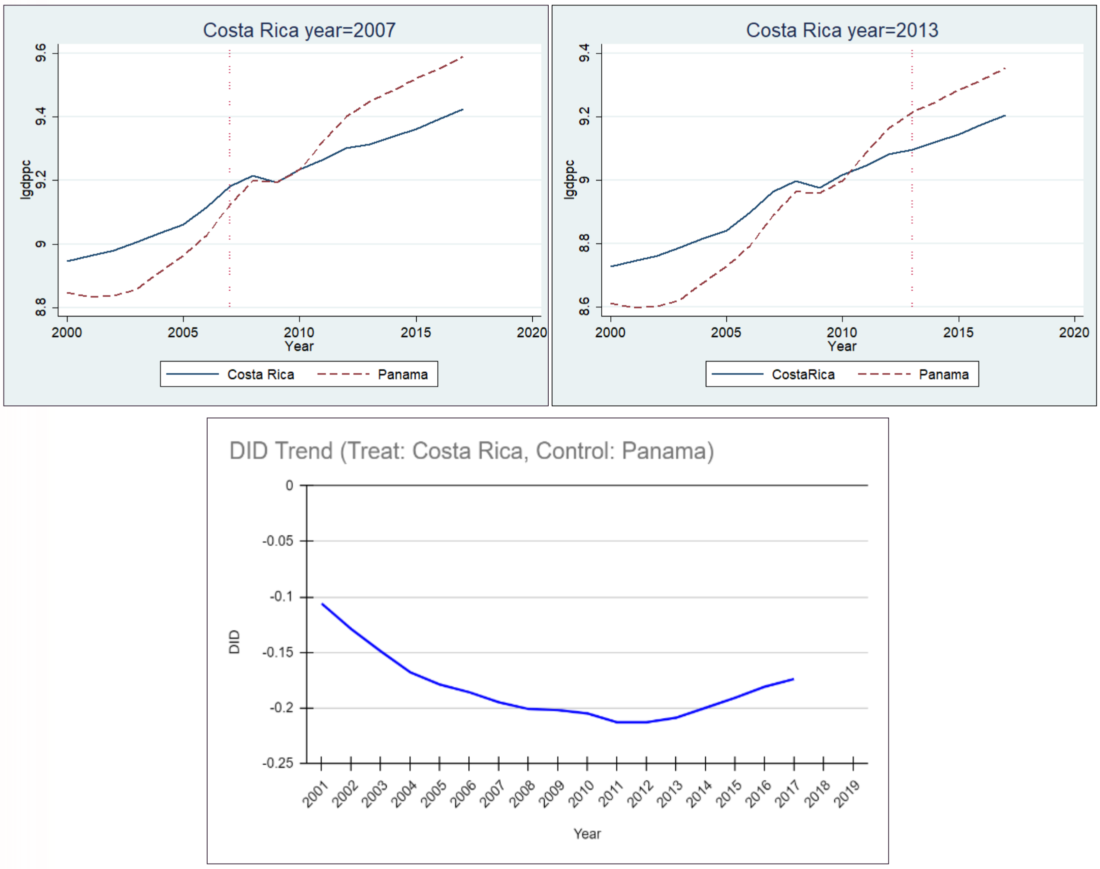
Figure 3.6 illustrates Costa Rica as the treated country and Panama as the control country. Costa Rica cut ties with Taiwan after 63 years in 2007, while Panama remained Taiwan’s diplomatic partner until a switch to China in 2017. The empirical period is from 2000 to 2017. The graph on the upper left shows the (log of) GDP per capita trends of both countries with the break year of 2007, and the one at the upper right shows the (log of) GDP per capita trends of both, with the interruption year of 2013.

The DID trend graph at the bottom applies to both analyses using the break year 2007 and the interruption year 2013. It shows a downward sloping curve from 2001 to 2012, when it reaches the lowest point with a negative DID value. The results are statistically significant, showing that Costa Rica’s economic growth rate is observed to be weaker than Panama’s during that period.

The DID trend continues its decline after 2007, showing that the gap between Costa Rica and Panama keeps on shrinking. The negative DID value is statistically significant within the 2007 to 2012 interval, indicating that Costa Rica’s economic performance was worse after cutting diplomatic ties with Taiwan.

After 2013, the DID trend appears to increase from the lowest point, and the results are statistically significant during the period from 2013 to 2017. The DID trend shows that Costa Rica’s economic growth was a little stronger than that of the control country after the adoption of the BRI.

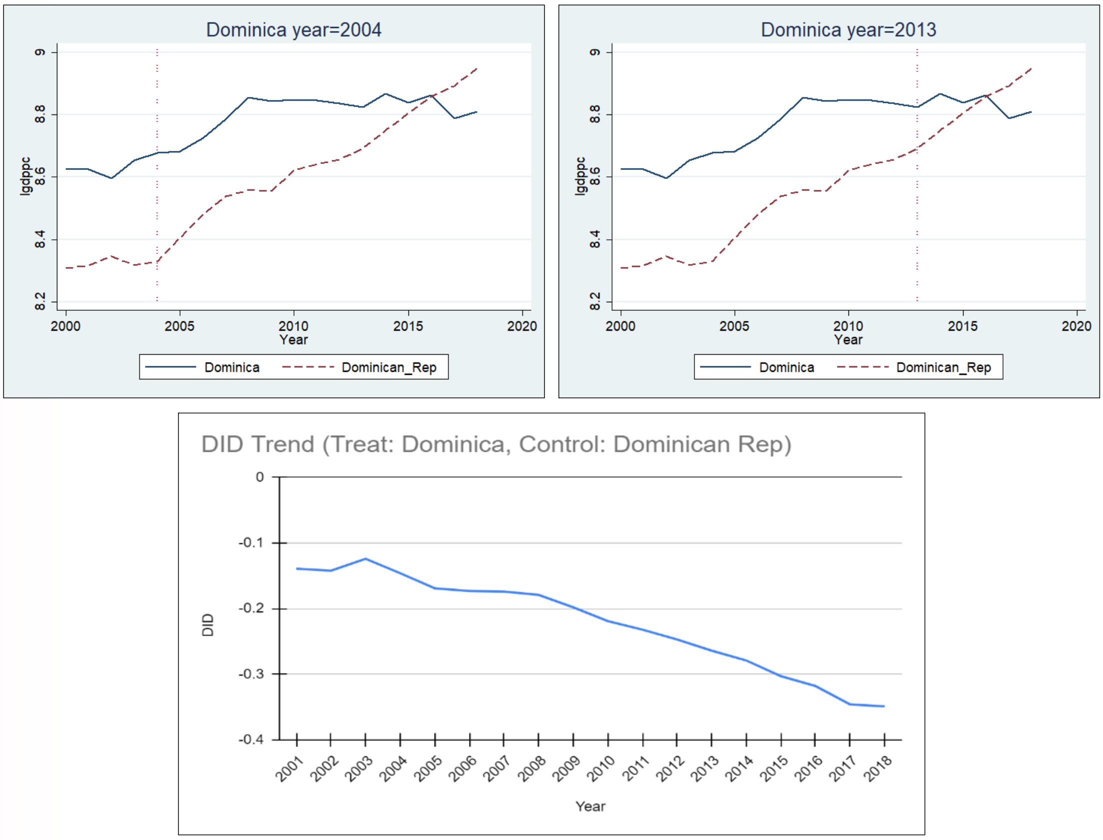
Figure 3.6 Costa Rica vs Panama



3.3.3.2 Dominica

Dominica, which broke away from Taiwan in 2004, is compared with the control country, the Dominican Republic, in Figure 3.7 with an assessed interval from 2000 to 2018. In line with the same consideration, the Dominican Republic was chosen as it remained a Taiwanese diplomatic partner until it switched to China in 2018. We find that although the GDP per capita of Dominica is greater than that of the Dominican Republic, its economic growth was weaker with a statistically significant, negative DID value for the empirical period. According to the DID trend, the value began to decrease mildly in 2003, and there was a decline between 2008 and 2017, when it reached its lowest value. From these results we can conclude that after Dominica switched its diplomatic recognition to China in 2004, its economic performance worsened. Moreover, Dominica did not enjoy positive economic performance after China extended its BRI to the region in 2013.

Figure 3.7 Dominica vs the Dominican Republic

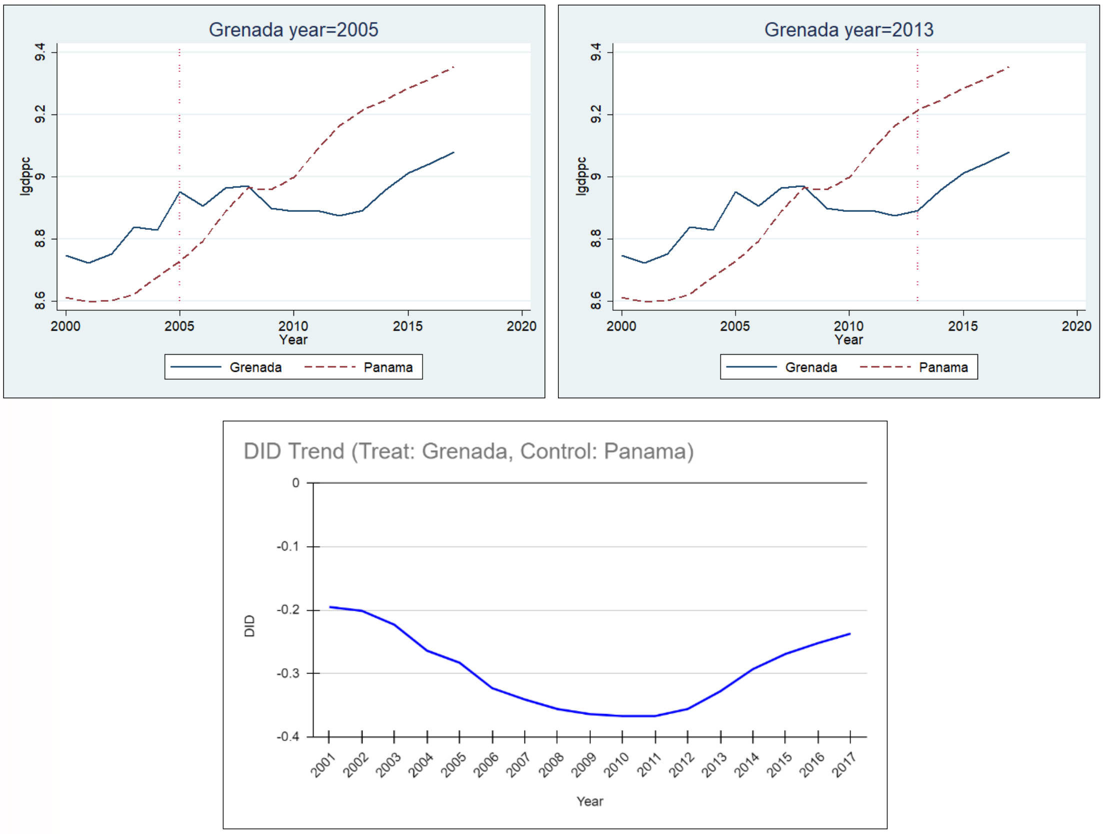


3.3.3.3 Grenada

Figure 3.8 presents the treated country Grenada, which broke away from Taiwan in 2005, and its control, Panama. The upper graphs show the (log of) GDP per capita trend of Grenada and Panama with both the break year of 2005 and interruption year of 2013. After 2008, Grenada had a lower GDP per capita than Panama. Again, Panama was chosen as it remained Taiwan's diplomatic partner until it switched to China in 2017.

According to the DID result, we see a statistically significant and negative DID value during the period from 2001 to 2017, meaning that Grenada's economy did not perform well in this period. The bottom graph of the DID trend shows a downward curve from 2000 to 2010 which turns upwards from 2011 to 2016, meaning that while Grenada's economy was recovering after 2011, it was still worse than Panama's, as is apparent in the negative DID value. Therefore, we find that although economic growth was slightly better than Panama's after the launch of the BRI, Grenada's economy did not do well. The DID trend also indicates that Grenada's economic performance suffered after it cut ties with Taiwan in 2005.

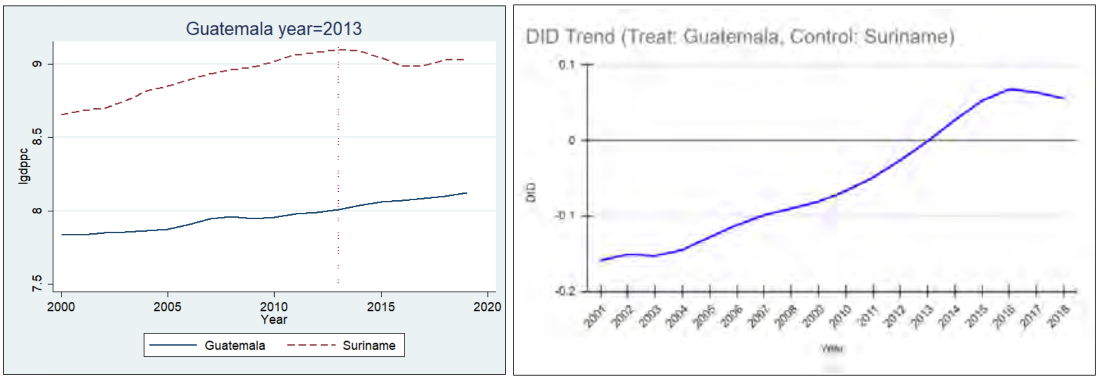
Figure 3.8 Grenada vs Panama



3.3.3.4 Guatemala

Figure 3.9 shows Guatemala as the treated country and Suriname as the control. Suriname was chosen as it is a long-term diplomatic partner of China whereas Guatemala has long recognized Taiwan. The assessed period is from 2000 to 2018. The DID trend rises from its lowest value in 2001 but remains negative until 2013. The result is statistically significant only in the period 2001 to 2009, with a negative DID value that shows Guatemala's economy struggling. After 2014, the DID value turns positive but is statistically insignificant, so we cannot verify that Guatemala's economy outperformed that of Suriname.

Figure 3.9 Guatemala vs Suriname

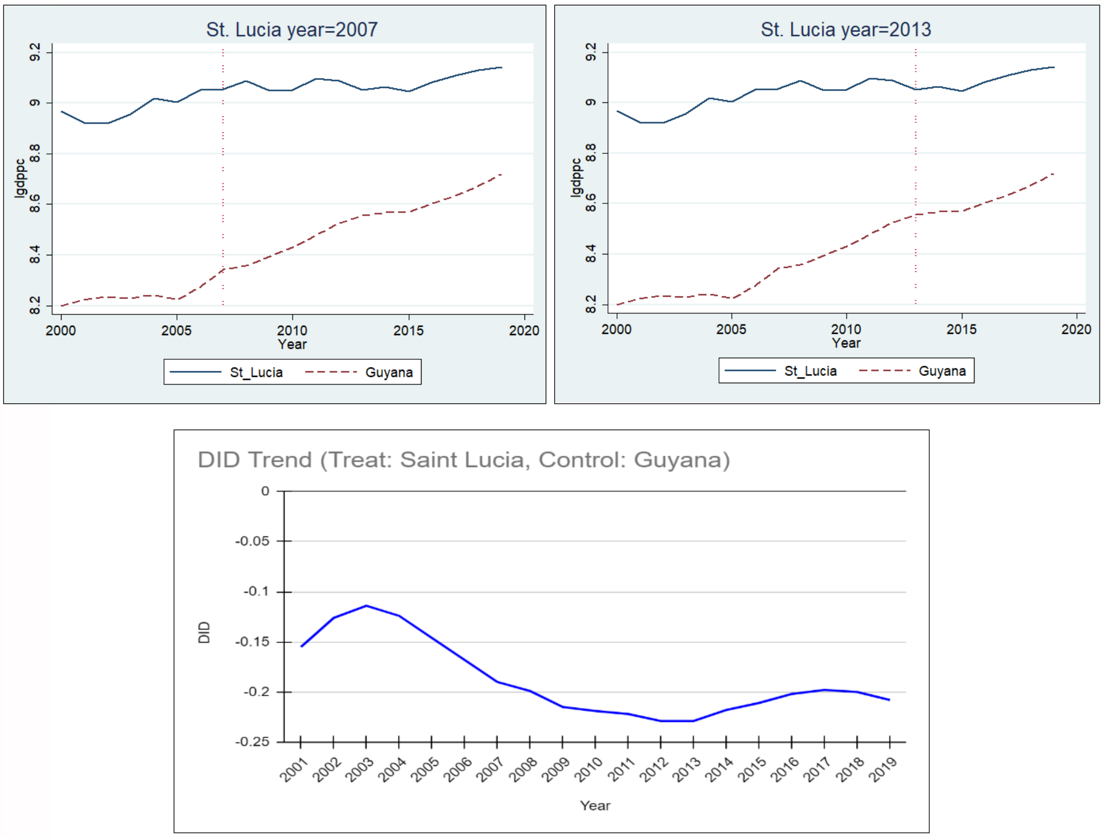


3.3.3.5 Saint Lucia

The (log of) GDP per capita trend of Saint Lucia compared with the control country, Guyana, is shown in Figure 3.10. One interruption year is 2007, when Saint Lucia re-established ties with Taiwan in 2007, while the other is 2013, when the BRI was adopted in the region. The observed period is from 2000 to 2019.

The DID trend displays a negative value and is statistically significant within the entire period, which can be interpreted as showing that Saint Lucia's economic performance lags behind that of Guyana. After establishing diplomatic ties with Taiwan in 2007, Saint Lucia presented a negative and statistically significant DID value, showing that it did not enjoy economic improvement after switching to Taiwan. In general, the DID trend value began a more pronounced decline after 2003 and a return to growth in 2013. During the period of 2003 to 2013, Saint Lucia's economy did not experience stronger growth than the control country.

Figure 3.10 Saint Lucia vs Guyana



3.3.4 Oceania

A total of 10 Oceanic countries – Fiji, the Marshall Islands, the Federated States of Micronesia (FSM), Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu – were selected to undergo DID analysis (see **ANNEX 3.8**).

As island nations in this region are generally small economies that are vulnerable to exogenous shocks, a longer empirical period was adopted to better illustrate their economic development. The empirical period is therefore set from 1970, when decolonialization started in the region, to 2019.

The control countries were selected based on their similarities to individual treated countries in three criteria: the level of GDP per capita, size of population and the country's key economic sectors. 1998 was selected as the breaking year for the Marshall Islands and Tonga, the year both countries cut ties with Taiwan. For the remaining eight states, the interruption year was set as 2006, when China initiated the first China Pacific Forum.

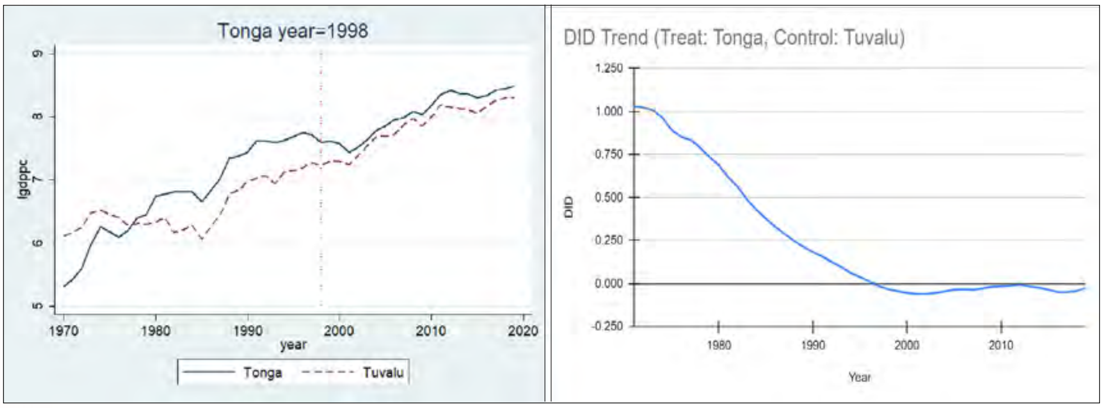
In the six Oceanic countries that yielded statistically significant results, three – the FSM, Palau, and Solomon Islands – presented negative DID values. That is, their economies did not perform well relative to their control countries after 2006. Tonga also presented a negative and statistically significant DID value, meaning that it did not perform well economically compared to its control country after cutting ties with Taiwan in 1998. Samoa and Tuvalu, on the other hand, presented positive and statistically significant DID result values, illustrating a better economic performance compared to their control countries after 2006.

In this chapter, we focus on Tuvalu and Tonga for our DID regression and trend analysis. An account of other countries will be provided in Chapter 6. A table showing the DID trend for Oceanic countries is included in **ANNEX 3.9.**

3.3.4.1 Tonga

Figure 3.11 illustrates the DID result for GDP per capita of the treated country, Tonga, and the control, Tuvalu, for the period 1970 to 2019. Tonga cut ties with Taiwan to establish diplomatic relations with China in 1998, while Tuvalu has been a long-term partner of Taiwan. In the right graph of Figure 3.11, Tonga's DID trend is shown to have decreased during the years 1971 to 1987, and the DID result is statistically significant. That is, Tonga's economic growth compared to Tuvalu shrank significantly during this period. From 1988 to 2002, the DID trend for Tonga was still gradually decreasing, but it was not statistically significant and so we cannot confidently conclude how the economy was performing during this period. The DID trend fluctuated slightly from 2002 to 2019, and we can see that Tonga's comparative growth was largely stagnant during this period.

Figure 3.11 Tonga VS Tuvalu

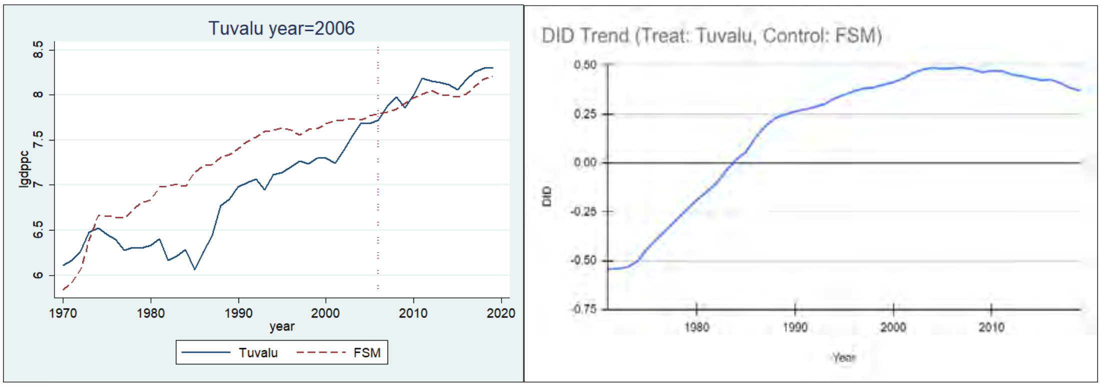


3.3.4.2 Tuvalu

Tuvalu's (log of) GDP per capita trend appears in the left graph of Figure 3.12, and the DID trend in the right. The treated country is Tuvalu, a long-term Taiwanese diplomatic partner in the Oceanic region, with the control country chosen as the FSM, which has long recognized Beijing. Both Micronesian countries rely heavily on fishing license fees and fisheries. The examined period is 1970 to 2019. According to the DID trend, the results are statistically insignificant in the decade from 1978 to 1988, and during this period we cannot assert whether or not Tuvalu's economy performed better. In 1989 it gives us a statistically significant empirical result and positive DID value. This indicates that Tuvalu's economy grew faster than the FSM.

According to the right graph, the DID trend reaches its highest point in 2007 with a positive DID value. In the period from 2004 to 2007, the DID trend does not fluctuate much and presents a flat curve with positive DID values for four years. This indicates that the economy performed at a high level. After 2007, the DID values began to ease off. Therefore, we find that Tuvalu enjoyed positive economic performance before 2006 and fluctuated somewhat afterwards.

Figure 3.12 Tuvalu Vs Federated States of Micronesia



3.4 Conclusion

Our empirical results show that countries switching diplomatic recognition from Taiwan to China do not necessarily enjoy a significant boost to their economic performance. The DID results indicate that of the nine African countries observed, five - Burkina Faso, São Tomé and Príncipe, Senegal, South Africa, and the Gambia - experienced economic downturns after the third FOCAC took place in 2006. The meeting was followed by a sharp increase in Chinese trade and investment on the continent (See Chapter 5). On the other hand, Chad and Malawi are observed to have experienced economic growth after 2006. However, Malawi's economic performance began to slow from 2008 to 2014 compared to the control country, Niger. Similarly, South Africa's economy did not improve after it cut ties with Taiwan in 1998 relative to its control country, Botswana. It stagnated further after 2004.

The empirical results also show that the economy of Eswatini, Taiwan's only remaining partner in the African region, began to slow after 2015. Taiwan's main projects in the country involve agriculture, animal husbandry and medical technology. It sent a technical training team to Eswatini and selected trainees to go to Taiwan for further instruction. Internet technology remains a high priority across the continent and further high-tech assistance for Eswatini can be expected to boost economic performance.

Of the 16 CEE countries tested, five - Croatia, the Czech Republic, Hungary, Montenegro, and Slovenia - did not perform better economically than their control country, Turkey, after the launch of the 16+1 initiative. This contributed to some of the frustration heard within the CEE that the format had not delivered on its promise of growth (see Chapter 7).

Of the 33 LAC countries that were considered, 21 were aligned with Beijing and 13 of these presented negative DID values, including statistically significant and insignificant ones. The results demonstrate that these countries did not see stronger economic growth after 2013, the year 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 ten Oceanic countries examined six - Fiji, the Federated States of Micronesia, Palau, Papua New Guinea, Solomon Islands, and Vanuatu - did not see a relative economic improvement compared with their control countries after 2006 when the first China Pacific Forum took place. We also see that Tonga, which switched recognition to China in 1998, still has comparatively weak economic growth, while the Taiwanese partner, Tuvalu, has enjoyed positive economic growth relative to its control country.

References

Card, D. & Krueger, A. B. (1994). Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania. American Economic Review, 94, 772-793.

World Bank, World Development Indicators. GDP per capita (constant 2010 US$).

United Nations Data. GDP, Per Capita GDP - US Dollars.

CHAPTER 4
The Impact of Diplomatic Ties on Economic Development: Taiwan and China in Latin America and the Caribbean

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Since 1971, Taiwan and China have competed strongly for diplomatic recognition in Latin America and the Caribbean. Perceived economic benefits have been a primary concern for countries as they decide which side to choose. This chapter focuses on two research questions about the economic impact of Taiwan-China diplomatic competition. First, have countries that switched ties indeed become better off? Second, given that the Belt and Road Initiative (BRI) has offered economic incentives to small states since its launch in 2013, do Taiwan-aligned countries that performed worse after that date tend to switch recognition to China to try to make up their losses? Using quantitative and qualitative methods, the findings demonstrate that changing relations from Taipei to Beijing does not necessarily lead to faster economic growth. Moreover, we find that Taiwan-aligned countries, even those with slower economic growth after 2013, are not necessarily motivated to sever ties with Taiwan. The policy implications of this chapter suggest that the Taiwanese government should strengthen economic links with its diplomatic partners by encouraging the involvement of its state-owned companies and working with US government agencies.

4.1 Introduction

Taiwan's diplomacy is largely shaped by its contest with China for international recognition (Hsiang, 2021). In 1969, Taiwan had formal relations with 70 countries, the most in its history, while China was recognized by 47. From 1970 to 2021, Taiwan established diplomatic ties with 32 countries, but 80 countries broke away and turned to China.

In the past two decades, China has used ever more instruments of economic statecraft to pursue its strategic goals (Alves, 2013; Teng, 2021, pp. 74-75). Recent studies suggest that countries that have abandoned Taiwan were attracted by Chinese promises related to the Belt-and-Road Initiative (BRI) (Shattuck 2020), which was adopted in 2013. Anticipated economic gains from China are a crucial motivation for a small state to open diplomatic relations. As one interviewee for this study indicates, "building ties with China is the default mode for Latin American countries because these countries expect that they can get much more aid and investment from China than from Taiwan" (Interviewee A1, October 30, 2021).

This chapter focuses on two research questions about the economic impact of Taiwan- China diplomatic competition. First, did countries that switched ties indeed become better off? Second, given that the BRI offers the prospect of more economic interaction with China, do Taiwan-aligned countries that were economically worse off after 2013 tend to switch relations to China?

To address these questions, this chapter examines Taiwan-aligned countries in the LAC region, where most of Taiwan's remaining diplomatic partners are located (8 out of 14). In the next section, I provide discussion on my testable hypotheses with the help of the difference-in-differences (DID) analysis. Third, I present four case studies in the LAC region to analyze the economic impact of Taiwanese and Chinese involvement. Lastly, I assess the findings and reach a conclusion.

4.2 International Political Economy and the Switching of Diplomatic Relations

Fifteen countries in the LAC region broke their ties with Taiwan and recognized China between 1971, when Beijing assumed the China seat at the UN, 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 LAC region under the "diplomatic truce" policy of the Ma Ying-jeou administration (2008-2016), China resumed fierce competition with Taiwan after President Tsai Ing-wen 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 April 2022, Taiwan maintained official diplomatic relations with fourteen 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. Zhang and Lacerda (2021) indicate that China's 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).

Anticipated gains are clearly a key in the decision-making process, but do ties with Beijing they bear fruit? Chen's (2018) analysis of nine countries that cut relations with Taiwan from 2000 to 2013 show that they received immediate and significant economic benefits from China. Moreover, Long and Urdinez (2021) argue 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, Long and Urdinez's (2021, 9-11) 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. As existing studies suggest, higher economic growth is associated with more foreign direct investment (Hansen and Rand, 2006) and more foreign aid (Karras, 2006). Therefore, I generate the following testable hypothesis:

"Switching Helps" hypothesis: Switching diplomatic recognition to Beijing tends to improve a country's economic performance to a significant extent.

As mentioned above, China took aggressive action to undermine Taiwan's diplomatic relations after President Tsai's election. One important instrument has been the Belt-and-Road Initiative (BRI). For instance, Panama (2017), the Dominican Republic (2018), and El Salvador (2018) joined the BRI as soon as they broke ties with Taiwan. It is likely that all these countries anticipated that the BRI would lead to economic gains. The former president of Panama, Juan Carlos Valera, was explicit when he expressed great hopes that the BRI project would lead to a substantial economic boost. (AP News, 2019). If economic performance is the most important rationale for Taiwan-aligned countries to switch relations, a Taiwan-aligned country would be more likely to do the same if it believed that other LAC countries had benefited from the BRI and achieved economic benefits. In contrast, if a Taiwan-aligned country finds that China's partners' economies became weaker after 2013, the country would try to avoid such a potentially negative outcome and would be less likely to sever diplomatic ties with Taiwan. Therefore, the following hypothesis can be generated:

"BRI Attracts" hypothesis: Taiwan-aligned countries tended to sever diplomatic ties with Taiwan if their economic growth slowed down after 2013.

In short, for the test of the "Switching Helps" hypothesis, I only focus on countries that severed ties with Taiwan. In contrast, for the test of the "BRI Attracts" hypothesis, I only consider the diplomatic behavior of long-term Taiwan-aligned countries. My assumption is that Taiwan's partners make their decision on relations after seeing the impact of the BRI on their Beijing-aligned neighbors.

Empirical Results

For the empirical analysis, I use the Difference-in-Difference (DID) design to examine the LAC countries that maintained diplomatic ties with Taiwan during the period from 2000 through 2019. To test the two proposed hypotheses, I categorize these countries into two groups. The category of diplomatic switchers will be used for the test of the "Switching Helps" hypothesis, and the countries are Costa Rica, Dominica, and Grenada. The category of long- term Taiwan partners will be used for the test of the "BRI Attracts" hypothesis, and the countries are Belize, the Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Paraguay, St. Kitts and Nevis, and St. Vincent and the Grenadines.

The purpose of the DID analysis is to calculate the effect of a treatment on an outcome (i.e., dependent variable) by comparing the average change over time in the dependent variable for the treatment group to the average change over time in the dependent variable for the control group. In my DID design, the unit of analysis is a country-year, the dependent variable is the level of GDP per capita, and there are fifteen countries in my analyses (see Table 4.1). I ran one DID model for each of the fifteen countries.

Table 4.1 Taiwan-Aligned Countries in Latin America and the Caribbean (2000-2019)

Country	Diplomatic relation with Taiwan
Belize	established since 1989
Costa Rica	established 1959-2007; severed since 2007
Dominica	established 1983-2004; severed since 2004
Dominican Republic	established 1957-2018; severed since 2018
El Salvador	established 1961-2018; severed since 2018
Grenada	established 1989-2005; severed since 2005
Guatemala	established since 1954
Haiti	established since 1965
Honduras	established since 1965
Nicaragua	established 1962-1985; severed 1985-1990; established 1990; severed since Dec. 2021
Panama	established 1954-2017; severed since 2017
Paraguay	established since 1957
St. Kitts and Nevis	established since 1983
Saint Lucia	established 1984-1997; severed 1997-2007; established since 2007
St. Vincent and the Grenadines	established since 1981

There are two kinds of treatment in my analysis, depending on whether a country belongs to the category of diplomatic switchers or to the category of long-term Taiwan partners. For diplomatic switchers, the treatment is the year when the diplomatic change occurred. If the "Switching Helps" hypothesis is supported, we expect to see a positive treatment effect, which suggests that the country's average change in GDP per capita between the pre-switching period and the post-switching period is higher than the control country's average change in GDP per capita in the same period. For long-term Taiwan partners, the treatment is 2013, the year when the BRI began to be adopted. If the "BRI Attracts" hypothesis is supported, we expect to see that most countries with negative treatment effects should have severed ties with Taiwan. The negative treatment effect here suggests that a Taiwan-aligned country's change in GDP per capita between the period of 2000-2013 and the post-2013 period is lower than a China- aligned counterpart's average change in GDP per capita between the period of 2000-2013 and the post-2013 period.

Note that the cases of the Dominican Republic, El Salvador, Nicaragua, and Panama pose some challenges to my analytical strategy. Although these countries broke ties with Taiwan recently, they are still considered as long-term Taiwan-aligned countries because the time period after the switch is too short to conduct meaningful DID analysis. Unlike most countries in the empirical analyses, the end year for the second period for the Dominican Republic, El Salvador, and Panama is not 2019 but the year when they severed ties with Taiwan, which was 2018 for the Dominican Republic and El Salvador, and 2017 for Panama. Because Nicaragua broke ties with Taiwan in December 2021, the end year for the second period is 2019.

Regarding the selection of the control countries, I adopt two selection criteria. First, to ensure comparability in economic performance over time between the treatment country and the control country, the level of economic development for the treatment country and the control country must be similar. In the analysis, I used the level of GDP per capita for each country as of 2019 as the basis for comparing GDP per capita among different countries. Second, the recognition policy for the control country must be consistent from the pre-treatment period through the post-treatment period. For the category of diplomatic switchers, because the treatment is the year of diplomatic conversion, the recognition policies for the treatment country and the control country are the same in the pre-treatment period, but their recognition policies are different in the post- treatment period. For instance, I selected Panama as the control country for Grenada because both countries have similar levels of GDP per capita, and both countries maintained diplomatic ties with Taiwan before 2005, but after 2005 Grenada switched to China while Panama stayed with Taiwan until 2017. For the category of long-term Taiwan partners, their control countries must have been aligned with Beijing for a long time. For instance, I selected Bolivia as the control country for Haiti because both countries have similar levels of GDP per capita and Haiti has long recognized Taiwan, while Bolivia has sided with China.

Table 4.2 DID Analyses for Taiwan-Aligned Countries in Latin America and the Caribbean (2000-2019)

Treatment Country	Diploma. Switcher	Period 1	Period 2	Control Country	DID Coeff.	P > |t|
Costa Rica	Yes	2000-2007	2007-2017	Panama	-0.195	0.006***
Dominica	Yes	2000-2004	2004-2018	Dominican Republic	-0.146	0.008***
Grenada	Yes	2000-2005	2005-2017	Panama	-0.283	0.000***
Saint Lucia	Yes	2000-2007	2007-2019	Guyana	-0.190	0.000***
Belize	No	2000-2013	2013-2019	Bolivia	- 0.296	0.000***
Dominican Republic	No	2000-2013	2013-2018	Mexico	0.277	0.000***
El Salvador	No	2000-2013	2013-2018	Suriname	- 0.003	0.89
Guatemala	No	2000-2013	2013-2019	Suriname	- 0.001	0.984
Haiti	No	2000-2013	2013-2019	Bolivia	0.223	0.000***
Honduras	No	2000-2013	2013-2019	Bolivia	-0.140	0.003***
Nicaragua	No	2000-2013	2013-2019	Bolivia	-0.061	0.180
Panama	No	2000-2013	2013-2017	Antigua and Barbuda	0.488	0.000***
Paraguay	No	2000-2013	2013-2019	Colombia	-0.007	0.886
St. Kitts and Nevis	No	2000-2013	2013-2019	Uruguay	-0.254	0.000***
St. Vincent and the Grenadines	No	2000-2013	2013-2019	Brazil	-0.003	0.953

Note: Saint Lucia is not a diplomatic switcher defined by this chapter; however, it switched diplomatic ties from China to Taiwan in 2007. Four countries broke ties with Taiwan recently: The Dominican Republic in 2018, El Salvador in 2018, Panama in 2017, Nicaragua in 2021.
*p<0.1; **p<0.05; ***p<0.01

Table 4.2 presents the empirical findings for the DID analyses. The results show that the "Switching Helps" hypothesis is not supported by the empirical evidence. Specifically, economic growth in Costa Rica, Dominica, and Grenada was slower after switching ties to China, and the DID results for these three countries all reach statistical significance. Therefore, the three cases provide strong evidence that switching ties from Taiwan to China slows down economic growth.[1]

While the "Switching Helps" hypothesis only considers countries that broke with Taiwan, it will also be relevant to examine the economic performance of the countries that switched to Taiwan. The DID result for Saint Lucia, the only country that broke with China in our analysis, is negative and statistically significant. This evidence suggests that after switching ties to Taiwan Saint Lucia's economic performance also slowed down, compared to its counterpart.

To better capture the findings for the tests of the "BRI Attracts" hypothesis, Table

4.3 summarizes the DID results for long-term Taiwan partners in Table 4.2. If the hypothesis is supported, we would expect to see countries with slower growth than China-aligned counterparts after 2013 in the lower-right cell and countries with faster economic growth than their China aligned counterparts after 2013 in the upper-left cell. However, the results in Table 4.3 are mixed. Among the nine countries that experienced slower economic growth, only two countries (El Salvador and Nicaragua) severed diplomatic ties with Taiwan. However, it is noteworthy that the DID results for these two countries are not statistically significant, which suggests that the evidence for the "BRI Attracts" hypothesis is not particularly strong.

Table 4.3 Economic Performance and the Recognition Policies of Long-Term Taiwan Partners

	Maintained Diplomatic Ties with Taiwan (2000-2019)	Severed Diplomatic Ties with Taiwan
Economy grows faster than the PRC-Allied Counterpart after 2013	None	Dominican Republic (2018) Panama (2017)
Economy grows slower than the PRC-Allied Counterpart after 2013	Belize Guatemala (the DID result is insignificant) Haiti Honduras Paraguay (the DID result is insignificant) St. Kitts and Nevis St. Vincent and the Grenadines (the DID result is insignificant)	El Salvador (2018; the DID result is insignificant) Nicaragua (2021; the DID result is insignificant)

While limited results in Table 4.3 show support for the "BRI Attracts" hypothesis, most remaining results in Table 4.3 are puzzling. The findings suggest that the Dominican Republic and Panama severed ties with Taiwan even though their economic growth had been faster than their China-aligned counterparts after 2013. This evidence suggests that some factors other than economic calculations play a more important role in explaining the two countries' diplomatic breach with Taiwan. One possible explanation is that these countries already had a good relationship with China. The Chinese government established offices for commercial development in the Dominican Republic and Panama in the 1990s, suggesting that China had developed closer relationships with them than with other Taiwan aligned countries.[2] Because the Trump administration "failed to pay too much attention to China's strong presence in Latin America" (Interviewee A2, December 13, 2021), it is not surprising that China targeted Taiwan-aligned countries with which it had better relations with the aim of winning formal diplomatic recognition.

The most puzzling results are the countries in the lower-left cell of Table 4.3. The results suggest that the seven countries were willing to maintain diplomatic relations with Taiwan even though similar countries, with Beijing ties, performed better after 2013. 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, debt traps, 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), which aims to support Taiwan in strengthening its official diplomatic relationships, might have had an impact. In particular, Section 5 of the TAIPEI Act indicates 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 counter measures by the US if countries break formal ties with Taiwan.

Third, Long and Urdinez (2021) argue that small states and "de facto states" like Taiwan have a tendency to recognize each other. De facto states build ties with small states to support their drive for sovereign statehood (James, 1999) and related benefits, such as help in applying for membership of international organizations (Coggins, 2014). In contrast, small states recognize de facto states in order to seek a relational status in which they "receive meaningful attention and respect from their partner," leading to the conclusion that "sustained attention from a near peer may trump the fickler attentions of a great power" (Long & Urdinez, 2021, p. 2). Long and Urdinez's case study of Paraguay supports this theory and my analyses further show that it might also be applied in the cases of Belize, Guatemala, Haiti, Honduras, and St. Vincent and the Grenadines. In addition to the incentive for "status seeking," it is possible that Taiwan might offer small states other incentives, such as bribes, to keep them on side. There is some anecdotal evidence for corruption in such relationships. However, it seems not to be as decisive a reason as status seeking because China would be able to more than match any such bribes in a contest for diplomatic recognition.

Overall, the empirical findings in this section suggest that switching ties from Taiwan to China does not necessarily help countries achieve faster economic growth. The DID results show that Costa Rica, Dominica and Grenada had slower growth after establishing official ties with China compared to a Taiwan-aligned counterpart with a similar level of GDP per capita. Moreover, I find that the BRI might not necessarily be such a powerful attraction. In my empirical analyses, El Salvador and Nicaragua are the only Taiwan-aligned countries that switched to China because its growth was slower than a China-aligned neighbor. My analyses show that in addition to economic concerns, factors such as US policy in the region and pre-existing relations between Beijing and Taiwan-aligned countries, as well as the appeal of high diplomatic status for small states, also help explain recognition policies.

4.3 Case Studies

To further illustrate the economic impact of diplomatic ties with China or Taiwan in third counties, I conducted a series of case studies. I selected Costa Rica and Saint Lucia to examine why switching ties did not promote faster economic growth. The case study of Guatemala aims to show why it is willing to maintain diplomatic ties with Taiwan, and the study of El Salvador aims to examine the impact of the BRI in its decision to break with Taipei.

4.3.1 Costa Rica

Costa Rica's GDP per capita in 2019 was $12,669.71, higher than the Latin America & Caribbean average of $8,692.73, making it an upper-middle-income country with a population of 5.05 million people. According to World Bank data, Costa Rica's GDP per capita growth over the past two decades was negative only in 2009 while all other years were positive, with an average of 2.43% growth for the last five years (2015-2019). In 2019, its top three export destinations were the United States (35%), the Netherlands (5.28%) and Guatemala (4.94%). On the other hand, its top three importing countries were the United States (43.74%), China (10.77%), and Mexico (6.62%). Costa Rica's largest exports are in agriculture and machinery.

In June 2007, Costa Rica switched diplomatic ties from Taiwan to China. A memorandum of understanding (MoU) on the day of transition was revealed in 2008 showing that in return for Costa Rica's 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. They signed their Joint Action Plan for Cooperation (2016-2020) in 2015. More importantly, Costa Rica joined the BRI as one of its emerging market countries in 2018.

However, after building formal ties, a trend of trade imbalances became increasingly clear. In 2008, one year after the switch, its 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. This evidence might help explain why Costa Rica's economic performance was not as strong as expected after the switch in ties (Interviewee A2, December 13, 2021).

A number of countries that joined the BRI later suffered from "buyer's remorse," a phenomenon highlighted by the suspension or cancellation of previously agreed projects. Costa Rica is one of the worst affected countries with troubled projects valued at $889.3 million (Malik et al., 2021, pp. 73-74). For example, the widening project from two to four lanes of the national highway between San José and Limón, National Route 32, has consistently fallen behind schedule (Rico 2021). The project was undertaken by China Harbour Engineering Company (CHEC) at a total cost of $485 million. The loan stipulated that the project be developed entirely by CHEC with the use of Chinese workers (Arias, 2014). In another troubled project, Costa Rica's state-owned oil company Refinadora Costarricense de Petróleo S.A. and China's state-owned oil company CNPC International Ltd. formed a joint venture in 2008 called the Chinese-Costa Rican Reconstruction Corporation (SORESCO). China Development Bank (CDB) offered Costa Rica a $900 million loan to build an oil refinery in Limon; however, the refinery project was suspended in 2013 after an environmental impact investigation and the project was cancelled in 2016 (Tico Times, 2016).

4.3.2 Saint Lucia

Saint Lucia's most significant exports are in the travel and tourism category. Beer, bananas, and plantains make up most of the agricultural exports. Its principal export destinations are the United Kingdom and the United States. Its largest importers are the United States, Trinidad and Tobago, and the United Kingdom. The labor market structure distributes 75.34% in the service sector, 14.69% in the industry sector and 9.97% in agriculture. GDP per capita was $11,611 in 2019 and the economic situation was described as stable.

In 2007, Saint Lucia broke ties with China and reestablished diplomatic relations with Taiwan. Taiwan helps to support the relationship by providing technological service assistance. The Taiwan International Cooperation and Development Fund (TaiwanICDF) plays an important role in educational and technical assistance and cooperation. By providing "free-standing technical cooperation" (FTC), Taiwan offers technical help through education or workshops conducted by a team of specialists and volunteers (Herrera Ramos, 2019). Taiwan has agreed to help Saint Lucia diversify its agriculture, facilitate tourism, develop livestock and create an information technology learning center, all in line with a poverty alleviation program agreed at the time relations were restored (CBS, 2007).

The main agricultural product on Saint Lucia is bananas, but banana production has been greatly affected by the abolition of preferential tariff treatment for Caribbean bananas by the European Union and by an outbreak of banana leaf spot disease (black sigatoka). In 2012, Taiwan started to send experts to Saint Lucia to study and provide advice on the banana industry and set up a banana leaf spot control project. Now the export volume of bananas from Saint Lucia is increasing. A related project of enhancing the efficiency of the production-distribution supply chain in the fruit and vegetable sector in Saint Lucia became a WTO case study in 2016.

In 2017, Taiwan donated equipment intended to improve aquaculture development. A government official in Saint Lucia welcomed the assistance saying that "aquaculture is growing tremendously across the island and the ministry (Department of Agriculture, Fisheries, Natural Resources) promotes the involvement of farmers in aquaculture" (Ministry of Agriculture, 2007). In addition to assistance in agriculture and fisheries, Taiwan also offers internship programs for health professionals to come to Taiwan. It also gave assistance for the rebuilding of a prominent local hospital (St. Jude Hospital) and provided essential medical equipment. Taiwan also offered information and communication technology, establishing a wireless local Area network (WLAN) in public areas.

While Taiwan has helped economic development in this way Saint Lucia's economic performance has not directly reflected the impact. One possible reason is the limited economic relationship between the two countries. In 2019, Saint Lucia's imports from Taiwan were only 0.06% of total imports, and Saint Lucia's exports to Taiwan were only 0.14% of total exports. Foreign investment from Taiwan to Saint Lucia was approximately $1.1 million, the result of a Taiwanese company's involvement in wood and bamboo products and manufacturing. There was no investment from Saint Lucia in Taiwan, and there are no pending economic or trade agreements between the two countries.

4.3.3 Guatemala

Guatemala is the largest economy in Central America and the largest of all Taiwan's diplomatic partners. However, it is not Taiwan's largest trading partner in Central America. Bilateral trade is much smaller than that between Guatemala and China, presenting a challenge to Taiwan's economic contribution. In 2019, Guatemala's exports to Taiwan were worth USD$61.9 million, while Guatemala's exports to China were three times larger. Guatemala's imports from Taiwan to Guatemala were worth

USD$135 million, while imports from China were worth USD$2.34 billion, more than 17 times larger.

Even though bilateral trade between Taiwan and Guatemala is limited, Taiwan has a long history of supporting Guatemala through aid and development assistance, which includes disaster relief, development infrastructure, international cooperation and technical assistance in agriculture and aquaculture. The wide range of capacity-building projects Taiwan has undertaken include technical assistance in the use of bamboo as a construction material and support for a Guatemalan government food processing project. For example, on bamboo industries, TaiwanICDF has provided a technical cooperation project for eight years on cultivation, construction techniques, and the promotion of training courses and workshops (TaiwanICDF, 2021).

In addition to technical cooperation, Taiwan has assisted Guatemala with critical infrastructure, the most notable one being national highway CA-9. The highway runs from Puerto Barrios in the north-east through Guatemala City to the port of San José in the south. It is an important and heavily congested route that has been described as a road canal because if it connects the Atlantic and Pacific Oceans. Since 2006, Taiwan has provided assistance for construction work and widening projects. The CA-9 project was contracted out to a Taiwanese company, Overseas Engineering and Construction Corporation (OECC), and was completed, with a third phase of works to follow.

Although bilateral trade between China and Guatemala is significant, relations between the two countries are not close. For instance, China used its veto power at the UN Security Council to block the deployment of 155 UN military observers to Guatemala to monitor the implementation of the post-civil war ceasefire agreement in 1997. The use of the veto was in response to Guatemala's diplomatic relationship with Taiwan and its repeated support for Taiwan's membership of the United Nations (Lewis, 1997). Another example relates to a troubled project build a power plant with a Chinese investment of US$700 million. The Chinese company, Machine New Energy Corporation (CMNC), and AEI Guatemala Jaguar Ltd formed a consortium to bid for the project. CMNC was the general contractor and the project started in 2010 but stalled three years later. Jaguar Energy Guatemala (JEG) filed an arbitration claim for damages against CMNC for breach of contract (Central America Data, 2013). The arbitral tribunal in Singapore ruled in favor of JEG and ordered that CMNC pay $149 million in damages due to the delay (Central America Data, 2016).

4.3.4 El Salvador

El Salvador is the smallest country in Central America with a per capita GDP ranked 29th among the 33 LAC countries. However, the country has managed to reduce poverty and economic inequality. The poverty rate fell from 39 percent to 22 percent in the twelve years after 2007. Likewise, the Gini index, which measures inequality, fell from 0.54 in 1998 to 0.38 in 2019. Despite these improvements, El Salvador still faces socioeconomic challenges that have hampered its economic development, such as political instability, natural disasters, increasing fiscal debt and the COVID-19 pandemic.

Taiwan and El Salvador had formal diplomatic relations from 1941 until 2018. During the Cold War period, the authoritarian Chinese Nationalist Party regime in Taiwan provided strong support for military governments in Central America, including El Salvador, which were fighting left-wing insurgencies. A number of these regimes were accused of atrocities against civilian populations and other severe human rights abuses. Since its democratic transition, Taiwan has shown more interest in promoting civil rights and democracy in the region. As a long-standing diplomatic partner, El Salvador consistently supported Taiwan's participation and involvement in international organizations such as the United Nations and the World Health Organization (WHO). In return, Taiwan funded programs through the TaiwanICDF to assist El Salvador in expanding its lending operations and provided technical assistance in the promotion and packaging of agricultural products. Taiwan signed free trade agreements with both El Salvador and Honduras.

However, Taiwanese assistance did little to stimulate rapid economic growth and El Salvador switched ties to China in August 2018. Beijing responded with 3,000 tons of rice and a pledge of US$150 million for 13 infrastructure projects, only a few of which have been initiated. Relations were further strengthened with the election of President Nayib Bukele in 2019. In December that year, he signed several MOUs with China, mostly for development projects amounting to $500 million. They included a sports stadium, a national library for San Salvador, a pier in La Libertad City, water treatment facilities in La Libertad and Ilopango, and the "Surf City" resort project to attract tourism (Álvarez-Ramírez 2020). El Salvador joined the BRI the same year.

Before severing ties with Taiwan, El Salvador had received a $20 million loan from China through the Inter-American Development Bank (IADB) to finance small and medium-sized enterprises (SMEs), according to AidData.[3] In July 2018, the then-president, Salvador Sánchez, drafted a proposal for providing a legal framework for Chinese foreign investment (Farah and Yates, 2019). The plan was to establish a special economic zone (SEZ) covering 14 percent of the country's land area and about half its coastline. The centerpiece was to be a Chinese-operated port at La Unión. However, the initiative was rejected by the Legislative Assembly (Gerard, 2021).

Taiwan said that relations were cut mainly because it had refused a request to help finance the port at La Unión (Public Diplomacy Coordination Council, 2018), although El Salvador denied the allegation. Built at a cost of $200 million and inaugurated in June 2010, the Port at La Unión was one El Salvador's largest infrastructure projects. On August 23, 2018, three days after the diplomatic switch, the Chinese state-owned company Asia-Pacific Xuanhao (APX) sought a one-hundred-year lease over the port and requested tax exemptions for 30 years. This prompted security worries in the United States because it opened the door to a possible Chinese military and intelligence base in Central America (Londoño 2019). The proposal, which resembles many other BRI projects, has gone no further. Japan had also threatened to withdraw its $102 million funding stream for the area if El Salvador granted operating rights to the Chinese company (Ellis 2021; Portada et al., 2020: 564).

4.4 Conclusion

In this chapter, I conducted quantitative and qualitative studies to examine the political and economic ramifications of Taiwan and China's contest for diplomatic recognition. The quantitative analyses showed that switching diplomatic relations does not necessarily lead to stronger economic performance. In the cases of Costa Rica, Dominica, and Grenada their economies grew steadily after switching ties from Taiwan to China, but growth was slower than for its Taiwan aligned counterpart. In addition, the empirical results demonstrated that being economically worse off does not necessarily motivate Taiwan's partners to switch. El Salvador and Nicaragua were the only cases that showed strong evidence of a Taiwan-aligned country abandoning Taipei because their growth was slower than that of a China-aligned neighbor.

The quantitative analyses also demonstrate puzzling results. I find that most of Taiwan's diplomatic partners had slower economic growth after 2013 compared to those recognizing China. This finding suggests that small states can be willing to pay a price for a higher relational status with Taiwan (Long and Urdinez 2021). One interviewee stated that the key reason small states were willing to maintain diplomatic relations with Taiwan was not financial but because "they have shared values of democracy," and having ties with Taiwan made small states have "a feeling of being accepted and respected" (Interviewee A1, October 30, 2021).

The case studies in the second half of the chapter focus on other aspects of the competition. Costa Rica experienced an increasingly large trade deficit with China after switching relations. In contrast, Saint Lucia and Guatemala both received significant technical assistance from Taiwan. However, this did not lead to much faster growth than their China-aligned counterparts. What are the policy implications? Although the two hypotheses about the economic motives for switching diplomatic relations are not strongly supported by the evidence, this does not suggest that economic considerations play no part. One implication is that the Taiwanese government should work harder to contribute to the economies of its diplomatic partners. The government agencies most responsible, the foreign ministry and economics ministry, work separately and lack coordination. A coordinated institutional framework would help them be more effective in advancing Taiwan's diplomatic position.

Moreover, the Taiwanese government should strengthen the role of state-owned companies, such as the Taiwan Agricultural Investment and Development Co. Ltd (TAIC) and Mitagri Co. Ltd. (Mitagri), in forging stronger economic links. One interviewee suggested that the current Taiwanese model of "assistance for free" fails to achieve sustainable economic outcomes and sustain political links (Interviewee A3, November 5, 2021). State-owned companies should be encouraged to take the lead in making investments and so stimulate further interest from the private sector.

Lastly, given that the United States is the largest trading partner across the region, Taiwan should seek further cooperation with Washington to shore up its diplomatic position. Taiwan's state-owned companies could work with the US International Development Finance Corporation (DFC) to make effective investments in Taiwan-aligned countries. The Taiwanese government could promote a strategic framework for state-owned companies and private companies to coordinate with US trade agencies to promote trade through existing FTAs such as the United States-Mexico-Canada Agreement (USMCA) and the Dominican Republic-Central America FTA (CAFTA-DR).

Notes

[1] To estimate the average treatment effect using the DID method, we specify an OLS regression model that includes an interaction variable of the treatment variable and the time period variable. The interaction coefficient provides the average treatment effect. We find a reduction of 0.195, 0.163, and 0.301 of logged GDP per capita for Costa Rica, Dominica, Grenada, compared to their controlled counterparts.

[2] Currently, Haiti is the only Taiwan-aligned country that has a Chinese commercial development office.

[3] See https://china.aiddata.org/projects/85351/.

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Appendix

This appendix lists the codes and positions held by the three individuals that I interviewed in Taiwan between October and December 2021. The interviews were conducted in Taipei City. Information regarding each of the interviewees is followed by the city and date when the meeting took place. I list the interviews in alphabetical order by the interviewees' last name. In compliance with the rules of the IRB, the interview data are anonymous to preserve confidentiality.

Interviewee A1. Foreign diplomat in Taiwan. October 30, 2021
Interviewee A2. Taiwanese diplomat. December 13, 2021
Interviewee A3. Former TaiwanICDF executive officer. November 5, 2021

CHAPTER 5
Economic Development and Africa's Diplpmatic and Grassroots Relations with China and Taiwan

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Taiwan and China have both used diplomatic relations with African countries to bolster their global standing – but have African countries benefited from switching ties to, or maintaining ties with, China during the period of improving Africa-China economic relations? Have closer diplomatic relations with China contributed to improved economic performance in African countries? Furthermore, have closer diplomatic relations with Beijing limited the policy space for African states to engage Taiwan? Finally, how have Taiwanese business and civil society actors promoted informal relations between Taiwan and African countries in the absence of government-to-government ties? To answer these questions, this chapter focuses on four case studies: two long-term African diplomatic partners of Taiwan which broke ties in order to establish relations with China - Malawi (2008) and South Africa (1998); and two African countries which have never been diplomatic partners but are nonetheless two of Taiwan's top trading partners in Africa - Angola and Nigeria. The chapter considers available economic data, the secondary literature evaluating these countries' evolving relationships with China, and interviews with African diplomats, Taiwanese businesspeople, and civil society actors who have worked or lived in African countries and helped promote informal relations. The chapter finds that a closer diplomatic relationship with China does not automatically translate into greater overall economic growth; greater economic dependence on China does not translate into less space for economic engagement with Taiwan; and people-to-people relations may be more important for sustaining Taiwan's relations with Africa in the long run than state-to-state relations.

5.1 Introduction

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 continued presence on the UN Security Council, the US encouraged Taiwan to deepen agricultural development cooperation with newly independent African states (Liu, 2013). China, at the time excluded from the UN and competing with the Soviet Union, built relationships with newly independent African states and liberation movements, providing military training and development assistance; the most famous being the construction of the Tanzania-Zambia Railway between 1970 and 1975 (Monson, 2009). In 1971, Beijing prevailed over Taipei at the UN with the support of African countries. During the 1990s, Taiwan improved its diplomatic standing 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 these gains from a peak of ten diplomatic partners in 1997.

The Forum on China-Africa Cooperation (FOCAC) was first held in 2000 and 2003 as ministerial meetings, but the 2006 Forum on China-Africa Cooperation hosted in Beijing was organized as a full summit, involving 41 heads of state from 48 African states(Shelton and Paruk, 2008). It was given prominent media attention and China's first policy white paper on Africa was unveiled. Most importantly, 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). Following FOCAC, there was a sharp increase in trade and investment with Africa, and economic relations have deepened further since. The forum set the pattern for subsequent triannual forums, during which trade deals, financing packages, and investment budgets were announced. For example, $60 billion in 2015, $60 billion in 2018, and $40 billion in 2021 (Sun, 2021). Attendance at FOCAC and eligibility for financing and aid are premised on acceptance of the "One China Principle" and exclude countries that recognize Taiwan (although China did extend invitations to Taiwan's diplomatic partners to be "observers" during the early FOCAC). As of 2022, Eswatini remains Taiwan's last diplomatic partner in Africa. Burkina Faso cut ties with Taiwan in 2018 just before that year's FOCAC, during which China expressed hopes that Eswatini would one day "join the China-Africa family" (Gao, 2018).

China's diplomatic success has been supported by growing economic links over the same period. In this chapter, I answer three questions: 1) Have closer diplomatic relations with China contributed to improved economic performance in African countries? 2) Have closer diplomatic relations with China limited the policy space for African states to engage Taiwan? 3) How have Taiwanese business and civil society actors promoted informal relations between Taiwan and African countries in the absence of government-to-government ties?

To answer these questions, this chapter focuses on four case studies: two long-term African diplomatic partners of Taiwan which broke ties in order establish relations with China: Malawi (2008) and South Africa (1998); and two African countries which have never been diplomatic partners but are nonetheless two of Taiwan's top trading partners in Africa: Angola and Nigeria. The chapter considers both the available economic data and the secondary literature evaluating these countries' evolving relationships with China, with an eye on the implications for relations with Taiwan[1]. The chapter also relies on extended interviews with 19 Taiwanese businesspeople, African diplomats in Taiwan, and civil society actors who have worked or lived in multiple African countries and played key roles in promoting informal relations. The choice of these countries and their interlocutors are not intended to be comprehensive in their representation of all Taiwan's relations with Africa, but to shed light on the specific issues in question.

The findings of this chapter are that 1) a closer diplomatic relationship with China does not automatically translate into greater overall economic growth because there are many other factors affecting economic performance. 2) Likewise, greater economic dependency on China does not necessarily mean a reduction in a state's policy space, meaning there may be more scope for informal engagements with Taiwan. 3) For Taiwan, the government's emphasis on formal diplomatic ties and government-to-government relations may overlook how economic and social relations promoted by informal contacts have played a role in maintaining links between Taiwan and Africa.

5.2 Did Recognizing China Contribute to Economic Growth?

The common assumption is that countries recognize China to promote economic growth. However, many factors affect economic growth, and closer diplomatic relations with China don't automatically boost performance. In order to determine whether switching ties affects economic growth, a Difference-in-Differences (DID) analysis was conducted for countries in Africa, Latin America, and the Pacific (see Chapter 3). The fact that DID tests produce mixed results raises the question of why relations with China or Taiwan appear to help in some cases, but not in others. What are the causal factors? How do diplomatic relations with Beijing change a country's economic relations with China? How do these changes affect economic conditions? In order to evaluate this question, economic relations should be broken down into trade, FDI, aid, and finance.

The effects of trade between China and the Global South has been extensively debated. On the one hand, China's exports of manufactured goods have been found to be correlated with a decline in African manufacturing (Giovannetti & Sanfilippo, 2016; Marukawa, 2017). On the other hand, China's demand for raw materials has contributed 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 also more rapidly increase the volume of its imports from China.

The more attractive aspect of diplomatic ties with China is attracting investment and financing. In order to be eligible for state-promoted investment packages and financing, it is necessary to be diplomatic partners with China and not with Taiwan. For example, economic packages and pledges have typically been announced during the triannual FOCAC, but only countries recognizing China have been invited. Nonetheless, China has extended invitations to Taiwan's diplomatic partners before to attend as observers, perhaps in order to advertise the promised benefits of switching. For countries seeking to diversify their economies, 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, which contribute to local manufacturing (Munemo, 2013; Wolf, 2017). Some African countries, such as Ethiopia, have even sought to replicate the East Asian "flying geese model." (Lin & Xu, 2019). The financing of infrastructure projects with Chinese loans has been more controversial because it has contributed to an unsustainable the 0debt burden in many countries. On the other hand, improved infrastructure and continued financing is nonetheless necessary for long term economic growth (Ryder & Fu, 2021).

The economic effects of closer ties with China are not one-dimensional, and it also must be remembered that China is not the only relevant actor which affects economic performance. Therefore, the justification that closer diplomatic ties with China will deliver economic growth may burden Chinese and African leaders with higher expectations than they can deliver.

5.2.1 Case Study: Malawi

Shortly after Malawi broke ties with Taiwan to recognize China in 2008, President Bingu wa Muratharika is alleged to have "told the nation that Malawi will not only benefit from aid but also China's rich experience. He said it would help turn Malawi from poverty to riches" (Mweninguwe, 2017). Did Malawi's decision to switch contribute to Malawi's economic growth?

Based on the methodology of Difference-in-Differences (DID) analysis (see Chapter 3), comparing GDP per capita growth trends vis-à-vis Niger (the control country for the analysis) before and after recognition, Malawi's economic performance began to slow during the six years following its establishment of ties with China. What happened?

The first effect of switching ties was increased trade volume. Malawi's exports to China increased, doubling between 2007 and 2010, according to the Malawi Ministry of Trade (Ndzendze, 2019). Ndzendze argues that recognizing Taiwan may be costly for countries by denying them access to the larger Chinese market, and that the prospect of increasing exports may be a motivation for countries to recognize China. Rich and Banerjee (2015) argue that countries that don't depend on exports may be less susceptible to Chinese pressure to abandon Taiwan. However, the case of Malawi's rapid increase in exports is not replicated in the case of both the Gambia and Burkina Faso, where trade with China, including exports, was already rising before there was a change in ties.[2]

Nonetheless, the volume of Malawi's imports from China increased even more (ANNEX 5.1). Before 2008, Malawi had less trade with China than did Niger (an average of 25 million USD per year versus 51 million USD per year), but it also had a smaller trade deficit with China (24 million per year versus 51 million per year), and already exported more to China overall than did Niger (4 million versus 985 thousand). After 2008, Malawi's exports to China increased even further but its trade deficit also expanded (to over 100 million in 2009, and upwards to a peak of 500 million in 2019).[3] Malawi's exports were primarily agricultural before 2008, providing 90% of the country's foreign exchange (Banik & Chasukwa, 2016, p. 149). Malawi's exports to China after 2008 have followed the same pattern (Nkhoma, 2020).

Nonetheless, although Malawi now receives nearly 20% of its imports from China, China is still a smaller trade partner overall than other countries in the region, particularly South Africa (Nkhoma, 2020). Furthermore, China's share of Malawi's exports peaked at 5.8% in 2015, meaning that its contribution to Malawi's GDP has never surpassed 1%.[4] In general, Africa's agricultural exports to China have been limited despite efforts to promote them (cf. Brautigam, 2015). De Bruyn (2014) found the impact of China on Malawi's agriculture to be limited.

Chinese FDI to Malawi increased after 2008, but high levels of FDI stock were not reported until 2013.[5] Overall, total FDI stock and flow remained higher in Niger during the whole period (400 million per year and 500 million total flow vs. 150 million per year and 85 million flow), meaning that while Malawi converged with Niger in terms of trade with China, it did not converge in terms of FDI. Nonetheless, early Chinese FDI in Malawi was concentrated in manufacturing (Thindwa, 2014, p. 51-52), generating 13,796 jobs between 2005 and 2012, a "significant" number according to Thindwa (2014, p. 60), but still substantially below some of the numbers promised. The overall contribution of industry to Malawi's GDP has hovered generally at 15% since 2001, with no visible growth after recognizing China in 2008, although in 2017 it increased to almost 19%, beating a previous record of

18% in 2007, a year before the switch.[6]

Mweningure (2017) writes that Malawi's debt to China is "most worrying to many Malawians." However, while Malawi's debt has risen over the last decade, the government reports that that only 9% of that debt was owed to China in 2019, a number which dropped to 6% in 2021.[7]

The data suggests that recognizing China has had a limited effect on improving Malawi's economic performance. As for Malawi's worsening performance in the 2010s, there were other factors. For example, in 2011, several major Western donors suspended aid to Murtharika's government on grounds of corruption. At the time, 40% of Malawi's national budget was dependent on Western aid (Banik & Chasukwa, 2016, p. 147). The suspension of aid contributed to an economic crisis, part of which was related to a lack of foreign exchange, which in turn led to anti-government demonstrations. During the demonstrations, Chinese traders, whose numbers increased after 2008, became targets of vandalism or violence. This led to the passage of a law, supported by the Chinese Embassy, limiting where foreign traders could operate (Nkhoma, 2020). While Chinese traders were targeted, some have argued that support from "emerging donors" at the state level, including China, but also India and Arab states, may have actually lessened the scale of the economic crisis (Banik & Chasukwa, 2016, p. 150).

This example demonstrates an important fact; the economic effects or lack of effects of diplomatic relations with China may be less relevant than is sometimes assumed. China is 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. It is worth mentioning that African leaders have also shown an interest in other East Asian states such as Singapore, Malaysia, South Korea, and Taiwan for similar reasons.

However, Chinese diplomats, African leaders, and particularly media reports frequently oversell what investment pledges and project proposals will deliver. For example, while conducting fieldwork in Tanzania in 2015, I personally encountered frequent media reports about Chinese investment packages and plans, only to discover later that reporters had recorded investment pledges as done deals, or misreported private investment plans as projects supported by the Chinese state. Such exaggerations can lead to disappointment. For example, in Malawi at the time of the switch, many NGOs and government agencies approached the Chinese embassy directly asking for financial support, a situation which led the ambassador to say publicly that China was not a "miracle performer," a complaint that caused a minor diplomatic incident early in the relationship (Nkhoma, 2020, p 694). When, in a ten-year retrospective of relations with China, Mweingure (2017) notes that "the country has since remained poor," Malawian officials point to the other factors influencing long term economic growth, such as the effects of climate change.

What then does recognizing China deliver? During the 10th year anniversary of Malawi-China ties, government officials pointed not to economic growth, but to specific projects completed by China (Mweningure, 2017). In fact, one of the reasons China is attractive to politicians is the extent to which China can deliver "visible" signs of development in the short term (Banik & Chasukwa, 2016).

Besides economic benefits, another area where Taiwan and China have competed is medical diplomacy. China has a long history of sending medical teams to Africa, and Taiwan, with its own well-developed health system, has also engaged in medical diplomacy in Africa. In Malawi, one of the biggest projects was the establishment of the Rainbow Clinic, an HIV/AIDS clinic at Mzuzu Central Hospital funded by Taiwan's International Cooperation and Development Fund (ICDF) and managed by Pingtung Christian University (Hsu, 2007). Following the break in ties between Taiwan and Malawi in 2008, Taiwan's medical team was withdrawn. As reported by China's National Health Commission, Malawi requested China's assistance and China provided its own medical team (NHC, 2013). However, according to a doctor who worked for the old Taiwanese team, the Chinese medics were unable to provide HIV/AIDS care, so the government approved the hospital's request to continue its relationship with Pingtung Christian University. This was permitted on a non-governmental basis alongside, but in a separate ward from, that operated by the Chinese doctors. Taiwanese media also reported that staff at Mzuzu Hospital were disappointed at the low English proficiency of the Chinese team (Luo, 2016). The head of Pingtung Christian University used his own funds to continue operating the clinic, and through an affiliated NGO registered in Norway, continued to operate in Malawi and promote exchanges between the two sides (Liu, 2021). The ICDF has also continued to fund such projects as medical training and the management of HIV/AIDS, tuberculosis, and hypertension in mobile populations.[8] In 2020, Pingtung Christian University was still providing medical training and there were Taiwanese doctors involved in tackling the COVID-19 pandemic (Liu, 2021; Tsou, 2020).

Following the establishment of diplomatic relations between Malawi and China, Beijing also became engaged in the medical sector. Following a longstanding model, a medical team was dispatched from a paired province, in this case Shanxi (Li, 2011). "Health and Medical Care" are described by Chinese officials as one of the four "pillars" of assistance alongside infrastructure, agriculture, and education (Banik & Chasukwa, 2016, 153). Studies have found that while there is appreciation for Chinese medical assistance, communication problems and a lack of transparency have produced some frustration among Malawian health workers involved in implementation (Daly et. al, 2020). Evaluating the Chinese medical team's performance in Malawi compared to Ethiopia, Grande et. al (2020, p. 21) argues that "whereas the Chinese government pays close attention to the program's visibility and messaging, far less attention is given to program improvement and performance against basic indicators." In any case, there has been a long stream of medical assistance from China, including funding for the construction of clinics, equipment donations and training.[9] Most recently, assistance was given during the COVID-19 pandemic (Xinhua, 2021), a period in which the Pingtung Christian University program was also offering assistance (Liu, 2021).

The lesson is that delivering visible signs of development or assistance have political value, and may indeed help people, but projects may still lag on other metrics. Nonetheless, in these cases, it is important to look at how individual actors implement programs and interact with people, which I will discuss in a section below.

5.3 Does Recognizing China Limit Policy Space for Engaging Taiwan?

There may be an assumption that countries which develop close economic relations with China will avoid contacts with Taiwan (Grimm et al., 2014, p. 37). This is related to the assumption that economic dependence translates into limited political choices. However, the opposite may be true. Within an overall situation of structural inequality and dependency, African leaders and politicians have historically taken advantage of competition among external actors. For example, African decisions to switch diplomatic ties have often been initiated by the contingencies of domestic politics rather than Chinese pressure alone. In several cases, African leaders facing organized opposition or close elections have requested more aid or contributions than Taiwan was willing to provide, leading to an opening for China. This was widely reported in the case of the Gambia (Shih, 2013), but from interviews I conducted with Taiwanese businesspeople, I heard similar stories about Chad, which according to one story, broke ties in 2006 after Taiwan rejected providing the President funds needed to pay civil servants. What this implies is that African states have more agency to drive decisions than the concept of "Chinese pressure" implies.

Furthermore, China has generally tolerated informal economic relations between its diplomatic partners and Taiwan, including the operation of representative offices, provided these relations don't involve direct government-to-government interactions. However, the precise red lines may be contingent on the state of cross-strait politics. For example, China did not establish relations with the Gambia while the KMT was in power in Taiwan, seemingly upholding the "diplomatic truce", which was contingent on Taiwan supporting the "One China" principle. When the DPP came to power in 2016, China quickly moved to recognize the Gambia and continued poaching other diplomatic partners. Nonetheless, African states may sometimes take initiatives on their own against Taiwan even without evidence of Chinese pressure. The complicated interaction between when and how China applies pressure, and the political motivations of African leaders, mean that greater economic dependence on China is not necessarily correlated with greater limitations on relations with Taiwan.

5.3.1 Case Study: South Africa

Apartheid South Africa developed a close relationship with Taiwan during the later stages of the Cold War. Starting in the 1980s, South Africa encouraged Taiwanese people to migrate and invest in industries near the so-called "Homelands", and the Taiwanese population reached a peak of at least 50,000 in the 1990s (Park, 2017, p. 32). However, despite Taiwan's association with the apartheid government, and support for recognizing China within the new government, the ANC did not immediately break ties after democratization. Ideologically, the African National Congress (ANC) and Chinese Communist Party (CCP) were natural allies. However, the ANC was historically closer to the Soviet Union and was therefore on the opposite side to China during the Angolan civil war (Taylor, 2000). Furthermore, during the democratization process, Taiwan tried to maintain its relations with South Africa by developing ties with the ANC, providing funding for their 1994 election campaign (Davis 1998) and funding for the Reconstruction and Development Program (Anthony & Kim, 2017, p. 206).

President Nelson Mandela made a concerted but ultimately fruitless effort to convince China to accept dual recognition (Williams & Hurst, 2018). The decision to accept China's terms for establishing diplomatic relations were eventually justified within South Africa on economic rather than ideological grounds. China provided a larger future market for South African exports and for investment than Taiwan. In the 1990s, Taiwan was still one of South Africa's largest trading partners, but it could not compete with China (Anthony & Kim, 2017, p. 208). The second reason was that China indicated that South Africa's access to Hong Kong, where South Africa maintained crucial business links, might be disrupted if it continued to recognize Taiwan (Lin, 2007).

Nonetheless, despite agreeing to China's terms, South Africa gave Taiwan a 13-month transition period, making the switch in diplomatic ties relatively amicable (Alden and Wu, 2014). The embassies were replaced by liaison offices. Despite the suspension of official development programs, trade and investment at the private level between South Africa and Taiwan continued as before. In 1999, there were still 311 Taiwanese-run factories, an increase from de-recognition the year before (Lin, 2007, p. 340). The subsequent decline and repatriation of Taiwanese has been attributed to concerns about security and labor conflicts rather than the absence of diplomatic relations (Anthony & Kim, 2017), something echoed in interviews I conducted with Taiwanese residents of South Africa.

South Africa's diplomatic and economic relationship with China has grown closer since, with South Africa invited into the BRICS group and being upgraded by China to a "comprehensive strategic partnership" in 2013. Intra-party exchanges between the ANC and CCP have also deepened, to the extent that the CCP helped the ANC establish its own political school modeled on the CCP (Benabdallah, 2020). This relationship has led to allegations that South Africa is becoming increasingly dependent on China. South Africa has, for example, repeatedly denied visas to the Dalai Lama, a decision criticized for putting business interests ahead of the country's reputation as a human rights defender. The late Archbishop Desmond Tutu was one of many senior figures to speak out against the decision (Park 2017, 43; Muresan & Naidu, 2021). According to one South African official I spoke to, the relationship is "frank and open" and based on "mutual respect" which serves South Africa's interests. Despite this, South Africa and Taiwan have maintained not just business links, but also unofficial political ties. These include economic cooperation, dialogue forums (Tseng, 2008), and contacts between Taiwanese politicians and South African parliamentarians (albeit largely opposition members) (Schultz & Chang, 2019). Nonetheless, the absence of diplomatic ties means that Taiwan can't communicate directly with South African officials and must rely on lower levels of the bureaucracy (including the deputy minister level), or the mediation of non-state actors (Anthony & Kim, 2017, p. 209).

Anthony and Kim, writing about the early 2010s, interpret China's tolerance of these unofficial links to be reflective of a form of "economic pragmatism" which characterizes not just cross-strait relations, but globalization more generally. According to this interpretation, China would only interfere in South Africa-Taiwan relations if they became "political." This state of affairs may have changed in the late 2010s. Following the election of President Tsai Ing-wen, China suspended the so-called "diplomatic truce," establishing ties with the Gambia three years after it had broken with Taiwan and moving forward to establish ties with São Tomé and Príncipe and Burkina Faso. Beijing also put pressure on Eswatini, with the former Chinese Ambassador to South Africa, Lin Songtian, stating that the southern African kingdom might suffer consequences if it continued to recognize Taiwan (du Plessis, 2020). The ambassador had raised the specter of economic coercion, although any such measures have yet to materialize.

While China has not challenged the presence of Taiwan's liaison offices in South Africa, the Solly Msimanga scandal may reflect new circumstances. In December 2016, Solly Msimanga, the Mayor of Tshwane in Pretoria and a member of the opposition Democratic Alliance (DA), visited Taipei at the invitation of the mayor, Ko Wen-Je. His visit not only received public condemnation from the Chinese embassy in South Africa, but also from South Africa's foreign ministry and the governing ANC, both of which accused Msimanga of contravening South Africa's foreign policy by engaging in government-to-government meetings (China File, 2017). Such actions should also be seen in the context of domestic politics. Besides the DA, another opposition party, the Inkatha Freedom Party (IFP) has also had close ties with Taiwan since the early 1990s. It took part in delegations to Taiwan in 2016, 2018 and 2019, each time prompting complaints from the Chinese embassy (October, 2016; Shange, 2018). According to a South African official, the government is now discouraging reciprocal visits between politicians.

Grimm, Kim, and Anthony, operating on the assumption that China tolerates business links that fall short of political contacts, argue that South Africa and others may have succumbed to a "culture of self-censorship" (2014, p. 37) by cutting links with Taipei above and beyond any mandate from Beijing. This implies that South Africa and other African governments may have greater space for engaging Taiwan but have chosen not to out of an abundance of caution. In some cases where African officials have taken actions against Taiwan or attempted to minimize contacts, there is evidence that it did not initiate with the Chinese Embassy. For example, when Uganda's Ministry of Foreign Affairs attempted to prevent athletes from attending the 2017 Universiade in Taipei, the Chairman of the Uganda Taiwanese Chamber of Commerce, Jeff Lin went to the Chinese Embassy and was told that that while they opposed diplomatic contacts, they did not oppose "people to people activities" like sporting events (Chen, 2017). However, in other cases, the exact point of genesis in putting pressure on Taiwan is not entirely clear, which simply demonstrates the role and agency of African actors, as in the case of Nigeria below.

5.3.2 Case Study: Angola and Nigeria

Taiwan has never had formal diplomatic relations with either Angola or Nigeria. Nonetheless, they are Taiwan's two largest trade partners in Africa after South Africa. Angola and Nigeria have also developed close economic relations with China over the past two decades, but to different degrees. Angola and Nigeria are both oil exporters, but whereas Angola's economy is primarily dependent on oil exports (86.7% of exports in 2019, with exports being 39% of GDP), Nigeria's economy is more diversified (oil 72% of exports but exports only 12% of GDP); and whereas Angola's primary oil customer is China (62.4% in 2019), Nigeria's customers are more diverse (China took only 3.95% in 2019).[10] Finally, China's investment in Angola, and Angola's debt to China, are greater than Nigeria's. A cursory glance would suggest that Angola has been more dependent on China than Nigeria (ANNEX 5.2). However, an examination of Nigeria and Angola's recent political relations with Taiwan and China suggests the situation is more complicated.

Taiwan established a trade office in Lagos in 1991, the same year Nigeria moved its capital to Abuja (Abubakar, 2021). In 2001, Taiwan also moved its trade office to Abuja, prompting complaints from China that it was behaving like an embassy. In

2004, the Nigerian government attempted to evict the office from the capital and force it back to Lagos, using the military to close it down for five months. However, following negotiations, the office was allowed to remain (Vanguard, 2017). Nigeria may have attempted to assuage Beijing by publicly endorsing China's enactment of its "Anti-Secession Law" the following year. The office itself remained unmolested until January 2017 when Nigeria abruptly ordered Taiwan to move it back to Lagos and to change the name in its title from "Taiwan" to "Taipei" (Oshodi, 2018). During the confrontation, Nigeria even asked its director, Morgan Chao, to leave Nigeria saying that his safety could not be guaranteed. In June, the military was sent in to evict the staff and seal the premises.

What had happened? Why did Nigeria suddenly become hostile to Taiwan? In the wake of the incident, there were multiple interpretations. One report drew a connection between the eviction and a visit by the Chinese Foreign Minister, Wang Yi, to Nigeria around the same time. Wang pledged US$40 billion in funding for infrastructure construction during the visit (Oshodi, 2018). According to this narrative, Nigeria's move was either requested by the Chinese or was done proactively as a favor. Another interpretation is that Nigeria wanted to improve relations with China in exchange for support for Nigeria's bid for a seat on the UN Security Council (Abubakar, 2021). Oshodi (2018) argues that Nigerian officials may have natural sympathy for China's sovereignty claims over Taiwan given Nigeria's own history with independence movements in Biafra.

According to a Nigerian official I interviewed, the impetus for the move was not due to any change on the Nigerian side but the changing relationship between Taiwan and China. The official would not confirm which side initiated the move but said the full closure of the Taiwanese office had been considered. However, when reviewing the original 1990 MOU, the Nigerians discovered that while the office was allowed to engage in economic activities, it was forbidden from any "political" role.

During an interview with a Taiwanese businessperson, I heard another story which attributes the incident to the individual initiative by China's ambassador to Nigeria. According to this account, the ambassador, seeking to impress his superiors in Beijing, approached one of President Buhari's secretaries and "bribed" him to bring the matter before the president. Buhari signed the order but that did not guarantee the authorities would actually enforce it, so the ambassador also "bribed" the local police to act on the order. Although the veracity of these stories cannot be verified, they point to the fact that there are a range of different interests and actors on both the Nigerian and Chinese sides.

Nonetheless, providing a diplomatic assessment of the move, the Nigerian official I interviewed argued that the move may have been a blessing in disguise for Taiwan. While Abuja is the official capital, Lagos is the economic center of Nigeria and the economic hub for all of West Africa. The official observed that Taiwan's office became more active after the move and bilateral trade increased.

By comparison, Angola's trade dependency on China has shown little sign of succumbing to political dependency. Following the end of a two-decade civil war, Angola accepted a $2 billion oil-backed reconstruction loan from China and welcomed Chinese construction companies and thousands of workers into the country to fulfill the contracts. As Lucy Corkin described it in 2011, the relationship was a "marriage of convenience." China had had a less amicable relationship with

Angola than with other African states during the Cold War because, alongside the US and South Africa, Beijing had backed the Union for the Total Independence of Angola (UNITA) against the Soviet-backed government which eventually prevailed. During the early 1990s, when prices for oil were still low, Angola explored the possibility of establishing diplomatic relations with Taiwan (Campos & Vines, 2008). In 1992, Taiwan opened a representative office in Angola but closed it in 2001 on its own initiative. Angola's acceptance of the Chinese loan in 2004 after the end of the civil war in 2002 reflected a larger strategy on the part of Angolan leaders to diversify reconstruction financing (Corkin, 2011). An IMF package they had rejected had included political conditionality and transparency reporting requirements; the Chinese loan did not. Rather than making Angola dependent on China the strategy may have reflected Angola's desire to "diversify dependency" beyond the IMF (de Carvalho et. al, 2021).

Nonetheless, Angola's positive economic performance in the following decade was dependent on high oil prices, driven by Chinese demand, and China itself was the primary importer of Angolan oil. Following the drop in oil prices in the mid-2010s, however, Angola's debt to China, payable in kind, had become a liability (ibid.).

Furthermore, following a political transition in 2017, the new government has investigated business deals made by its predecessor, threatening the position of Chinese companies whose privileges depended on connections with officials now out of power (ibid.). Finally, notwithstanding geopolitical jitters in the 2000s about China taking over Angola's oil blocks, China's direct control of oil exploration and drilling in Angola is still limited, and most of the production is still controlled by Western oil companies. Furthermore, exploration of deep-sea oil fields remains dominated by Western companies and technology (ibid.).

This suggests China may be more dependent on Angola than vice versa, one reason it has sought to diversify its own oil supplies. Angola may, from one perspective, have greater latitude to develop relations with Taiwan. Angola was Taiwan's largest trade partner in Africa in 2006 and remains the second largest today. However, this trade relationship is mediated through the international oil market, not any direct linkages. Taiwan closed its office early in 2001 and there are no more than twenty Taiwanese people in Angola today. They are far outnumbered by the Chinese business community which has had longer experience and closer relationships with Angolan officials. Notwithstanding claims that the Angola-China relationship is "on the rocks" (ibid.), these people-to-people relationships likely mitigate against a conspicuous diplomatic push by Taiwan.

5.3.3 The Motivations of African Political Actors

African states have pursued closer ties with China, sometimes at the expense of relations with Taiwan, for a variety of reasons. The history and memory of Third World solidarity is important, particularly in countries like Tanzania, and it features prominently in diplomatic rhetoric. However, the motivations for why any particular political leader pursues closer relations with China are more complex.

Economic benefits, as discussed above, are always a key factor whoever the donor may be. As one official from an African country told me in Taiwan, "The agenda of the continent is not secret - it's about infrastructure, health, poverty alleviation, job creation, industrialization...if you meet us there, I think you're going to be welcomed." China is welcomed because it is perceived to deliver specific goods. For example, multiple officials mentioned FOCAC, the China Import-Export Bank and the New Development Bank as specific points of attraction. Officials from Somaliland also noted the appeal of China's "non-interference" policy but pointed out that attitudes may now be changing because of concern about debt burdens and "economic colonization." African officials based in Taiwan nonetheless emphasized that Taiwan had a positive role to play if it could align itself with Africa's priorities. For example, a Nigerian official mentioned technology transfer as something Taiwan was capable of providing.

Besides any interest in attracting investment, there are also regional political and geopolitical factors. For example, both Nigeria and South Africa want to be members of the UN Security Council or at least promote UN reform. A South African official pointed to China's support for South Africa's membership of the BRICS grouping as an important gain from the relationship. Somaliland, by contrast, sees little prospect of gaining Chinese recognition of its independence. An official said the de facto state therefore saw little risk in establishing informal relations with Taiwan, with which it feels a natural solidarity because of their international marginalization. China has little scope to retaliate against Somaliland because they have little trade, and the Somalilanders who do business in China use foreign passports anyway. In addition, Somaliland's outreach to Taiwan appears to some extent to be aimed at an audience in the United States. For example, during a recent visit to Washington, representatives from Somaliland lobbied congress for support by emphasizing the ties they had established with Taiwan. They framed the relationship in the context of "opposing" China in Africa (Kine, 2021). The narrative may not reflect the full complexities of Africa's relationships with China, but Somaliland's appeal to "New Cold War" sentiment in the United States may reflect a strategy to use Taiwan to leverage more support from the United States. This is, of course, similar to what Taiwan has been doing to bolster support for its own security.

However, a more mundane motivation is that of politicians seeking to consolidate support by channeling resources from powerful outside actors, a condition of so-called "dependent agency" (Bayart, 2000). The interests of political actors in establishing ties with Taiwan in the 1990s or establishing ties with China after the 2000s reflect this. While the prospects for establishing diplomatic ties, or setting up representative offices, may be limited, Taiwanese businesses have greater opportunities. As one Taiwanese businessperson I interviewed explained, no African government minister would turn them away if they came to propose building a factory.

5.4 Grassroots Economic and Social Relations Between Africa and Taiwan

The emphasis on government-to-government relations between Taiwan and Africa may be useful for demonstrating Taiwan's sovereignty but a state-centered approach can undervalue the role of people-to-people contacts. Not only have informal ties in business and civil society helped maintain connections to Africa in the absence of diplomatic ties, they have also provided resources for Taiwan's foreign policy in terms of social capital and expertise in places the Taiwanese state can't go. Nonetheless, private sector actors I interviewed said that Taiwan's government retains a traditional mindset about relations with Africa and does not fully utilize or support the networks and expertise developed by such individuals.

In order to understand how private actors have developed and maintained relations between Taiwan and Africa, it is necessary to look beyond the four cases discussed above (Malawi, South Africa, Nigeria, and Angola) and consider Taiwanese engagements across Africa. The following sections are based on interviews with Taiwanese businesspeople and NGO workers conducted in Taiwan.

5.4.1 How Private Actors have Developed Relations between Taiwan and Africa

The Taiwanese were among the earliest "ethnic Chinese" actors in post-colonial Africa. The largest number went to South Africa, reaching at least 50,000 in the 1990s (Park, 2017). Before 1998, there were 620 Taiwanese businesses in South Africa with a total capital investment of $US 1.5 billion, employing 45,000 people (Anthony & Kim, 2017). While these numbers have declined, people-to-people relations with South Africa remain the closest. Continent-wide, in 2020, according to Taiwan's Overseas Community Affairs Council, there were 10,000 Taiwanese operating 400 businesses across 28 African countries. Although they are outnumbered by Chinese migrants, some Taiwanese, on account of being earlier arrivals, are prominent figures in what is locally considered the "Chinese community." In Ghana, a Taiwanese man I interviewed, who first arrived in the early 1980s, is now a well-known industrialist. In Nigeria, the head of the Taiwanese business association is developing the first Taiwanese-owned industrial park in the country. In Uganda and Tanzania, Taiwanese have headed Chinese business associations. In Ghana and Cameroon, the head of a customs clearance house has established a Taiwan showroom featuring Taiwanese products. In Malawi, in 2008, the same year ties were cut, a Taiwanese social enterprise investor, in collaboration with European NGOs, developed a coffee enterprise selling seeds to smallholder farmers and purchasing their yields. He has politically connected friends and has been invited by neighboring countries to invest there as well.

Many of these individuals and their families established their businesses, livelihoods and relationships independent of the Taiwanese government. They established themselves in countries with which Taiwan has never had diplomatic relations.

More recently, a younger generation of Taiwanese have established ties with Africa through NGOs (both Taiwan-based and international),[11] churches[12] and Taiwan-based Buddhist charity organizations (such as Tzu Chi[13] and the Amitofo Care Center[14]). African students from countries other than Taiwan's diplomatic partners have also arrived in Taiwan through partnerships between universities and foreign NGOs.[15] Other organizations, like Wow Africa,[16] have established media platforms designed to improve knowledge about Africa in Taiwan. Tsou (2020) lists 18 different NGOs from Taiwan that are active in Africa in health, social welfare and agriculture.

These efforts supplement those of organizations like the Taiwan-Africa Business Association (TABA) and the government sponsored Africa-Taiwan Economic Forum (ATEF), which have organized trade delegations and seminars in collaboration with African representatives, the Ministry of Foreign Affairs, and the Overseas Community council to promote trade investment.

5.4.2 How People-to-People Relations have promoted diplomatic relations

Taiwanese private actors have had greater mobility and freedom of access in Africa than Taiwanese government officials, meaning that some have personal networks with local high-ranking officials. For example, as discussed above, a Taiwanese business person based in Uganda was able to directly negotiate the passage of athletes competing in the 2017 Universiade from being blocked by that country's Ministry of Foreign Affairs. In the past, Taiwan's diplomacy in Africa has depended, in a quiet way, on the social capital of these networks. One such person I interviewed, a man who began doing business in Africa in the 1980s leading business delegations, developed such a wide network of contacts that Taiwan's government often recruited him for sensitive negotiations with African leaders who were contemplating breaking ties. In Nigeria, it was the head of the Taiwanese Business Association, who assisted the trade office in finding a new location after being evicted from Abuja. In order to forestall the possibility of China pressuring a Nigerian landlord in the future, this individual purchased the property himself to let to Taiwan's trade office.

Perhaps the most successful recent example of non-state ties supporting diplomatic relations is the establishment of informal relations between Taiwan and Somaliland. Volunteers from the Taiwan Root Medical Corps (TRMC) were the first to go to Somaliland, laying a bridge for the later establishment of relations (Tsou 2020, p. 23). Indeed, one of the officials at Somaliland's office in Taiwan first came to Taiwan on a Taiwan MOFA scholarship several years before ties were established.

Taiwanese in Africa nonetheless have to walk a thin line given the presence of China. The people I have interviewed generally agree that China does not directly interfere in their economic or social activities unless it is too "political." One person considered this a form of pressure, explaining how displaying a Taiwanese flag in the office, or arranging Double Ten (national day) celebrations, can lead to friction. Taiwanese who have played more active roles facilitating contacts between African and Taiwanese officials have faced greater challenges. For example, the government of Mozambique ran a trade office in Taipei for several years through the efforts of a young Taiwanese man who was raised in South Africa and Mozambique after his family migrated there in the 1990s. According to my interview with him, the office in Taipei was eventually closed by Mozambique due to pressure from the Chinese government. The individual who helped the Taiwanese government negotiate with African governments (see above) told me that he used to have no trouble traveling or giving talks at trade exhibitions, but that he was now often blocked.

Nonetheless, many Taiwanese in Africa consider it practical to maintain cordial relations with Chinese embassies mindful that they can offer assistance, such as during the pandemic. Some of this is a deliberate attempt to win Taiwanese sympathy. Indeed, several interviewees claimed that in the past they had received more preferential treatment than mainlanders. For example, Taiwanese who showed up at some Chinese embassies applying for their Taiwan Compatriot Pass (the document China provides Taiwanese in lieu of a visa for visiting China) would be served on the spot rather than being asked to make an appointment online first. According to one interviewee, however, this has changed in the past few years. However, when a Chinese embassy extends invitations to events, some will politely attend, insisting nonetheless that they maintain red lines. Some said they socialize with Chinese people and even officials in non-political settings but avoid explicitly political settings such as the Overseas Chinese Association for the Peaceful Unification of China. Maintaining good relations with Chinese people is important for Taiwanese businesspeople because many rely on them as customers or even business partners. As one Taiwanese businessperson implied, the purpose of maintaining of good relations with Chinese officials was that turning down invitations to such events as Chinese New Year celebrations might mark them as pro-independence, and possibly negatively affect their business. As another businessperson argued, it is a good idea to maintain cordial relations with the Chinese Embassy because "they can help you" in the event of trouble, especially given the lack of a Taiwanese diplomatic presence. Those Taiwanese who maintained a distance from "political" activities implied that they did so for the simple reason of patriotism towards their own country.

5.4.3 The Limits and Vulnerabilities of State-to-State Relations

A frequent criticism from private Taiwanese actors is that their government has not done enough to promote or support investment in Africa. This is despite the president's "Africa Plan," established in 2018, which has in fact depended on the Overseas Community Affairs Council, and the Taiwan-Africa Business Association, to mobilize Taiwan's existing business networks in Africa. Nonetheless, the government's activities have been criticized as limited primarily to educational seminars and verbal encouragement. Instead, as several interviewees argue, the government should provide material incentives and support for investors and consider ways of collaborating with third parties from other countries to jointly support projects.

Rich and Banerjee (2015) write that "economic diplomacy offers Taiwan options to expand its role in international relations where formal diplomatic recognition is unlikely." However, Taiwan alone can't compete on the same scale as China. Taiwanese businesspeople in Africa also don't necessarily see themselves in direct competition with Chinese businesses. Instead, they are trying to develop a niche offering higher quality products and services. Multiple interviewees pointed to the sale of Taiwanese machinery as an area where Taiwanese can compete on quality and service. In that respect, their positioning is similar to other countries competing on their country-brand in Africa (such as Turkey).

The challenge is the cultural gap between government officials and business or civil society actors. Taiwan's government is hesitant to interfere in the "free market" by directly supporting businesses. By contrast, there is a perception that the Chinese state does much more to support at least its SOEs in Africa. The challenge, according to one African official, is that Taiwanese businesspeople are very cautious about investing in Africa due to a lack of sufficient information. In the case of Somaliland, the official argues more could be done to help the government survey the country's resources and opportunities. Another official observed that Chinese investors tend to be better informed about Africa than their Taiwanese counterparts.

On the other hand, business and civil society leaders criticize a traditional mindset which places too much attention on diplomatic partners rather than building relationships everywhere, and which understands economic relations with Africa too much in terms of "aid" rather than "business." Taiwanese businesspeople, especially those with long-term experience in Africa, emphasize the body of expertise they possess, implying that the Ministry of Foreign Affairs lacks sufficient area expertise in Africa. This is underlined by the fact there is no dedicated research institute in Taiwan for African studies. This is despite the fact there was a small surge in the number of African diplomatic partners during the 1990s. The comparison with the development of Southeast Asian studies in Taiwan is instructive. Academic connections between Taiwan and Africa have therefore been largely on a person-to-person level. Indeed, the first African research center was opened at National Chung Hsing University in 2018 by a single professor, an agricultural engineer by training, who has collaborated with various NGOs on projects in multiple African countries. However, he has been unable to receive funding from MOFA, which would only fund the center if it was holding events during formal diplomatic events like hosting the King of Eswatini during his visits to Taiwan.

The Taiwan government supports NGO initiatives through agencies like the ICDF (Tsou 2020), but despite some exceptions, interviewees said there was much institutional pressure to focus on regions where Taiwan has a diplomatic presence. When countries break ties with Taiwan, or impose difficulties on Taiwan, the standard diplomatic response has been the principle of reciprocity. Nonetheless, the people I have interviewed have found these actions counter-productive because they unnecessarily damage informal links which can be preserved to the advantage of Taiwan even after a formal break in ties. For example, one of the most controversial actions taken by Taiwan after a break in ties is the suspension of scholarships for students, often in the middle of their semester. Several interviewees pointed out that punishing students for the actions of their governments neglects the role the students could play in future relations. For example, engineering students may become customers for Taiwan's machinery exports, while others may continue to feel gratitude for Taiwan's role in their education. It is worth mentioning that educational networks are one of the ways China has developed rapport with African countries (Benabdallah, 2020). MOFA, the Ministry of Education, and the Taiwan International Graduate Program (TIGP) do offer international scholarships, and there are African students from non-diplomatic partners in Taiwan, but the limited number of Taiwan representative offices in Africa limits their reach. There are also private recruitment efforts. However, close oversight of educational exchanges is necessary, especially those led by private universities, which have repeatedly lured foreign students to Taiwan on false promises of education while placing them in exploitative factory work (Yang, 2022). This can be very damaging for Taiwan's reputation.

Taiwanese private actors have occasionally taken steps to preserve ties after diplomatic breaks, such as extending tuition and living support to students stranded in Taiwan. The same is true for projects in Africa. As discussed earlier, when Taiwan cut funding from its programs in Malawi after 2008, Pingtung Christian Hospital and its owner took over the funding and operation of the Taiwan-built Rainbow AIDS clinic (Liu, 2021). For comparison, Chinese private actors have also been an important part of China-Africa relations. For example, in Burkina Faso, relations between Chinese wholesale traders and Burkinabe businesspeople established a constituency in favor of diplomatic relations years before the government switched ties in 2018 (Mohammad, 2018).

While it is unlikely that Taiwan will create a lobby for reestablishing formal ties, creating a constituency of people friendly to Taiwan can help in other ways. This is important because most people in Africa, like elsewhere, don't understand the nuances of the China-Taiwan conflict. When African governments release statements supporting China's positions on Taiwan, Hong Kong or Xinjiang, it partly reflects their suspicion of the West, but it also reflects the low stakes and low opportunity costs involved. Maintaining channels of communication at least ensures there is some level of opportunity for people to hear Taiwan's story from ordinary Taiwanese themselves rather than from either Western or Chinese media. As one

Taiwanese engaged in NGO projects in Africa explained it to me, his only "condition" for assistance is that if Taiwan ever gets attacked by China, they will at least say something publicly on Taiwan's behalf. According to Pingtung Christian University, local officials in Malawi have expressed gratitude that Taiwanese have continued to help in the medical field despite the loss of formal ties (Tsou 2020, p.16).

A wide network of people-to-people relations may be more dependable than government-to-government relations, which are vulnerable to not just Chinese pressure, but more fundamentally to the decisions of a limited number of African political actors. As in the case of China, Taiwan's high-level relationships with African countries have primarily been close relationships with rulers and political elites. This makes Taiwan's diplomatic relations particularly vulnerable to the whims of individual leaders or to political changes in leadership. An official from Somaliland stressed to me that Taiwan needed to have a close understanding of what they called "tribal" issues, that is, which group is in power and which is not. Reviewing the history of diplomatic switches, Bhaso Ndzendze (2020) observes that "of the four states that were not new democracies but still switched (i.e., Senegal, Chad, Malawi and São Tomé and Príncipe), three (Chad, Malawi and São Tomé and Príncipe) did so within a year of an upcoming election following a declining performance in the preceding presidential election by the incumbent leaders."

The other reason this situation makes Taiwan vulnerable is that it links the legitimacy of relations with Taiwan to the legitimacy of the ruler. For example, Rich and Banerjee (2015) have found statistically that in the past the less democratic an African country was the more likely it was to recognize Taiwan. China faces similar challenges as the case of Angola after the end of the De Santos regime demonstrates.

These facts raise uncomfortable questions about the long-term sustainability of Taiwan's relations with its last formal diplomatic partner in Africa, the Kingdom of Eswatini, which international news reports never fail to remind us is Africa's last "absolute monarchy." Given Eswatini's importance to MOFA, the country receives prominent attention at government sponsored events in Taipei. Taiwanese diplomats and businesspeople I have spoken to all describe their relationships with the king in glowing personal terms as a close friend who is a strong supporter of Taiwan. While this may reassure them of Eswatini's friendliness to Taiwan, last year's violent pro-democracy and anti-monarchy demonstrations in the country, and their subsequent repression by the state, indicate a risk for Taiwan's relations in the event of democratization or political transition (Dlamini, 2021).

This poses a dilemma for Taiwan's argument that its foreign policy is based on democratic values and that the countries it has the closest ties to are also democracies. The argument holds if Taiwan keeps the focus on its informal relations with Lithuania or Somaliland but is less convincing for pro-democratic opponents of the government in Eswatini as well as opponents of Taiwan's diplomatic presence in Africa. Historically, African states that recognized Taiwan were more likely to be undemocratic and democratization in those states has usually led to the recognition of China (Rich & Banerjee, 2015). This dilemma is by no means unique to Taiwan, reflecting the contradictions between what countries would like to believe about themselves and the pragmatic choices they make. Nonetheless, it is important to acknowledge the contradiction and recognize how it affects how one's country is perceived. The fact South Africa didn't immediately break ties with Taiwan after 1994 is one example of how Taiwan protected itself by getting on board with democratic trends. Of course, if Taiwan was to start getting visibly close to Eswatini's opposition, that could have the effect of pushing the government towards China. In either case, the long-term endurance of Eswatini's ties with Taiwan will ultimately depend on how Swazi society at large feels about the relationship.

5.5 Conclusion

The findings of this chapter have been that a closer diplomatic relationship with China does not automatically translate into greater overall economic growth because there are many other factors affecting economic performance. Likewise, greater economic dependency on China does not necessarily mean a reduction in a state's policy space, meaning there may be more scope for informal engagements with Taiwan. Nonetheless, for Taiwan, economic and social relations promoted by people-to-people relations with African countries may have a key role in extending relations beyond the limits of formal ties. As one Taiwanese entrepreneur explained, Taiwan should seek to have as many global relationships as possible because relationships are a good in themselves.

Notes

[1]The selection of these four cases is based primarily on their importance as Taiwan's top trade partners in Africa. In terms of conducting DID analysis on the effects of switching ties to China, most of the cases occurring after the 2006 Forum on China Africa Cooperation (the Gambia (2016), São Tomé and Príncipe (2016), Burkina Faso (2018)) are too recent for long-term effects to be measured. Malawi, a long-partner which switched ties in 2008, offers a case with more data and existing scholarship.

[2]UN Comtrade Data, accessed from trademap.org.

[3]UN Comtrade Data, accessed from trademap.org.

[4]UN Comtrade Data, accessed from trademap.org.

[5]SAIS-CARI Data.

[6]World Bank data.

[7]Data from Malawi Ministry of Finance https://www.finance.gov.mw/

[8]Taiwan International Cooperation and Development Fund https://www.icdf.org.tw/lp.asp?ctNode=30817&CtUnit=172&BaseDSD=100&mp=2

[9]AIDDATA. Global Chinese Development Finance Database, version 2.0., accessed from https://china.aiddata.org/

[10]Data from UN Comtrade Data, World Bank Data, and the Observatory of Economic Complexity (oec.world)

[11]Love Binti (https://www.lovebinti.org/mission); 還有我 And Me Taiwan (https://www.facebook.com/andmetaiwan/)

[12]Step30 International Ministries (https://www.step30.org/)

[13]https://www.tzuchi.org.tw/en/index.php?option=com_content&view=category&layout=blog&id=87&Itemid=272

[14]https://www.acc.org.tw/en/text?id=2

[15]For example, the International Program for Sustainable Development, in cooperation with the Jane Goodall Institute, at Chang Jung Christian University (https://dweb.cjcu.edu.tw/ipsd?lang=en)

[16]https://wowafrica.tw/

[17]http://amebse.nchu.edu.tw/new_page_81.htm

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CHAPTER 6
Economic Development and Diplomatic Relations with Taiwan and China in Oceania

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Over the past two decades, China has significantly increased its political and economic influence in the Pacific through loans, aid and other aspects of economic engagement. Its activities have drawn much attention from researchers and officials who promote the narrative of "China as an alternative" to the traditional powers in the region. Taiwan's engagement, on the other hand, has received relatively little attention. This chapter examines the implications of diplomatic relations with either Taiwan or China and how they affect economic development in the island countries in Oceania. We assess economic and trade data over the past two decades and compare economic performances. Analysis using the Difference-in-Differences method shows that siding with Taiwan is an economically reasonable choice for small island states that rely heavily on fisheries. Larger countries whose revenue relies on resource extraction depend on China as an export destination and are thus more vulnerable to political pressure from Beijing. We argue that diversified import and export markets are a key requirement for countries attempting to resist pressure and preserve their independence of action. Taiwan and its partners should adopt a diplomatic approach with an Oceania-centered perspective, taking account of the region's vision of sustainable development and its focus on the impact of climate change.

6.1 Introduction

Of the remaining states that officially recognize Taiwan (14 as of 2022), four of them are Pacific islands countries: the Marshall Islands, Nauru, Palau and Tuvalu. Two others, the Solomon Islands and Kiribati, switched to Beijing in 2019. During tussles over diplomatic recognition in the Pacific, arguments are frequently made that establishing diplomatic ties with China enhances economic development because of the country's vast economic clout. However, there has been no systematic research on the real-world impact of such changes.

This chapter examines the impact of the diplomatic choice between Beijing and Taipei on economic development across Oceania. The countries are far from homogeneous. They vary in size, natural resources and sub-region. Some scholars have used the MIRAB model to assess these economies, focusing on migration (MI), remittances (R), foreign aid (A) and public bureaucracy (B) (Bertram, 1999). However, such a system cannot be applied to the region as a whole. We decided to study twelve countries from the three sub-regions to allow for geographical variations. Economic engagement by Taiwan and China follows very different paths. Taiwan's has limited trade and investment, except in fisheries and some tourism, while China has mass volume in exports and imports, and pursues its Belt and Road Initiative. The BRI includes the involvement of state-owned companies in the mining industry and infrastructure projects. The initiative has been accused of causing huge debt burdens and exposing countries to financial risk. We have chosen to focus on developments in fisheries, resource extraction and tourism.

6.2 The Changing Geopolitical Context and Related Studies in Oceania

Over the past fifteen years, much attention has been paid to China's expanding presence in the Pacific. The Pacific islands form part of China's ambitions global agenda, as unveiled in the Belt and Road Initiative launched by President Xi Jinping in 2013. China had already made clear its intent with the first China-Pacific Island Countries Economic Development and Cooperation Forum in 2006. Follow-ups were held in 2013 and 2019. Beijing adopted an approach to the region distinct from the US-led framework which is based on security. By positioning itself as a developing country, China presented a South-to-South discourse, and differentiated itself from OECD aid donors by stressing its adherence to the concept 'non-interference'. Many leaders of Oceanian countries welcomed China's deeper participation. Diplomatic competition with Taiwan is seen as one motivating factor for China's greater involvement. It has taken a more aggressive approach to the region since President Tsai Ing-wen took office in 2016 and had some success when the Solomon Islands and Kiribati switched ties to Beijing in 2019.

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[1]. 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.

Most of the existing literature addresses two distinct perspectives: "China as a threat" and "China as an alternative". The threat discourse, mainly framed by the US and Australian commentators, is based on geopolitical, economic and military concerns, and warns that China's rise will undermine well-established international norms and practices. For example, in 2018, the US-China Economic and Security Review Commission said Beijing's growing influence in the region "could threaten the Compact of Free Association agreements…over the long term." [2] The US think tank, the Rand Corporation, published a policy paper, entitled 'America's Pacific Island Allies: The Freely Associated States and Chinese Influence' (Grossman et al, 2019). The report illustrates that Chinese influence has a security impact on US national interests and its relations with allied countries. The issue was discussed much earlier in Australia. In 2003 an article titled "Dragon in Paradise: China's Rising Star in Oceania" appeared in The National Interest in which authors John Henderson and Benjamin Reilly (2003, p. 98) warned of the "important long-term consequences" of China's growing role in Oceania, and many commentators followed it up.

These researchers (Windybank, 2005; Dobell, 2007; Shie, 2007, Brady & Henderson, 2010) raise concerns about three major aspects: the Chinese military and security issues, Chinese loans and the potential for debt traps, and the threat of corruption and environmental hazards. There has been much discussion of China's possible plans to build military infrastructure[3] in the region as well as worries over surveillance.[4] Chinese aid and especially concession loans have been criticized for destabilizing Pacific countries, making Pacific politics more corrupt and violent, and leaving some countries in a debt trap. Chinese investments in extracting the rich natural resources of the region[5] have also been linked to issues of domestic corruption and environmental hazards.

The "China as an alternative" discourse has mainly been framed by academics, including indigenous scholars, as well as some leaders of island countries (Wesley-Smith, 2007; Wesley-Smith, 2013; Iati, 2016; Fry & Tarte, 2015; Aqorau, 2021; Tarcisius, 2021). It contends that China's rise offers Pacific island states an alternative not available in the past and increases their leverage with the traditional powers in the region. The discourse focuses on Oceanic-centered perspectives and agency. As Greg Fry (2019, p. 323) suggests, while the West sees a threat to its interests in the Pacific at a time of global rivalry, the Pacific island states have acquired greater bargaining power.[6] China-Taiwan competition, which was once seen as a risk factor that could destabilize regional politics,[7] is now presented as an area where island states can have agency and assert their sovereignty. For example, Sandra Tarte (2008, 2021) says the Fijian government has been proactive in forging a strategic partnership with China through its Look North policy. Island politicians increasingly prefer to frame China as a partner rather than simply as an alternative. Dame Meg Taylor (2016), the former Secretary-General of the Pacific Islands Forum, stated that the region sought genuine partnerships with all actors 'who shared the same vision with us', and 'rejects the terms of the dilemma that presents the Pacific with a choice between a China alternative and our traditional partners'.

'China as an alternative' has challenged the perception of 'China as a threat' and become the dominating narrative in regional academic circles. While many scholars highlight the potential benefits for states that align themselves with China, others have cautioned that weak institutions in some Oceanian countries might make them vulnerable while 'dancing with the dragon' (Kabutaulaka, 2019, Foukona, 2019, Aqorau, 2021). Moreover, the idea of China as an alternative often lacks critical examination of Chinese rhetoric. For example, as the world's second largest economic entity and a growing military and economic presence in the region, China is hardly in the same category of 'developing country' as the Pacific island countries. Some caution that its imperial ambitions at home and abroad make the concept of South-South cooperation nothing but an illusion. China's 'non-interference' mantra in the Pacific requires careful examination. For example, during the 2018 Pacific Islands Forum meeting in Nauru, the president of the host country, Baron Waqa, had a heated argument with the head of the Chinese delegation, who demanded that he addressed the forum before the Prime Minister of Tuvalu, which recognized Taiwan. During the 2019 APEC meeting at Port Moresby, China appeared to override the host country in many ways: it lined the main roads of the city with Chinese flags before the meeting, banned international media from the meeting of eight Pacific leaders with President Xi, and Chinese officials forced their way into the PNG foreign ministry office demanding to see the minister (Rogin, 2018). Chinese officials also engaged in obtrusive surveillance of Fijian guests who attended Taiwan's national day celebration at the Grand Pacific Hotel in Suva and assaulted a Taiwanese diplomat (BBC, 2020).

In addition to the above cases reported by the media, the growing Chinese presence in the Pacific islands has been perceived by many islanders as something other than 'non-interference'. While one could argue that the policy mainly refers to the fact that China's aid is less conditional than that from OECD countries, China cannot be said to have adopted a policy of non-interference in the domestic and international affairs of island countries. Most significant of all is the unnegotiable imposition of the 'One China Principle' on Beijing's diplomatic partners and the obstruction of any attempt to build relationships with Taiwan. For example, Prime Minister Sogavare of the Solomon Islands made a U-turn after his country's switch to Beijing in 2019 and started to emphasize the One China Principle.[8] Though the country's foreign policy since independence has always stressed 'friends to all, enemies to none', some Solomon Island politicians have since made negative comments about Taiwan in accord with China's ideology. This has upset many citizens who adhere to the country's original principles. Taiwan has only two representative offices in Pacific countries where it has no formal diplomatic ties - in Fiji and Papua New Guinea - for the purpose of maintaining economic links and working on collaborative projects. However, both were forced to change and downgrade their names in recent years;[9] moreover, Fiji withdrew its Trade and Tourism Representative Office in Taipei directly after a meeting between the prime minister and China's President Xi in 2017. It's notable that supporters of China in the region stress the importance of sovereignty but seldom criticize China for interfering in foreign policy decisions and blocking links with Taiwan. When island countries attempt to partner with China as a strategy against Western hegemony and interference, they must deal with the ambitions of a new hegemon which have become even more explicit under President Xi and the initiation of "wolf warrior diplomacy".

Taiwan has been an important participant in the development of Oceania. However, there has been relatively little research into Taiwan's role and perspectives in the Pacific (Atkinson 2010, D'Arcy 2015, and Dayant and Pryke 2018). Both the 'China as a threat' and 'China as an alternative' narratives center on China and divert attention from Taiwan's interaction with Pacific island countries. But Taiwan's role in Oceania stands by itself as an important topic. In this chapter, we will assess Taiwan' economic presence and the interplay with other regional powers including China, the United States, Australia, New Zealand and Japan.

6.3 Preliminary Findings & Analysis

Before the Solomon Islands switched diplomatic relations to China in September 2019, some argued that it made sense in economic terms because China was its largest trading partner. However, this assumption requires more examination. A few months after the switch, the world was hit by COVID-19 and it is unreasonable to attribute the country's economic decline in 2020 and 2021 to the switch in relations. Nevertheless, we can still ask to what extent diplomatic relations with China or Taiwan have contributed to economic development in the island states.

In this chapter, we study the economic development of Oceanian countries and examine their correlation with diplomatic recognition of Taiwan or China. We first consider the general economic and trade data of the region over the past two decades and compare economic performances. We first apply the Difference-in-Differences method as a way to look into the economic growth of island countries that side with either Taiwan or China. We will then discuss the different impact on the sectors of fisheries, mining and tourism.

6.3.1 General picture of economic development in Oceania

The countries of Oceania vary greatly in size and natural resources and have many regional differences. They are also presented with different ways of engaging with China and Taiwan. We have chosen twelve countries from the three sub-regions to cover the range of variations (See Table 6.1).

Table 6.1 General Information on Pacific Countries in 2019

Country	Population[10]	GDP Per Capita[11] (USD)	Total Aid[12]		Main Type of Aid	Industrial Sectors	Diplomatic Relations with Taiwan
			Committed	Spent			
Nauru	10,764	12,351	28.58	2.11	Grant	Agriculture Financial Service	• First establishment: 1980 • Breaking off: 2002 • Re-establishment: 2005
Tuvalu	11,655	4,036	59.63	17.49	Grant	Public Sector Fishing Agriculture	• 1979-Present
Palau	18,001	15,572	9.45	5.98	Grant Loan	Tourism Agriculture Fishing	• 1999-Present
Marshall Islands	58,791	4,038	52.92	7.8	Grant	Shipping Agriculture Fishing	• 1998-Present
Tonga	104,497	4,865	82.45	17.03	Grant Loan	Tourism Construction Fishing	• Establishment: 1972 • Breaking off: 1998
Federated States of Micronesia	113,811	3,640	87.94	25.89	Grant Loan	Fishing Tourism Agriculture	• No Diplomatic Relations
Kiribati	117,608	1,657	28.5	9.48	Grant Loan	Agriculture Fishing Tourism	• Establishment: 2003 • Breaking off: 2019
Samoa	197,093	4,285	101.10	55.42	Grant Loan	Agriculture Fishing Tourism	• Establishment: 1972 • Breaking off: 1975
Vanuatu	299,882	3,023	14.63	66.57	Loan Grant	Agriculture Fishing Tourism	• No Diplomatic Relations
Solomon Islands	669,821	1,945	200.19	32.12	Grant Loan	Agriculture Fishing Forestry	• Establishment: 1983 • Breaking off: 2019
Fiji	889,955	6,185	42.69	58.55	Grant Loan	Tourism Fishing Manufacturing	• No Diplomatic Relations
Papua New Guinea	8,776,119	2,845	990.01	317.22	Loan Grant	Agriculture Forestry Fishing	• No Diplomatic Relations

Source: World Bank, UN data, and Lowy Institute Pacific Aid Map.
Note: In the "Main Aid Type" column, a cell where "Grant" is located above and "Loan" is below indicates that the country received a larger proportion of grants than loans from donors in 2019, and vice versa.

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 exports and imports, pursues the Belt and Road Initiative, and involves state-owned companies in the mining industry and infrastructure projects.

Taiwan's overall trade with Oceania, though smaller than that of China, South Korea, Australia and Japan, amounted to US$1.2 billion in 2017 (see Table 6.2), at a similar level with the United States. However, Taiwan's trade concentrates mainly on fisheries (esp. Marshall Islands) and LNG (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. 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 (state-owned or related) companies have invested in extractive industries (see 6.4.2). 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.

Table 6.2 Trade with Pacific Island Countries (2017) (US$ Millions)

	Taiwan	China	United States	Australia	New Zealand	Japan	South Korea	France
Nauru	0	1	2	38	4	7	5	0
Tuvalu	3	81	1	3	3	21	5	0
Palau	22	18	20	2	1	2	10	0
Marshall Islands	131	3,103	610	3	4	1,337	6,894	4
Tonga	5	29	20	13	52	9	4	3
Federated States of Micronesia	31	38	46	3	3	3	52	1
Kiribati	3	17	9	19	12	22	15	0
Samoa	2	66	43	39	83	14	32	3
Vanuatu	3	81	13	59	33	101	16	8
Solomon Islands	20	657	13	101	33	21	31	1
Fiji	57	386	288	460	394	115	217	13
Papua New Guinea	923	2,839	227	3,888	140	2,617	237	73
Total	1,200	7,278	1,292	4,628	762	4,269	7,518	106

Source: IHS Markit Global Trade Atlas, as cited in Ethan Meick, Michelle Ker, and Chan Han May, "China's Engagement in the Pacific Islands: Implications for the United States," U.S.-China Economic and Security Review Commission, June 14, 2018.

A significant portion of financial resources for island economies comes from aid and loans from international donors and organizations. According to a database compiled by the Lowy Institute, the most significant donor countries in order of size are the United States, Australia, China, Japan, New Zealand and Taiwan (see Table 6.3). A significant portion of China's pledged assistance is in the form of concessional loans for infrastructure, which have been criticized for carrying a potential debt risk (especially in the case of Tonga, PNG and Samoa). Facing up to China's greater involvement in the region, the United States, Australia, New Zealand and Japan have started to increase their input, and the aid landscape may change in the next few years. Taiwan has also been an important aid donor in the Pacific. It has set up representative offices in PNG and Fiji which have been become involved in cooperation projects. In addition to the Ministry of Foreign Affairs, Taiwanese aid is mainly distributed by its International Cooperation and Development Fund (TaiwanICDF).[10] Taiwan's long-term projects in Oceania focus on healthcare, agriculture (including horticulture, poultry and livestock, and aquaculture) and education. It has also provided solar panels and assistance in energy efficiency.[11]

Table 6.3 Donor Countries' Cumulative Aid in Selected Pacific Countries (1980– Present) (US$ millions)

	Taiwan	China	United States	Australia	New Zealand	Japan	South Korea	France
Nauru	40	0	0	172	24	24	0.818	0
Tuvalu	19	0	0.11	127	66	69	2.94	0.01
Palau	26	0	265	38	2.91	142	1.67	0
Marshall Islands	51	0	772	40	4.2	93	3	0.004478
Tonga	0	219	15	355	192	169	1.83	0.449
Federated States of Micronesia	0	143	1000	53	3.77	112	2.76	0.00994
Kiribati	162	44	0.105	310	157	113	7.28	0.012
Samoa	0	239	14	402	197	168	3.34	0.339
Vanuatu	0	210	35	813	233	197	2.75	37
Solomon Islands	122	51	31	2000	301	222	53	0.665
Fiji	18	405	25	758	138	136	38	8.18
Papua New Guinea	7.6	7,000	79	7,000	276	674	13	1.18
Total	445.60	8,311	2,236.22	12,068	1,594.88	2,119	130.53	47.85

Source: Lowy Institute Pacific Aid Map.

6.3.2 Key findings using Difference -in-Differences analysis

Difference-in-Differences (DID) is used to study the change in economic performance by comparing two countries over a period of time (see Chapter 3 for detail). We pair countries for comparison based on their similarities in three criteria: levels of GDP per capita, size of population and key economic sectors (see Table 6.1). Through preliminary DID analysis, we find that the method works better for countries that are economically stable through a longer period of time (Tuvalu, Marshall Islands, FSM, Tonga, Samoa and partly Kiribati). Countries that suffer from traumatic events and GDP ruptures present too much noise in the data and are excluded from our DID analysis.[12 13 14]

Of the six countries on which we conducted DID analysis, all except Samoa are small island states that rely heavily on fisheries. We made the following findings:

1) Comparing two long term diplomatic partners of Taiwan and China—that is, Tuvalu and FSM respectively. Both of them are Micronesian countries that rely heavily on fisheries and fishing license fees. FSM has a greater EEZ and received significant funding from the US under the Compact of Free Association (COFA) agreement; it appears to be in a more advantageous position than Tuvalu. However, the GDP per capita of Tuvalu has out-performed FSM over the past twenty years.

The DID trend indicates that Tuvalu's growth slowed (though still performing better than FSM) after 2007. There are two possible explanations. After the global financial crisis in 2007, demands for cargo dropped and many Tuvaluans lost their jobs in the global shipping business, which hit the value of remittances.[15] China's aid to FSM might also have contributed to its economy. However, when using 2006 as the break year — the generally agreed moment when China significantly increased its economic presence and aid engagement in the Pacific (following the 1st China-Pacific Islands Economic Cooperation Forum and the visit of Wen Jiabao) — DID data shows that Tuvalu performed much better than FSM (DID=0.458, p is significant).

2) DID analysis between two COFA countries in Micronesia (which adhere to the Compact of Free Association agreement with the United States)—the Marshall Islands (which switched relations to Taiwan in 1998) and FSM—shows no significant difference using either 1998 or 2006 as the break year.

Figure 6.1 DID Analysis : Tuvalu VS. FSM

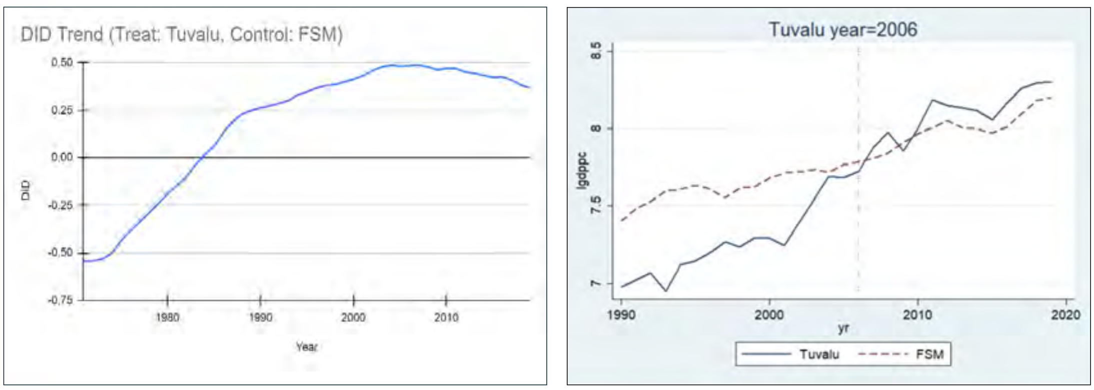
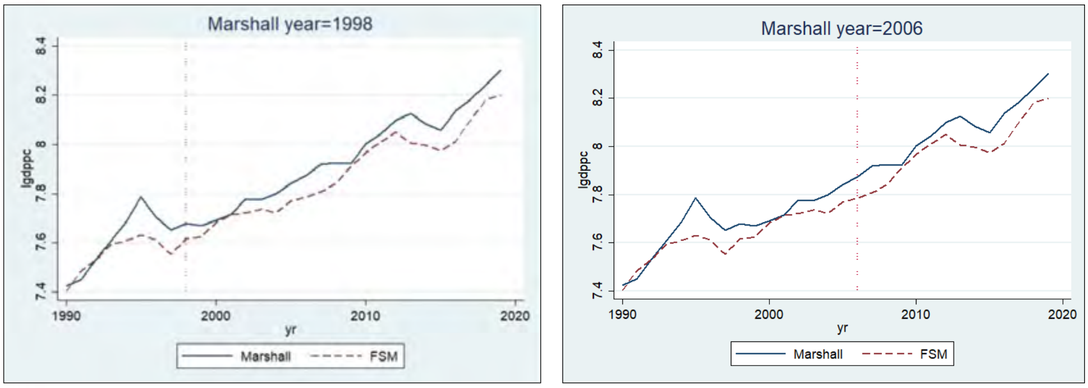


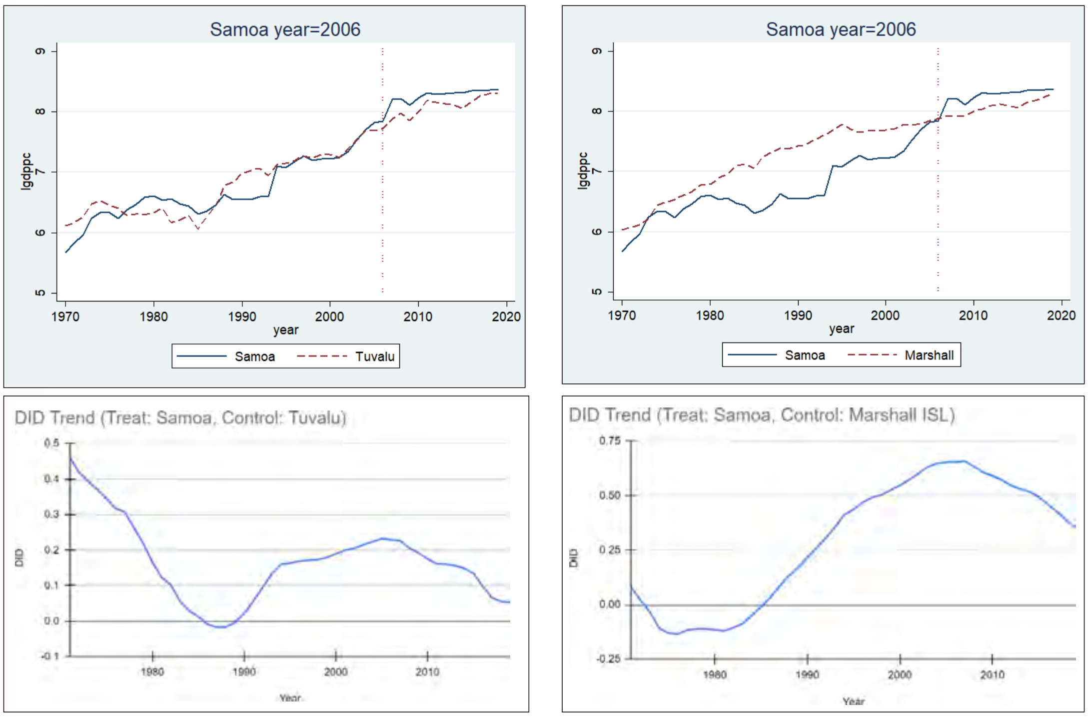
Figure 6.2 DID Analysis: Marshall Islands VS. FSM

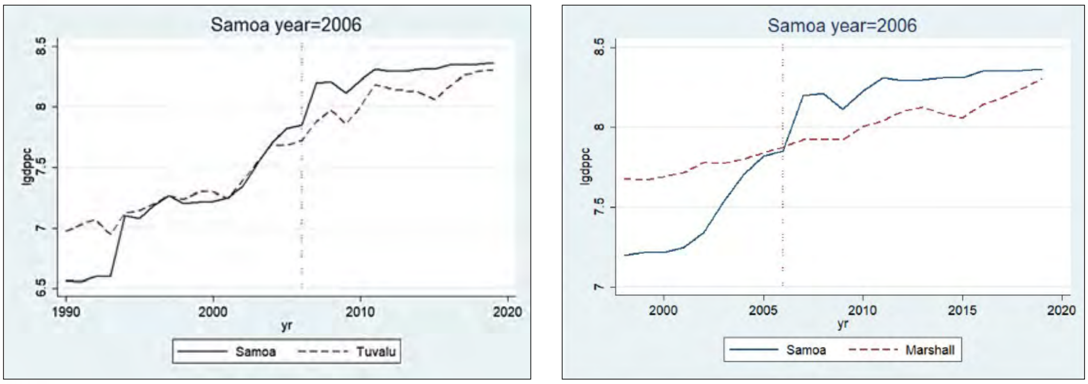


3) Samoa is a long-term and strong partner of China in the region, with Beijing funding a lot of its infrastructure. The country also has large migrant communities (especially in New Zealand) and a good level of remittances. Its population is much larger than that of Tuvalu or the Marshall Islands (20K, 6K and 1K respectively) and all three countries have similar GDPs per capita, ranging between $4000 and $5000 (nearly $5000 for Samoa, and nearly $4000 for the other two).

The GDP per capita of Samoa grew rapidly 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 ten years. While China continues to pour resources into the country, 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.[16]

Figure 6.3 DID Analysis: Samoa VS. Tuvalu; Samoa VS. Marshall Island





4) Tonga broke with Taiwan and established diplomatic relations with China in 1998. Its economy was stronger than Tuvalu's in the 1980s and 1990s, however, the gap between the two narrowed after the turn of the century. Using 1998 as the break year, DID analysis shows that Tonga did not perform as well as Tuvalu after the switch (DID=-0.327, p is significant). Two factors other than the switch might have contributed to the setback: Tonga was hit hard by several cyclones (especially cyclone Gita in 2018) and suffered from the 2006 riot in the capital, Nuku'alofa. After a few years of decline after 1998, its economic growth is now approaching that of Tuvalu. However, Tonga has high levels of debt while Tuvalu has maintained healthier national finances.

Figure 6.4 DID Analysis: Tonga VS. Tuvalu

6.3.3 *Summary*

Given that there are many factors that can influence a change in economic performance, we cannot conclude that maintaining diplomatic relations with Taiwan or China has a decisive impact. However, the above four pairs of comparison have clearly shown that in the case of small island economies, siding with Taiwan is an economically reasonable choice—it might help the economy to some extent or does not put it in a disadvantaged position with neighbors that remain with China. On the other hand, China's aid and loans might boost the economy for a period (such as in the example of Samoa and maybe for Tonga) but the gains might not last for long; or it might not help as much as expected (e.g. FSM). However, Tonga and Samoa are now heavily in debt to China while Taiwan's partners have no such burden.

6.4 Important Economic Activities in Relation to Diplomatic Relations

6.4.1 Fisheries

As Oceanian countries became independent in the 1970s the pursuit of economic interests in their Exclusive Economic Zones (EEZ) and the exercise of their maritime jurisdiction became linked with the idea of self-determination (Aqorau, 2015). In order to effectively manage fishery resources and reduce illegal fishing, Oceanian countries signed agreements with various countries and established regional and sub-regional fishery agreements and organizations to optimize the fair and sustainable use of sea creatures. The 1982 Nauru Agreement became a highly influential model in the region.[17]

In 2007, the parties to the Nauru Agreement (PNA) adopted a vessel day scheme (VDS) for the management of purse seine fishing, open water fishing in the Western and Central Pacific Ocean (WCPO) and implemented it in 2012 under the Palau Agreement (Aqorau, 2009)[18]. Under the scheme, vessels must purchase days on which to fish in the waters of the PNA states, thus strengthening the group's position as a regional fisheries organization and building its geopolitical influence.

Taiwan has been an important player in the Oceanian fisheries sector since the 1970s. Its role in the industry has helped stimulate economic development while at the same time extending Taiwan's diplomatic outreach. For example, According to Marinaccio (2019), Tuvalu decided to establish diplomatic ties with Taiwan in order to manage its fishing industry. In 2004, Taiwan not only participated in the WCPFC as a founding member but some Taiwanese companies also cooperated with Pacific countries to establish fishing facilities, increasing employment as well as other benefits. FCF Co, Ltd., for instance, established fishery bases in Guam and Fiji in the 1980s. In addition, in 2000, Taiwan worked with the government of Papua New Guinea to establish the South Seas Tuna Corporation (SSTC). The Taiwanese enterprise, Koo's Fishing Co., Ltd. also initiated a localization company project in the Marshall Islands in 2000. According to 2020 statistics from the Western and Central Pacific Fisheries Commission (WCPFC), Taiwan's take ranked third, with 216,000 metric tons of albacore, bigeye, skipjack and yellowfin in the Western and Central Pacific area, behind only Japan and South Korea.

China by contrast is a new player in the fisheries sector in Oceania. Starting from 1988, Chinese fishing boats started to establish oceanic tuna fisheries and expanded to account for a quarter of the tuna catch in the region. It now has the largest fishing fleet in the region with many of its vessels subsidized by the government. Some politicians in the FSM have argued that 'the small size of the FSM economy, the Chinese demand for its fish and the proximity of FSM to the huge Chinese market' mean that China can have a powerful impact on 'transforming the economic fortunes of FSM overnight for very little cost to itself' (Puas & D'Arcy, 2021, p. 291-292).

Changes in the geopolitical situation might impact on the functioning of regional fisheries management organizations and agreements. In 2021, for instance, the government of Kiribati announced that it would open up the Phoenix Islands Protected Area (PIPA) to commercial fishing, a move purportedly instigated by China (Herr, 2021). In this way, it has been claimed, China could gain preferred access to abundant tuna resources as well as a militarily strategic location in Kiribati. Climate change is another factor affecting marine ecology; for example, more and more fish are moving into the open sea. According to research (Bell, 2021), the total biomass of skipjack, yellowfin, and bigeye tuna in the waters of the ten Pacific island states could decline by an average of 13 percent by 2050.

Over the past two decades Taiwan has implemented cooperation projects with its Pacific partners to assist in enhancing the capabilities of fisheries and towards the goal of more sustainable management of marine resources. For instance, since 2010, Taiwan has launched the "Regional Fishery Observer Training Program" to train Pacific representatives to become observers and contribute to sustainable fisheries that comply with the regulations of regional organizations, The project could also increase employment opportunities and the growth of remittances. In addition, Taiwan has helped some Pacific countries set up sustainable fish farming operations. The Taiwan Technical Mission has cooperated with Kiribati since 2004 to revitalize fish farming (artificial breeding of milkfish). Taiwan could still do more, with help needed for the onshore construction of fishing facilities. It could also hire more workers from the Pacific islands and improve their labor conditions and regulate Taiwanese vessels toward sustainable fishing.

6.4.2 Logging and Mining

Natural resource extraction has played an important role in the economic development of some Oceanic countries. Forestry resources, including timber exports and agro-forestry (e.g. oil palm, sugar, bio-ethanol.) contribute significantly to GDP, especially in the Melanesian countries. In both the Solomon Islands and Papua New Guinea, ethnic Chinese, especially Malaysians of Chinese descent (Filer, 2013a, 2013b), have dominated the industry[19]. There is no evidence that they are supported monetarily by the Chinese state or state-owned enterprises; however, they may have contributed to the fact that China is the monopoly export market (Filer 2013a, p. 322). Many islanders have pointed out that they are very influential in domestic politics (e.g. D'Arcy et al., 2014) and some have speculated about the role they play in the diplomatic field. Chinese investment in mining has attracted more attention and we will focus on mining in this section.

In discussing how exploration projects shape national economies, the most dramatic example is Nauru, where the ups and downs of phosphate production dominate its economic performance and the people's well-being (Connell, 2006; Pollock, 2014). Phosphate mining was Nauru's main source of income in the 1970s and 80s, in the early years after independence, and it had one of the highest GDPs per capita in the world. The Nauru government utilized the revenue to make international investments, but many ended in failure. As Nauru's phosphate revenue declined in the1990s, government expenditure began to exceed revenue. Mining almost ended in the first few years of the 21st century and the country switched diplomatic relations to China in 2002. However, the economy does not seem to have benefitted from the change and Nauru switched ties back to Taiwan in 2005. In 2007, with investment from New Zealand and Australia, Nauru recommenced secondary phosphate mining. However, as the output and scale of the operations were not as large as before, aid (especially from Australia and Taiwan), fisheries and revenue from an Australian detention center now account for a significant portion of national income.

Papua New Guinea has the richest resources in the region. Its economic development depends on extraction industries, such as agriculture, forestry and mining. Its largest exports are minerals, which then facilitate the development of other industries such as construction. Gold remains the most important metal export accounting for more than three-quarters of revenue. In addition, the Ramu Nickel mine and, in recent years, liquefied natural gas (LNG) have also become major pillars of the PNG economy. In 2017, for instance, LNG production accounted for 16% of GDP.

The huge revenues of PNG's mining industry also attract investment from other countries and transnational corporations. According to the USGS 2016 Minerals Yearbook, with the notable exception of the government owned OK Tedi Mining Ltd., most are owned and operated by international companies, including from Australia, the United Kingdom, South Africa, Japan, Singapore and China. In March 2005, the Chinese Metallurgical Construction (Group) Corporation, a large state-owned construction and operating company, purchased a majority stake in the Ramu Nickel & cobalt mine. In 2006, the PNG government signed an agreement that allowed the China Exploration and Engineering Bureau to further prospect for gold, copper, chromite and magnesium. The Chinese group, Zijin Mining Group, owns a large share in the Pogera gold mine in the Enga region. Some projects are still at the planning stage; for example, the Frieda River Copper project which is owned mainly by PanAust, a subsidiary of Guandong Rising Asset Management (Gessler, 2017). In terms of LNG cooperation, in 2009, China Petroleum & Chemical Corporation agreed to purchase 2 million tons of LNG annually from the country. Taiwan started to buy LNG in 2013; in 2017 Taiwan was the fifth largest importer of LNG from the country at about 17%, and LNG from there will account for 9% of Taiwan's LNG imports in 2022[20]. PNG has a long history of resource extraction and China is a late comer. The situation is different in the Solomon Islands and Fiji.

Gold Ridge gold mine in the Solomon Islands started operation in 1998 and once accounted for more than 20% of the country's GDP. Initially owned by the Australian company, St Barbara, it ceased operation in 2014 after security threats and flooding. It was then sold to the landowner group, Gold Ridge Community Ltd, which sought investment from an Australia based Chinese company, AXF Resources, and additional investment from the Chinese company, Wanguo International Mining in 2017.[21] Soon after the switch of diplomatic recognition from Taiwan to China in September 2019, it was revealed that the state-owned China Railway Group Ltd. had signed a deal with Gold Ridge Mining Ltd (GRML) to construct and lease a railway and a mining service station.[22] The government of the Solomon Islands hopes to reopen the gold mines and develop other resources such as bauxite and nickel to diversify its economy and become less dependent on the logging industry.[23] However, there have been many controversies. Ships carrying bauxite from the Bintan Mining Company (Hong Kong-based, owned by Indonesian Chinese) spilled heavy fuel around the island of Rennell, the location of a UNESCO World Heritage site, in 2019.[24] The Australian-owned company, Axiom Mining, encountered licensing and regulation problems after it started operations in Isabel Province in the same year. It accused the government of accepting bribes and favoring its replacement by Bintan, which happened shortly after the country switched diplomatic recognition to China.[25] Some of the companies involved in mining were initially logging companies, such as the Asia Pacific Investment Development Ltd (APID), which is involved in bauxite mining on Rennell,[26] and the proposal for a nickel mine at Choiseul comes from the Solomon Islands Mining Company Ltd (SIMCL), which is owned by the Filipino Chinese logger, Johnny Sy. Another logger, Garry Cheah, used to operate the Solomon Islands Resources Company Limited (SIRCL), which carried out nickel prospecting in Isabel. The owners of SIRCL, the Hong Kong-based investor, New Origin Resource Company Ltd., later sold it to another Chinese enterprise, Hangzhou Gowin Mineral Product Ltd.[27]

The mineral extraction industry has had a slow start in Fiji and is dominated by investment from China.[28] The major mineral commodity export has been gold. Vatukoula Gold Mines was initially owned and operated by a UK registered company (Banks 2013), but Zhongrun Internal of China increased its holding to some 66% in 2014. (USGS Mineral 2015 Yearbook). Both bauxite and cement mining operations are run and majority owned by the Chinese companies, Xinfa, Tengy and PCL.

Logging and mining companies have played important roles in these countries (Bainton & Skrzypek, 2021; Allen, 2018). Peter Kenilorea Jr., a Solomon Islands MP, pointed out that an underlying cause of the recent riots in Honiara was long-term discontent with the corrupt relationship between the government and the foreign logging and mining companies.[29] Chinese engagement with the mining industry in Melanesia has been growing and Chinese companies have sometimes replaced earlier Australian investors. While some Chinese companies are run by ethnic Chinese loggers, we have seen a deeper involvement by companies (private or state-owned) from mainland China and they now dominate the newly developed mineral industries in the Solomon Islands and Fiji. Their investments coincided with the islands' development of closer relations with Beijing. Capital in PNG is more diversified. It is worth noting that, though still in the planning stage, China has approached several Pacific countries about participation in future projects to explore deep-sea mining (Zhang, 2018).

Table 6.4 Chinese Mining Investments in the Pacific

Country	Metals	Operating Company/ Project	Notes
PNG	Gold & Silver	The Porgera Gold mine	Jointly owned by the Chinese Zijin Mining Group and the Barrick Gold Corp
	Nickel & Cobalt	The MCC Ramu Nickel Cobalt project	Majority owned and operated by China Metallurgical Corporation
Solomon Islands	Gold & Silver	The Gold Ridge gold mine	Wanguo International Mining Group, China Railway Group Ltd.
	Bauxite	Asia Pacific Investment and Development Ltd. (APID)	Registered in Hong Kong
	Nickel	Axiom Mining	Australian mining and exploration company (incorporated in Hong Kong)
Fiji	Gold & Silver	Vatukoula Gold Mines plc.	Majority owned by Zhongrun Resources Investment Corporation
	Bauxite	Xinfa Aurum Explorations Ltd.	Shandong Xinfa Aluminum and Electricity group. 1st Chinese company to obtain mining license, 2011
	Cement	Pacific Cement Ltd. (PCL)	Majority owned by Fijian Holding Ltd. Corp
		Tengy Cement Company Ltd.	A China investment company
New Caledonia	Nickle	The Chinese Caledonian Mining Company	Joint venture of the Chinese Jinchuan Group and the Société Minière du Sud Pacifique.

Source: USGS Mineral Yearbook, Gessler (2017)

6.4.3 Tourism

Oceania received 2.9 million visitors in 2019, contributing USD $4 billion in visitor spending to regional economies. As a percentage of GDP, tourism receipts accounted for a large share in many Pacific countries and territories. According to the 2018 Annual South Pacific Tourism Organization (SPTO) tourism overview, tourism in the Cook Islands reached 66% of GDP, and Fiji's tourism sector generated over 35%. For Vanuatu, tourism's contribution to GDP was 48.2%. For the Cook Islands, Fiji, and Vanuatu, more than 70% of air arrivals are for the purpose of leisure travel. In addition, direct employment in the sector totaled 90,821, not including those working in support services and related businesses[30]. Across the region, the tourism industry has become an essential ingredient in islands' culture, cuisine, traditional artifacts and environment. Tourism is the central industry, part of life and the major economic driver in Oceania.

In recent years, Chinese tourists, investment and tourism development projects have brought new challenges to the Pacific. In Vanuatu, The Chinese have ventured into real estate, including investment in tourist enterprises. As an example, when the Evergreen Co., the original owner of the famous Cascades waterfall, defaulted on its repayments, the asset was sold off to Blue Spring, a Chinese company, which also runs tour packages. Chinese investment in casinos and resorts in the Commonwealth of the Northern Marianas Islands (CNMI) has brought in many Chinese tourists as well as controversies, including concern over money laundering and the close proximity of some developments to land leased to the US Department of Defense. CNMI entered an agreement with a Hong Kong based Chinese company, Imperial Pacific, to build a large casino in Saipan (Meick et al., 2018).[31] On the island of Yap in the Federated States of Micronesia (FSM), Chinese investors from the company, ETG, proposed the construction of a 10,000-room mega-resort and casino complex, which was supported by Yap's Governor, Tony Ganngiyan (Bohane, 2016). Local politicians and islanders were divided over the proposal (Huang 2017). In addition, the mayor of Rongelap in the Republic of the Marshall Islands, James Matayoshi, proposed plans for the atoll to become a special administrative province in 2018 (RNZ, 2018). The plan is to offer loose visa and tax requirements, open the island up to foreign investors, and promote the construction of casinos and direct flights from China. The proposal has caused turbulence in domestic politics; the then president, Hilda Heine, believed that it was her criticism of the project that led to votes of no confidence against her in parliament (The Marshalls Islands Journal, 2020).

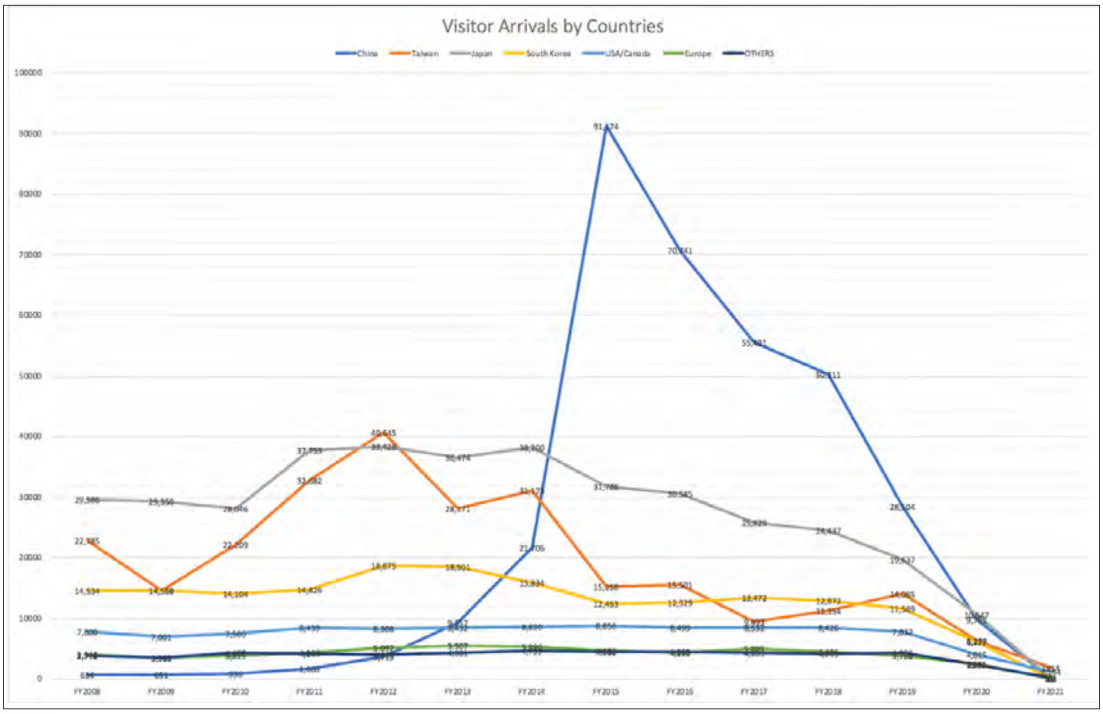
6.4.3.1 Tourism in Palau

From 1947-1994, Palau was under the US-administered UN Trust Territory of the Pacific Islands (TTPI).[32] Palau became a self-governing republic in 1994 and is a signatory to the Compact of Free Association (COFA) agreement with the United States. Palau established diplomatic relations with Taiwan in 1999. According to the Lowy Institute, Taiwan was ranked as its second largest aid donor after Japan in 2021.[33]

The economy of Palau is dominated by tourism, fishing, and subsistence agriculture. The government is a major employer and relies on financial assistance from the US. World Bank data for 2019 shows an estimated GDP per capita of $14,907, the highest in Oceania.[34] Palau's economy is centered on tourism, which accounted for 43% of GDP in 2018. Before 2010, Palau's tourism industry was driven largely by scuba divers from Japan, Korea and Taiwan. Visitors from Taiwan and Japan constituted some 70 percent of the total from 2000 to 2010 (Yamashita, 2000). However, an estimated 85 percent of revenues go to foreign operators from Japan and Taiwan.

In 2010, Palau opened up tourism to China. The number of Chinese tourists spiked dramatically to a historic high of 91,174 in 2015, a 10-fold increase over 2010 (Lyons, 2018). Tourist arrivals from China in 2010 made up less than two percent of all visitors rising to more than 54% in 2016.[35] Chinese tourists to Palau shared some characteristics: (1) they travelled to Palau in package tour groups; (2) the groups prepaid for their full itinerary resulting in lower in-country spending; (3) Palau became heavily dependent on one market; (4) hotels came under pressure to offer high-quality service. In November 2017, the Chinese government took steps to block Palau as a tourist destination. It removed Palau from its list of countries with Approved Destination Status (ADS), which allows state-run agents to operate group package tours to approved nations.[36] The result was very dramatic, with a precipitate fall in the number of tourists from China. Media reports said Palau had been targeted because it maintained diplomatic relations with Taiwan, and China was hoping to turn up the pressure (Master, 2018).

Figure 6.5 Tourists to Palar (From 2008-2021)



Source: Bureau of Immigration, Republic of Palau.

6.4.3.2 Palau's Path

Palau has a strong determination to safeguard its culture and physical environment. In 1979, 75% of Palauan people voted for a nuclear-free constitution, the first in the world. In terms of marine management, Palau passed the Palau National Marine Sanctuary Act in October 2015. The sanctuary is the world's sixth largest fully protected area. In 2017, Palau became the first nation to make an eco-promise, known as the Palau Pledge, aiming to tackle tourism related damage to the environment (Medel, 2020). The Palau Pledge has both old and modern roots that include the cultural concept of 'BUL', a traditional requirement to respect the ecosystem. As the former President of Palau, Tommy Remengesau, said in an interview, Palau adapted to the Chinese embargo by focusing on higher spending visitors rather than mass tourism, which had taken a toll on the environment (Master, 2018). His message was clear: The Chinese ban would not hurt the economy but rather offer Palau a chance to diversify its tourism industry. The government released a framework for a new responsible tourism policy, clearly stating Palau's vision for the industry. Palau aims for a diverse, high-value and low-impact tourism. Tourism has become an area through which it can assert its voice and sovereignty in the face of challenges from global powers. Lastly, in March 2021, Palau and Taiwan opened a travel corridor, meaning Taiwanese tourists do not have to undergo quarantine upon arrival. As Palau and Taiwan continue their economic partnership, the country's experience offers many ideas about how Taiwan can deepen relations with Oceanian countries through their own visions of development.

6.5 Policy Implications

Based on the above analysis, and in reference to our interviews, there are several policy implications for the government of Taiwan and its partners.

Creating a friendlier diplomatic environment for Taiwan

Taiwan needs assistance for deeper participation and an upgraded position in multilateral regional organizations. Taiwan now has diplomatic relations with only four countries in the region and has only been able to set up representative offices in two other countries, both of which were recently forced to downgrade their names. Through multilateral aid projects and a more active presence in regional organizations, the international community could help Taiwan engage with more countries and build more relationships.

For small islands that rely on the fishing sector, aligning with Taiwan rather than China can be a good choice if the aim is a stable and expanding economy. However, there is scope for better quality investment in the sector, as well as for more training and the provision of better employment opportunities for island seafarers. Countries that export large quantities of raw materials to China are more likely to be dependent on the Chinese market and be vulnerable to Chinese sanctions. They, therefore, find it harder to build closer relations with Taiwan. Taiwan is of course unable to match China in its demand for raw materials, so additional outside help is needed for island states to diversify their export markets and build economic resilience. Taiwan could work with international partners to encourage investment in fisheries, mining and tourism as an alternative for islands unwilling to accept Chinese domination of trade and aid.

Taiwan could take a diplomatic approach that takes more account of an Oceania centered perspective and is more culturally sensitive

Taiwan should understand and respect Oceanian countries' strong sense of agency and sovereignty in forming their foreign policies and development priorities. Taiwan's aid projects should address more directly the issue of climate change (including mitigation, green energy, carbon remission, and the threat of extreme weather and water shortages).[37] As Marshall Sahlins (1993) points out, development also needs individuals who are embedded in the social structures of Oceania. Taiwan should back projects that aim to boost local employment, for example by upgrading fisheries and cargo facilities and focusing on employment instead of the payment of license fees alone. It could also assist local retailers and other small businesses. Doing business in Oceania is all about building relationships. These relationships should be rooted in inclusivity, reciprocity, mutual care and shared island values.[38] Oceania is deeply committed to the concept of sustainability. This is not only about development but also about collaboration, partnerships and relationships. Business activities should not be based on a single, short-term event but on sustainable cooperation and exchange.

Transforming Taiwanese aid to contribute more directly to economic development

Taiwan's International Cooperation Development Fund (ICDF) agricultural team could be relaunched as a business instead of just a channel for aid. Agricultural teams could collaborate with local businesses to open local stores and food processing factories. This would not only deepen Taiwan's presence but also create job opportunities for locals. Cultural industries are another potential field of investment. Taiwan could create business activities and offer employment through text, music, television and film production, as well as crafts and design. Taiwan could also support the development of cultural and eco-friendly tourism by promoting distinctive architecture and preserving cultural heritage.

Taiwan as part of Oceania

In recent years, Taiwan has highlighted its Austronesian heritage to make a stronger cultural connection with Oceanian countries, including an attempt to establish an Austronesian Forum as a new regional platform for Taiwan and its partners. While the term Austronesian is rather academic and needs more time to become familiar to the general public (Marinaccio, 2021), there is a growing understanding and acceptance of it in the region. However, there are limitations in its application—for example, the vast majority of the population in inland PNG are non-Austronesian. On the other hand, the term indigenous does not mean much to many islanders either. Lessons could be learned from the developing area of 'Oceanian diplomacy' (Carter et al., 2021), which makes more use of Oceanian concepts and terminology. Tuvalu presents a good example in this area. Taiwan should consider working with its diplomatic partners to come up with an appropriate Austronesian term as part of a diplomatic narrative or theme that would resonate across the region. The Taiwanese government could also consider setting up a trade office to offer a platform and information center for local populations.[39]

Notes

[1] The UK has also pledged a new approach entitled 'Pacific Uplift'. Indonesia talked about 'Pacific Elevation' in 2019.

[2] Ethan Meick, Michelle Ker, and Chan Han May, "China's Engagement in the Pacific Islands: Implications for the United States," U.S.-China Economic and Security Review Commission, 2018.

[3] There are news reports that China has an interest in establishing military bases in Fiji, Vanuatu and Kiribati; and the newly singed secret security pact between China and the Solomon Islands has also raised concerns. However, there is no confirmation of any activity or firm plans yet.

[4] The huge investment of Chinese casinos in CNMI has raised concerns in the US because of the proximity of the casino to a US military base. The other example concerns the undersea cable network in the Pacific. For example, the Solomon Islands originally selected a British-American company, Xtera, to install the cable to connect the country to Sydney and had secured funding assistance from the Asian Development Bank (ADB). However, the government under then prime minister, Manasseh Sogavare, switched to Huawei, a Chinese telecommunications giant. The projects drew concern from the Australian government over their security

implications. Australia replaced Huawei, agreeing to fund the construction of a new undersea telecommunications cable that would link Papua New Guinea, the Solomon Islands and Australia. Recently, the US, Australia and Japan took over the cable project in Micronesia, probably for similar security concerns.

[5] See 6.4.2 for details.

[6] In terms of international trade negotiations, Pacific countries have strong agency, in the context of regional geopolitics (Morgan 2015).

[7] Taiwan's aid is also criticized as less transparent and less-regulated.

[8] See "Sogavare reiterates commitment to 'one China policy'" https://solomons.gov.sb/sogavare-reiterates-commitment-to-one-china-policy/

[9] Taiwan's representative office in Fiji was also forced to change the name from 'Trade Mission of the Republic of China to the Republic of Fiji' to 'Taipei Trade Office in Fiji' in the July of 2019. A year earlier, Taiwan's representative office in PNG was also forced to change from 'Trade Mission of the Republic of China (Taiwan) in Papua New Guinea' to 'Taipei Economic and Cultural Office in Papua New Guinea' before APEC 2018 took place in Port Moresby.

[10] https://www.icdf.org.tw/

[11] E.g. 'Home Energy Efficiency and Renewable Energy Project in the Marshall Islands' https://www.icdf.org.tw/ct.asp?xItem=41455&ctNode=30040&mp=2

[12] E.g. civil strife or coups in Fiji, the Solomon Islands and PNG; closing and opening of phosphate mine in Nauru.

[13] There is no suitable pair in the region for the comparison with Palau and Vanuatu.

[14] All DID results and graphs come from work by Dr. Ling-yu Chen and Dr. Jinji Chen. See Ch.3 for details.

[15] Tuvalu's ambassador to Taiwan also gave similar accounts. Their government is still trying to work with Taiwanese cargo companies to get employment for experienced sailors.

[16] See "New Samoa PM cancels China-funded port" https://islandtimes.org/new-samoa- pm-cancels-china-funded-port/

[17] Members include the Federated States of Micronesia, Kiribati, the Marshall Islands, Nauru, Palau, Papua New Guinea, the Solomon Islands and Tuvalu. These countries collectively control 25-30% of the world's tuna supply, and control around

50% of the global supply of skipjack tuna See PNA (n.d.)

[18] The VDS is a rights-based management mechanism that aims to limit fishing by purse seine vessels by setting benchmark prices and allocating tradable fishing days (Yeeting, 2018).

[19] Some are logging illegally. For example, a recent case in the Solomon Islands. See "Isabel landowners fight for ownership over Tubi logs", The Islandsun, https://theislandsun.com.sb/isabel-landowners-fight-for-ownership-over-tubi-logs (Last visited Jan. 10, 2022)

[20] Chinese demand spurs LNG investment in Papua New Guinea, Nikkei Asia, https://asia.nikkei.com/Economy/Chinese-demand-spurs-LNG-investment-in-Papua- New-Guinea (Last visited Jan. 11, 2022).

[21] See USGS Mineral Yearbook. "Chinese redevelopment of Solomon Islands' Gold Ridge mine dubbed 'way over the top'" , ABC News, https://www.abc.net.au/news/2019-10- 30/china-cites-early-harvest-benefits-in-guadalcanal-deal/11654596 (Last visited Jan. 7, 2022).

[22] "Debt-trap diplomacy: China secures Gold Ridge Mine in Solomon Islands", Taiwan Times, https://www.taiwannews.com.tw/en/news/3780779 (Last visited Jan. 6 2022)

[23] "Mixed prospects for the mining sector, The Economist Intelligence", http://country.eiu.com/article.aspx?articleid=1697603353 (Last visited Dec. 27, 2021).

[24] "Concern for oil spill near East Rennell, Solomon Islands, in central Pacific", UNESCO, http://www.unesco-hist.org/index.php?r=en/article/info&id=1478 (Last visited Jan. 3, 2022)

[25] Axiom mining claims Solomon PM's Chief of Staff sought $700,000, Papua New Guinea Mine Watch, https://ramumine.wordpress.com/2019/12/05/axiom-mining-claims- solomon-pms-chief-of-staff-sought-700000/ (Last visited Jan. 4, 2022)

[26] "Logging company "reinvented" itself as bauxite miner in Solomon Islands, says researcher", ABC News, https://www.abc.net.au/radio- australia/programs/pacificbeat/logging-company-reinvented-itself-as-miner/10899386 (Last visited Jan. 2, 2022). Warning from Isabel, The Islandsun, https://theislandsun.com.sb/warning-from-isabel/ (Last visited Jan. 2,2022).

[27] "Isabel landowners refused to sign access agreement", The Islandsun, https://theislandsun.com.sb/isabel-landowners-refused-to-sign-access-agreement/ (Last visited Jan. 2, 2022)

[28] According to the USGS 2017-18 Mineral Yearbook, only Chinese companies had

produced mineral exports. The 2015 Year Book listed other investments in gold mines by Canada, Australia and Japan, but it seems they are still in the planning stage.

[29] See "Analysts point to logging and mining to explain Solomon Islands unrest" https://news.mongabay.com/2022/01/analysts-point-to-logging-and-mining-to-explain- solomon-islands-unrest/?fbclid=IwAR01c6C-- fk7rKJRXXqmNNCS_t7vHxEb1Dv0rJE33ECaGOI2JAju2t6L7gc

[30] SPTO Annual Visitor Arrivals Report, 2019 https://pic.or.jp/ja/wp- content/uploads/2019/07/2018-Annual-Visitor-Arrivals-ReportF.pdf

[31] The New York Times contends that the Imperial Pacific project has been linked to China's BRI, which even incorporates American territory for economic development.

[32] United Nations trust territory administered by the United States in parts of Micronesia after World War II. Areas administered as part of the TTPI included the modern-day Marshall Islands, Federated States of Micronesia, Palau, and the Commonwealth of the Northern Mariana Islands.

[33]Data collected from Lowy Institute Pacific Aid Map https://pacificaidmap.lowyinstitute.org/dashboard (Last visited Jan. 10, 2022).

[34] Data collected from The World FactBook. https://www.cia.gov/the-world-factbook/countries/palau/#economy (Last visited Jan. 10, 2022).

[35] The data is collected from the official statistics database maintained by the Palauan government: https://www.palaugov.pw/executive- branch/ministries/finance/budgetandplanning/immigration-tourism-statistics/

[36] The China Approved Destination Status (ADS) scheme is an arrangement between various countries and Chinese governments. The scheme allows Chinese tourists to travel to certain countries in guided groups.

[37] For climate change diplomacy and China's response, please see Goulding 2015, Zhang 2020.

[38] As a successful Taiwanese indigenous businessman points out, 'once we have sustainable business relations, we know the market and we know our opportunity and position in the market'.

[39] "Tuvalu's foreign policy and values". https://devpolicy.org/tuvalus-foreign-policy-and- values-20200609-2/

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CHAPTER 7
Economic Versus Political Engagement with China and Taiwan in Central and Eastern Europe

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The chapter focuses on economic relations and their possible effects on relations between China/Taiwan and three Central and Eastern European (CEE) countries: Poland, the Czech Republic and Hungary. Since there have been no switches in diplomatic relations in this region, we examine whether stronger economic links lead to better perceptions of China and Taiwan in the region, and whether diplomatic gestures by the CEE3 generate more economic engagement with either. Based on interviews with researchers, diplomats and businesspeople, we found little evidence that economic interactions affect diplomatic relations. However, Taiwanese investments will have a better chance of enhancing political ties in the future if they focus on high tech sectors rather than manufacturing and assembly. As regards political ties affecting economic engagement, we found a clear link between the level of Chinese investment stock in CEE countries and the depth of political relationships with Beijing. Recent developments that have seen friendly gestures from some CEE countries towards Taipei suggest they may too have an impact on economic links with Taiwan.

7.1 Introduction

The transition of Central and Eastern European (CEE) countries from centrally planned to market economies in the late 20th century transformed the region's external economic relations. During this transition period, CEE went through radical economic restructuring, largely induced by foreign capital. Multinational enterprises (MNEs) realized significant investment projects and established their own production networks in the region. Investors, mainly from core European countries, were attracted by macroeconomic factors, including relatively low unit labor costs, market size, openness to trade and proximity. Institutional factors, such as the prospects for CEE countries' economic integration with the European Union (EU) also increased FDI inflows.

Compared with investments from Western Europe and the US, non-Euro-Atlantic FDI remained modest in CEE, although the first wave of such investment did start directly after the transition and picked up again from the early 2000s. Both Chinese and Taiwanese companies have targeted the CEE region: some smaller companies first arrived in the 1990s, while medium sized and bigger companies made their first investments after the millennium, with the Czech Republic, Hungary and Poland

(CEE3) among the most popular destinations.

Historically, geographically and politically bound to Europe and highly dependent on the European Union for trade and investment, the CEE region as a whole has not managed to reach a common position on China. Some countries have more reservations about the growing Chinese presence, while others are more welcoming in the hope of greater economic opportunities. CEE countries are also aware that even lower levels of cooperation with Taiwan may provoke a backlash from China, although some of them are willing to take the risk. This diversity of approaches is also reflected in their attitude towards Taiwan.

In line with the above, the aim of the chapter is to analyze economic relations - and their possible effects on the political terrain - between China and Taiwan and the CEE3 region. Besides presenting the evolution of diplomatic relations, trade, and investment volumes since 2000, we outline how important the CEE region is in Chinese/Taiwanese companies' expansion strategies and the main factors that make it attractive. The study will also examine the effects of China/Taiwan-CEE economic relations on their image in CEE3 countries. The chapter intends to analyze whether China and Taiwan are perceived better as a result of greater economic activities and whether diplomatic gestures from the CEE3 can generate more trade and investment.

7.2 Methodology

We focus on the Czech Republic, Hungary and Poland because they have received the most Chinese and Taiwanese FDI in the region and have significant trade links, while adopting different political stances towards Beijing and Taipei. Other CEE countries - such as Lithuania or Slovakia – would also have been interesting to analyze politically due to their recent slight but tangible shifts in foreign policy towards Taiwan. However, economic ties are far from being significant between either the Baltic country or Slovakia and China or Taiwan, and as a result there is not much at stake and little scope for retaliation.

Our methodological approach comprises a mix of qualitative interpretative methods such as interviews and qualitative document analysis, complemented by secondary literature and news sources. Interviews were conducted either in person or online with company officials, representatives of chambers of commerce, diplomats and government officials. Where personal interviews were not possible, the authors used other sources, such as former employees, business professionals, experts, and academics from the CEE3. The interviews were conducted anonymously, and all interviewees were guaranteed confidentiality. The interviews were semi-structured and analyzed based on extensive notetaking during and after the interviews. To complement our arguments and to dig deeper into the institutional and societal contexts of the host countries, we also relied on qualitative document analysis of governmental policy reports, news reports, corporate publications (e.g., annual reports) and corporate databases (such as Orbis).

7.3 An area of contest between Beijing and Taipei?

Even though all CEE3 countries have diplomatic relations with China and have accepted the "One China Principle", during their transition these countries - as Turcsanyi (2020a) puts it - "became some of the most active substantive partners of Taiwan". That is, these new democracies genuinely sympathized with anti-communist Taiwan and saw opportunities in its dynamic economic performance. Almost all CEE countries opened representative offices in Taiwan, and Taipei representative offices were established in CEE capitals (Turcsanyi, 2020a). However, they were aware that even lower levels of cooperation with Taiwan could provoke China and as a result they decided not to engage further. In 2012 China decided to take its CEE relations to a higher level and initiated the 16+1 cooperation, that is a framework of cooperation between China and 16 CEE countries in political, economic and social arenas, with big yearly summits that serve as an opportunity to develop multilateral and bilateral relations.

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 it therefore lacks understanding of the local environment (Turcsanyi 2020b). China entered the region with more vigor with the global economic and financial crisis in 2008, after which Beijing began to consider CEE as a geographical gateway to the rest of the EU market (Szunomár 2018). CEE countries were also affected by the crisis and began reconsidering their predominantly west-bound orientation and exploring possibilities elsewhere, including China. In some countries (such as Hungary, the Czech Republic, Poland and Serbia) the process was further accelerated by the ascendence to power of politicians with skeptical views of the EU (Karásková et al. 2020).

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. In the CEE3, two countries – the Czech Republic and Poland - can be considered as more cautious towards China, while Hungary seems to be China's most trusted partner in the CEE region.

The Czech Republic has adopted the most critical approach towards China, challenging China over many human rights, Tibet and other issues. Starting from this rather cold and critical stance, Prague's relationship with China changed for a few years as the Chinese leadership found common ground with President Milos Zeman. As our expert interviews confirmed, after Czech 'political sympathy' developed, inflows of Chinese FDI began to increase. As a case in point Zeman - who was the only high-level European politician to participate in China's celebrations to mark the anniversary of the end of World War II in 2015 - declared that he wanted his country to be China's 'unsinkable aircraft-carrier' in Europe (The Economist, 2018). He also employed a Chinese adviser directly from a Chinese company with a controversial background. However, as soon as the biggest Chinese investor in the country, CEFC came under investigation by Chinese authorities for 'suspicion of violation of laws' (Lopatka & Aizhu, 2018), critical voices intensified in the Czech Republic. As a result, Czech-Chinese relations have been cooling off again, no significant Chinese FDI flows have arrived since then and disinvestment took place in 2017 (see Table 7.1 later).

Based on our interviews conducted with experts in China-Poland relations, Poland used to be more enthusiastic about the potential of its relationship with China but has taken a more critical stance recently, mainly for three reasons. First, the high trade deficit with China is seen as a problem: Polish imports from China have been eight to twelve times higher than Poland's exports to China over recent years, with the deficit reaching €20 billion according to Eurostat. Second, potential security risks associated with Chinese investments caused the Polish government to reconsider its positive approach. This reconsideration was signaled by the cancellation of tenders and a number of political statements (Szczudlik, 2017). As a probable result of this, investment flows have begun to stagnate. Third, as confirmed by one of our interviewees, since Russia presents a potential threat to Poland, the country has been the US's closest regional ally and as a result it often follows the US stance on China.

Hungarian governments – regardless of political orientation – have been working on developing relations with China for over two decades. Hungary launched a new foreign economic policy in the spring of 2012 aiming to diversify foreign economic relations: the "Eastern opening policy". Although the Orbán government has emphasized that it would like to maintain Hungary's strong and important economic relations with its traditional Western (European) partners, the main objective of this policy has been to reduce Hungary's economic dependence on trade and investment with the West. This has meant an opening to the east, particularly China. Besides promoting economic relations with China, Orbán'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 (BRI). This came during the visit of Foreign Minister Wang Yi to Budapest in June 2015. The Hungarian government was also very keen on promoting the Budapest-Belgrade railway, a long negotiated soon to be started construction project under the BRI umbrella. When signing the construction agreement in 2014, Orbán 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 used to be economic in the early 2000s, recently Hungary has used the 'China card' for political reasons (Turcsányi, 2020b) to demand better treatment from Western partners.

As described above, when it comes to China-CEE3 relations, the Czech Republic remained rather cautious and critical from the beginning, Poland used to be more enthusiastic but has taken a more critical stance recently, while Hungary and China have their own 'special relationship'. Understandably, the countries anxious about China tend to have a friendlier attitude towards Taiwan. While Lithuania, the Czech Republic and Poland seem to be open for more intense economic, cultural and scientific relationships with Taiwan, they always add that this does not imply any conflict or disagreement with the One China Principle. Thus, they try to avoid political commitments. However, recent developments may indicate some change in this area: a few CEE countries, including the Czech Republic sent coronavirus vaccines to Taiwan in 2021. The gesture was well received in Taipei and has been followed by a Taiwanese business mission to three of the countries and the prospect of further trade and investment (McEnchroe, 2021).

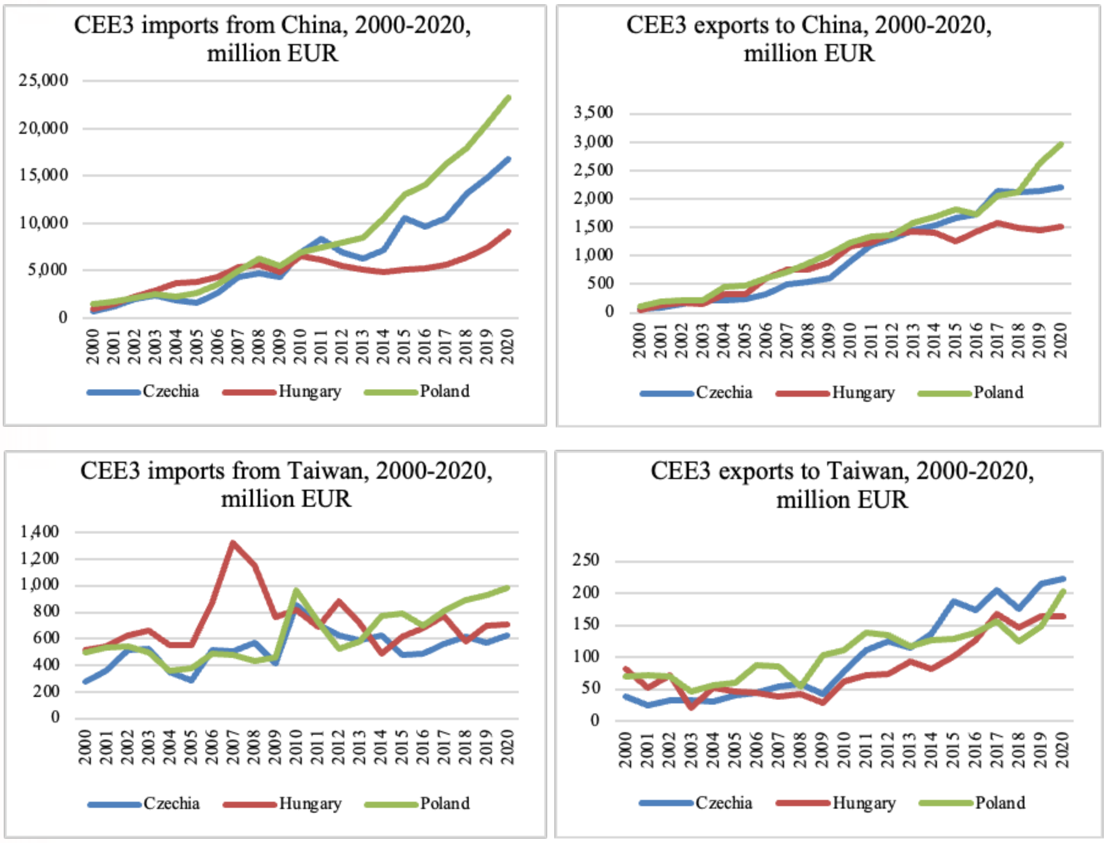
7.4 The growing Chinese footprint and moderately increasing Taiwanese presence in CEE3

In the past two decades, both the Taiwanese and Chinese economic presence in CEE3 has been characterized by developing trade relations and growing inflows of FDI.

7.4.1 Trade

A comparative analysis of CEE countries' trade with China (Karáskova et al., 2020) revealed that the majority of the countries (especially in the Baltic and the Balkans) have relatively low trade volumes with China. Within the whole CEE region, the Czech Republic, Hungary, Poland and Slovakia show the highest trade flows, followed by Romania, Slovenia, Serbia and Bulgaria. As regards trade between the CEE3 and China, it indeed increased substantially in the past twenty years (see Figure 7.1). In the case of imports from China, both the CEE3's EU membership (2004) and the launch of the 16+1 initiative (2012) gave new impetus to relations. However, while the CEE3's imports from China increased substantially, the growth of their exports to China remained rather modest after 2012 and even decreased slightly for a few years after 2014. As a result, trade deficits increased rapidly as well. Besides, despite the growth of trade between the two sides, the relative significance of China has barely increased as the total trade of CEE countries has been growing almost as fast as their trade with China. Likewise, the share of CEE countries in total EU-China trade has not grown extensively as EU-China trade itself has increased rapidly. That is, China's relative significance as a trade partner has not changed much as a result of the 16+1 cooperation, especially not in the case of exports.

Figure 7.1 CEE3 trade with China and Taiwan, 2000-2020

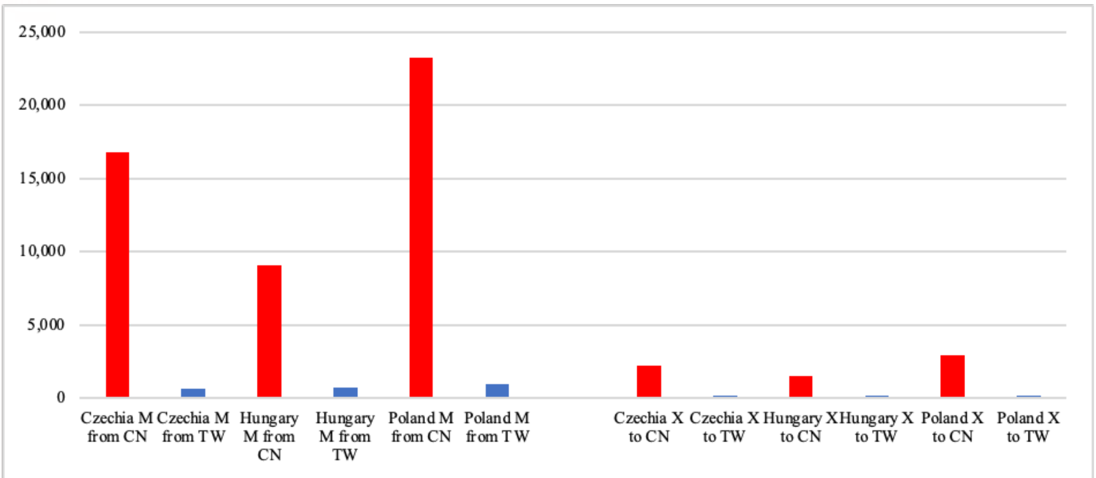


Source: own compilation based on Eurostat data

In the case of Taiwan-CEE3 trade relations - as Figure 7.1 shows - trade flows are more volatile, especially imports which are characterized by many ups and downs. Still, there has been a modest increase (compared with China) in the past two decades. Between 2000 and 2020, imports nearly doubled while exports tripled.

Based on Eurostat figures, the main import products from both China and Taiwan are machinery and electronics. CEE3 countries' exports are dominated by vehicles, machinery and electronics, while Poland also exports a significant amount of metal (including refined copper and copper alloys) to China.

FIGURE 7.2 CEE3 TRADE WITH CHINA AND TAIWAN, 2020, MILLION EUR



Source: own compilation based on Eurostat data

When comparing the CEE3's trade with China and Taiwan (see Figure 7.2), we can conclude that Poland, the biggest country in the region, is the largest recipient of both Chinese and Taiwanese imports, followed by the Czech Republic and Hungary. On the export side, it is again Poland - followed by the Czech Republic and Hungary - that exports the most to China. The Czech Republic exports the most to Taiwan, followed by Poland and Hungary. It should be stressed that the vast majority of the exports are generated by local subsidiaries of MNEs rather than CEE3-owned companies.

7.4.2 Investments

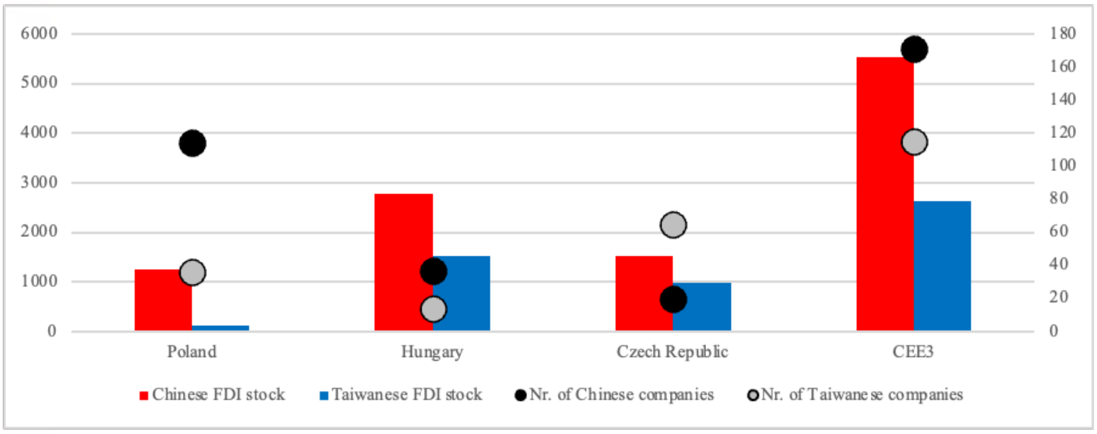
Although most investors in the CEE3 initially arrived from Western Europe, the first phase of inward East Asian FDI also came soon after the democratic transition of 1989. Japanese and Korean companies indicated their willingness to invest in the CEE3 even before the fall of the Iron Curtain in the late 1980s. But most of their investments took place during the first years of the democratic transition, in the 1990s. Taiwanese businesses made their first steps into CEE3 markets in this phase. The second impetus was given by the CEE3's accession process to the European Union (EU), which coincided with China's increasing global engagement, hallmarked by its "going global" policy. The CEE3's EU membership allowed East Asian investors to avoid trade barriers by using them as assembly bases. The third phase dates back to the global economic and financial crisis, when financially destressed companies all over Europe were often acquired by non-European companies. Regardless of this, the CEE3 have become increasingly open to investors from outside Europe.

As follows from the above, the CEE3 presence of Chinese and Taiwanese companies dates back to almost the same period. While smaller Taiwanese companies established their CEE3 presence in the 1990s, bigger companies, especially Taiwanese MNEs gained their foothold after the millennium. Smaller Chinese companies first became established during the 1990s, mainly by Chinese nationals living in Hungary, whose numbers had started to increase.

China's economic impact on CEE countries is still relatively small despite a significant increase over the past two decades (Garlick, 2019; Szunomár, 2020b; Turcsanyi, 2020b; Matura, 2021). Similarly, although to a relatively modest degree when compared to China, Taiwanese companies' investments have also increased during the same period (Turcsanyi, 2020a). The transformation of the global economy and the restructuring of China's economy fueled its interest in the CEE3, which presented new challenges and opportunities for East Asian companies (Jakóbowski, 2018; Szunomár, 2018; 2020b, Karásková et al., 2020). For China, after 2012 and 2013, this process has been amplified by 16+1 cooperation and the launch of the BRI.

By 2020 (see Figure 7.3) CEE3 countries had accumulated more than $5.5 billion in Chinese FDI and more than $2.6 billion from Taiwan, with Hungary receiving the most, followed by the Czech Republic and Poland. Interestingly, the numbers of companies show a somewhat opposite trend: Poland has the highest number of Chinese companies, followed by Hungary and the Czech Republic, while the number of Taiwanese companies is the highest in the Czech Republic, followed by Poland and Hungary. That is, Hungary has the highest stock of FDI from both China and Taiwan, while it hosts only a third as many Chinese companies as Poland and a quarter as many Taiwanese companies as the Czech Republic. The explanation is relatively simple: Hungary hosts mainly big MNEs from both China and Taiwan, with each of these investments having a relatively high value, while Poland and the Czech Republic host mainly smaller companies.

Figure 7.3 Chinese and Taiwanese FDI stock and number of companies in CEE3, million USD (left axis) and number (right axis), 2020



Source: own compilation based on OECD (FDI stock) and Orbis database (Nr. of companies)

Based on OECD statistics, Chinese and Taiwanese yearly FDI flows are relatively inconsistent in the whole CEE region, which probably means that FDI flows are connected to one or two big business deals per year. Disinvestments are less characteristic for the majority of the analyzed CEE3 countries; however, one big disinvestment did take place in the Czech Republic in 2018, probably as a result of financial problems in one particular Chinese company, CEFC China Energy, the major Chinese investor in the country.

Chinese investments are still dwarfed by, for example, German MNEs' investments in these countries. When calculating percentage shares, we found that Chinese FDI stock is around or below one per cent of total inward FDI stock in the CEE3 countries (see ANNEX 7.1). 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 stock 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 (see ANNEX 7.2). Taiwan's share of total FDI in the CEE3 is above 0.5 per cent only in the case of Hungary.

One notable phenomenon is that most East Asian companies tend to invest in the CEE3 via intermediary countries or companies instead of directly. Consequently, East Asian FDI in all CEE3 countries is considerably more substantial according to the data on the ultimate owners' country than on the immediate owners' one.

The main entry modes of and sectors targeted by Chinese and Taiwanese investment are similar in all CEE countries, although they are more diverse in the most popular target countries. Both Chinese and Taiwanese investors typically target secondary and tertiary sectors in the CEE3. Initially, their investment flowed mostly into manufacturing, but over time, services have also attracted investment. The main Chinese investors targeting the CEE3 countries are primarily interested in telecommunications, electronics, chemicals and transportation, while Taiwanese companies operate mainly in electronics manufacturing or assembly of machinery and transport equipment. Regarding their entry modes, Chinese companies have carried out greenfield projects, but mergers and acquisitions (M&A) became more frequent later on, especially after the global economic and financial crisis of 2008. Greenfield projects are even more typical for Taiwanese companies. It has to be added, though, that CEE countries – unlike countries in Western Europe – do not offer too many M&A opportunities since the number of successful, globally competitive companies is much lower. Among investing Chinese companies, we can find both privately-owned and state-owned enterprises, while Taiwanese companies are all privately-owned.

7.5 Differences and similarities: What makes the CEE3 attractive for Chinese and Taiwanese companies?

Host-country determinants or pull factors are the characteristics that attract FDI. Pull factors can be grouped into macroeconomic and institutional factors. Macroeconomic pull factors usually include access to markets, low factor costs and new opportunities for asset-seeking companies. Institutional factors usually include international and regional investment and trade agreements, host government policies and the role of different institutions (Makino et al., 2002; Buckley et al., 2007; Schüler-Zhou et al., 2012). We can further specify institutional factors by dividing them into two levels: the supranational level and the national level (McCaleb & Szunomár, 2017). Among possible pull factors that make CEE3 a favorable investment destination for Chinese and Taiwanese investors, we can find several similarities and a few differences (see Table 7.1).

Among similarities, the labor market is to be considered first, since a skilled labor force is available in sectors (mainly manufacturing) in which Chinese as well as Taiwanese interest is growing, with labor costs being lower in the CEE3 than the EU average. Similarly, corporate taxes can also play a role in the decision of East Asian companies to invest in the region. Nevertheless, the differences in labor costs and corporate taxes within the broader CEE region do not really seem to influence Chinese or Taiwanese investors. After all, there is more investment from China or Taiwan in the CEE3 than in Romania or Bulgaria where factor costs are lower. This can be explained by the theory of agglomeration (the more FDI a country hosts already, the more it will be able to attract), as inward FDI in CEE countries is highest in the CEE3 (McCaleb & Szunomár, 2017).

Although the above-mentioned efficiency-seeking motives play a role, the main type of both Chinese and Taiwanese FDI in the CEE3 seems to be market-seeking investment: by entering these markets, companies have access to the whole EU market. Moreover, they might also be attracted by free trade agreements (FTAs) between the EU and third countries and the EU's neighboring country policies. Their CEE3 subsidiaries aim to sell products in the CEE3 host countries, the EU and Northern American or even global markets (Wiśniewski, 2012, p. 121). Based on the interviews, Chinese as well as Taiwanese companies wanted to operate in the CEE3 due to their already existing businesses in Western Europe and to strengthen their presence in the wider European market. There are cases of both Chinese and Taiwanese companies following their customers or global partners to the CEE region. In addition, there are cases of Taiwanese companies following their Chinese partners to the CEE region.

Table 7.1 Major pull factors of analyzed Chinese and Taiwanese companies in CEE3

Macroeconomic pull factors	Institutional pull factors	
	supranational	national
market access	international and regional investment and trade agreements, free trade agreements	host government policies (including strategic partnership agreements between the government and certain companies); political relations
low factor costs (resources, materials, labor)	advanced institutional setting; institutional stability (such as IPR protection)	tax incentives, special economic zones
qualification of labor force	European production and services standards (such as product safety standards)	'golden visa' programs (residence visa for a certain amount of investment)
various opportunities for asset-seeking companies: brands, know-how, knowledge, networks, distribution channels, access to global value chains, etc.	chance for participation at EU level public procurement processes	institutions such as banks, government-related investment promotion agencies (IPAs)
company-level relations		possibility for more acquisitions through privatization opportunities
the high level of technology		home country diaspora in the host country

red colored factors refer only to Chinese companies, black colored factors characterize both

Source: own compilation based on the reviewed literature and company interviews

As for supranational institutional factors (see Table 7.1), the change in the CEE3 countries' institutional settings due to their economic integration into the EU has been an important driver of Chinese outward FDI in the region, especially in the manufacturing sector.

Another aspect of EU membership that has induced Chinese investment in the CEE3 is institutional stability, given unstable institutional, economic and political environments at home. These findings are in line with those of Clegg and Voss (2012) who argue that Chinese outward FDI in the EU shows 'an institutional arbitrage strategy' as 'Chinese firms invest in localities that offer clearer, more transparent and stable institutional environments. Such environments, like the EU, might lack the rapid economic growth recorded in China, but they offer greater planning and property rights security, as well as dedicated professional services that can support business development'.

National-level institutional factors include strategic agreements, tax incentives and privatization opportunities. Based on our observations as well as responses from interviewees, Chinese companies appreciate business agreements that are supported by the respective host country government. Thus, the high-level strategic agreements with foreign companies investing in Hungary offered by the Hungarian government, or the special economic zones created by the Polish state could also have spurred Chinese investment in the region. Moreover, personal political contacts between representatives of the respective host country government and Chinese companies also proved to be important when choosing a host country in the CEE3.

Based on interviews, we also found that in the case of Chinese MNEs' motives in the CEE3, a significant role is attributed to other less-quantifiable aspects, such as the size and response of the Chinese ethnic minority in the host country and the possibilities of acquiring visas and permanent residence permits. That is in line with Blonigen and Piger (2014) and Hijzen et al. (2008) who state that companies interested in acquiring foreign assets might be motivated by a common culture and language as well as trade costs. A clear example for that is the stock of Chinese investment in Hungary, which is the highest in the CEE3: Hungary has the largest Chinese diaspora population in the region, moreover, it is the only country that has introduced a special 'golden visa' program that enables foreign investors to acquire a residence visa in exchange for investing a certain amount of money.

In addition to the above-mentioned supranational and national-level institutional pull factors, political relations between China and respective CEE3 countries also seem to have influenced Chinese MNEs' investment decisions. Those countries that have acted in favor of China, supported Chinese global and regional initiatives and/or welcomed and fostered Chinese MNE's investments (see section 7.3 of this chapter) typically host – or have hosted during the period of rather friendly ties – more Chinese FDI stock than those countries that have a neutral or rather negative stance on China (see Graph 7.3 above).

While for Chinese companies political relations between the home and the host country are of utmost importance, Taiwanese companies are less concerned about the level of political cooperation. During our interviews almost all sources stressed that Taiwanese companies, especially the big ones, act in a highly pragmatic manner. This means that they do not really care about political relations but focus purely on business interests. In Hungary, for example, compared to the previous Socialist government, Fidesz has doubled subsidies to multinational companies and has been particularly keen to entice electronics and automotive manufacturers, where each job created received over 20,000 euro in public subsidies (Várhegyi, 2018). Fidesz, however, also strengthened relations with China further and as a result relations with Taiwan are considerably less developed than in other CEE3 countries. As confirmed by one of the Taiwanese companies' representatives based in Hungary, at first glance it may seem that Taiwanese MNEs are not receiving the same subsidies as the Chinese (i.e., the Hungarian government hasn't signed strategic cooperation agreements with them, the Hungarian Minister of Foreign Affairs and Trade did not attend the opening ceremonies of their companies), but in fact Taiwanese MNEs seem to be receiving the same or very similar incentives as their Chinese, German or US counterparts. Given the pragmatic strategy of Taiwanese MNEs, such incentives could indeed explain why Hungary is a relatively popular destination in Europe for Taiwanese companies, despite its political indifference - or even unfriendliness – towards Taiwan.

Of course, political relations do matter but only up to a certain point. Due to the relatively positive stance the Czech Republic has adopted towards Taiwan, the country is quite popular among Taiwanese people. Taiwanese media, for example, reports on events in the Czech Republic much more often than any other CEE country. And, this positive perception of the Czechs has influenced the location decisions of some Taiwanese companies, although this tendency is more typical of smaller companies. Big MNEs seem to follow different logic.

Although the Czech Republic hosts more Taiwanese companies than Hungary, when it comes to the stock of investment, Hungary is the most popular destination for Taiwanese companies in the CEE. And indeed: those few big Taiwanese MNEs with a presence in CEE seem to choose Hungary rather than Poland or the Czech Republic even if political relations are coldest there. One of our interviewees explained this by pointing out connections between Chinese and Taiwanese companies both globally and locally. That is, the majority of those big Taiwanese MNEs in the CEE3 - such as Foxconn, Giant, Sinbon, and Yageo - have a connection to China: either a production facility or a subsidy is located in the mainland, or they have some kind of cooperation with a Chinese company globally. As a result, as one of the expert interviewees confirmed, these Taiwanese companies often follow the 'Chinese way', that is they behave in a similar way to their Chinese counterparts, make similar decisions when it comes to location choice, or even follow Chinese companies to a specific - in our case CEE3 - location. These companies are learning from their Chinese partners' experience, leveraging these contacts and taking advantage of the results their Chinese partners have already achieved there. One of the Czech interviewees emphasized that sometimes even Chinese money is involved in Taiwanese companies' investment in a certain CEE3 location.

7.6 Conclusion: Are economic interactions affecting diplomatic relations or vice versa?

Both Chinese and Taiwanese companies have targeted the CEE region: smaller companies arrived in the 1990s, while medium sized and bigger companies made their first investments after the millennium, with the CEE3 being among the most popular destinations within the CEE region.

When it comes to factors that attract companies to a certain region, we differentiated between three types of pull factors: macroeconomic, institutional, and political. Based on interviews, we showed that Chinese and Taiwanese companies are attracted mainly by macroeconomic factors to CEE3 countries. These factors are, among others, market access (to the whole EU), relatively low factor (mainly labor) costs, and the qualifications of the labor force as well as company-level relations. Nevertheless, institutional factors, such as free trade agreements, institutional stability, tax, and other incentives, and the activities of investment promotion agencies are also important for both Chinese and Taiwanese companies when locating in the CEE3. Political factors, such as the level of political relations between the home and the respective host country, political gestures, and confidence-building measures, seem to play an important role only for Chinese companies.

In CEE Chinese companies tend to invest more in politically friendly countries, such as Hungary or Serbia, while investing less in countries that make critical statements about China from time to time. Economic relations don't really have an impact on political ties, that is, more Chinese investment doesn't necessarily result in better political relations between China and respective CEE3 countries. Political (or diplomatic) relations seem to be much more influenced by international trends, mainly by EU-level processes and decisions and the US stance. Hungary seems to be an exception here, at least in the sense that it goes against EU trends and unlike the other countries does not see engagement with China as risky. Still, even in the Hungarian case we do not see evidence that the economic relationship is positively affecting the political relationship, since Hungarian-Chinese political relations have been consistently good over the past two decades, while China's economic presence there is still not significant compared to, for instance, that of Western Europe.

While in the case of Chinese companies political ties tend to affect economic relations, rather than vice versa, we couldn't really find evidence of political factors affecting the location decisions of Taiwanese companies in the CEE3. In fact, Taiwanese companies seem to make such decisions based on other criteria. Big Taiwanese multinational companies in particular act in a highly pragmatic manner in the CEE3: they do not really take account of political relations but focus purely on business interests. That is, if they receive more investment incentives in Hungary, they choose that over the Czech Republic, even if the latter is politically more friendly than the former.

Another important observation is that the majority of big Taiwanese multinational companies with a presence in the CEE3 have a connection with China: either a subsidy on the mainland or cooperation at the global level. These Taiwanese companies are leveraging these contacts and tend to locate where other Chinese companies are located. Similarly, since Taiwanese multinationals do not want to risk their already existing relations with Chinese multinationals. It seems they are "keeping a low profile" in CEE and do not emphasize their 'Taiwaneseness'. Consequently, we couldn't really find evidence of economic interactions affecting diplomatic relations between Taiwan and the CEE3.

Although it seems that neither political nor economic relations have an impact on one another in the Taiwan-CEE3 case, recent developments have shown that diplomatic gestures may affect economic interactions: Lithuania, the Czech Republic, Poland and Slovakia sent coronavirus vaccines to Taiwan amidst the COVID pandemic in 2021. "In return", Taipei sent a delegation to three of the countries that could lead to more investment or business deals (McEnchroe, 2021).

Based on interview results, there may be a chance for Taiwanese investments to contribute to better political relations with the CEE3 countries in the future. Interviewees believed that if Taiwanese investment was introduced in sectors other than manufacturing and assembly - i.e., in high-technology, innovation, R&D - that could have a positive spill-over effect on political relations.

Notes

[1]CEE is a broader term encompassing the countries in Central Europe, the Baltics, Eastern Europe, and Southeast Europe (the Balkans). When using the term CEE, we refer to Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Montenegro, North Macedonia, Poland, Romania, Serbia, Slovakia and Slovenia. In this paper we mainly focus on three CEE countries (CEE3), the Czech Republic, Hungary and Poland.

[2]Although the 16+1 cooperation was formally launched in 2012, in Warsaw, China had initiated its new approach towards CEE countries in 2011, when the first China-CEE meeting took place in Budapest.

[3]Recently, in the case of China-CEE relations, we can also observe infrastructure projects carried out by Chinese companies, financed from Chinese loans, however, in the analysed CEE3 countries major infrastructure projects carried out by Chinese companies are less typical. One striking example for such a project is the Budapest-Belgrade railway, but even in this case construction work haven't yet started.

[4]In 1988 a Hungarian-Chinese consular agreement included the lifting of visa requirements between the two countries. In 1990, 11,000 Chinese immigrants arrived in Hungary, while in 1992 the number of immigrants was 27 000. Overall, in the 90s Hungary had a Chinese minority of approximately 40 000, up from just a few hundred in the previous decade.

[5] During the first waves of privatization after the CEE3's democratization process in the 1990s, the most valuable companies had already been sold to Western companies. According to expert interviews, Chinese partners tend to complain that almost nothing has been left for them.

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CHAPTER 8
FOREIGN INVESTMENT BY TAIWAN'S HIGH-TECH SECTOR AND ITS IMPACT

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The chapter focuses on the Taiwanese high-tech sector's investments in several geographic areas. Against the backdrop of global supply chain restructuring and emerging technology competition, it analyzes Taiwan's two representative industries: electronics manufacturing service (EMS) with a long production history in China, and the semiconductor foundry service with its well-established local cluster. Taiwanese EMS companies' investments in Central and Eastern Europe have facilitated the establishment of regional centers and led to a substantial economic impact on exports and employment. Meanwhile, owing to the trade and technology war between the US and China, and the launch of Taiwan's New South Bound Policy, the investments by Taiwan's EMS companies in Southeast and South Asia have become very substantial. For the semiconductor industry, sometimes known as the Silicon Shield, the highly efficient local cluster will continue to grow. Some critical foreign investments have been made lately to address global concerns over chip shortages and economic security. Policy initiatives to better support the global expansion of Taiwanese high-tech companies and relate them to foreign relations development are discussed.

8.1 Introduction

This chapter focuses on trade and investment involving Taiwan's high-tech sector in several geographic areas, complementing other chapters that focused on the contest for diplomatic recognition and on countries that have been targeted or courted by China. The studies have been made mainly from the point of view of the private sector by considering the business logic and decision-making processes of technology companies headquartered in Taiwan. Nonetheless, the major policies and actions of the governments of Taiwan, China, and the countries involved in a trade or investment relationship with Taiwan are examined. In addition, policy implications from the aspect of international relationship development are discussed whenever appropriate. Two representative high-tech subsectors of Taiwan are selected for the studies, focusing on regions or countries with substantial investments from Taiwan.

The first part of the chapter addresses the subsector of the EMS (Electronics Manufacturing Service) industry, for which Taiwanese companies have demonstrated their global significance. EMS providers offer a wide range of manufacturing and design services for electronic production, which may be complemented by additional value-added activities, such as global supply chain management and after-sales customer support during the entire product life cycle. Of the top 40 global EMS or ODM (Original Design Manufacturing) companies listed in 2020, ten were Taiwanese.[1] The leading five are Foxconn/Hon Hai, Pegatron, Quanta, Compal, and Wistron, with a combined revenue accounting for more than 70% of the overall revenue of the top 40. Hon Hai's revenue alone reached US$190 billion.

The EMS industry has relied heavily on production sites in China, which account for more than 70% of production capacity.[2] However, as part of a globalization strategy, many Taiwanese hi-tech companies began to invest in Central and Eastern Europe (CEE), including Foxconn's moves into the Czech Republic in 2000. Moreover, with the intensification of the US-China trade and technology war starting from 2018, many multinational enterprises (MNEs) have been trying to seek production sites outsides China to restructure their supply chains. As a result, some developing countries, such as Vietnam, Thailand and India, began to receive substantial investments from Taiwanese EMS companies and their upstream suppliers, giving these countries an indispensable future role in the EMS industry.

The second part of this chapter focuses on the semiconductor industry. In particular, Taiwan Semiconductor Manufacturing Co. Ltd. (TSMC), as the top semiconductor foundry service provider, has achieved a dominating market share of 55%, serving global customers including Apple, Nvidia, AMD, Qualcomm and Broadcom. TSMC is also one of the largest buyers of semiconductor materials and equipment. Although foreign investments by Taiwanese semiconductor companies were rare in the past, recent investments by TSMC in the US and Japan, and potential plans for expansion elsewhere, have drawn global attention, accentuated by the worldwide chip shortage.

8.2 Taiwanese EMS Companies' Investments in CEE

8.2.1 The Prominent Near-Shoring Status of CEE Countries

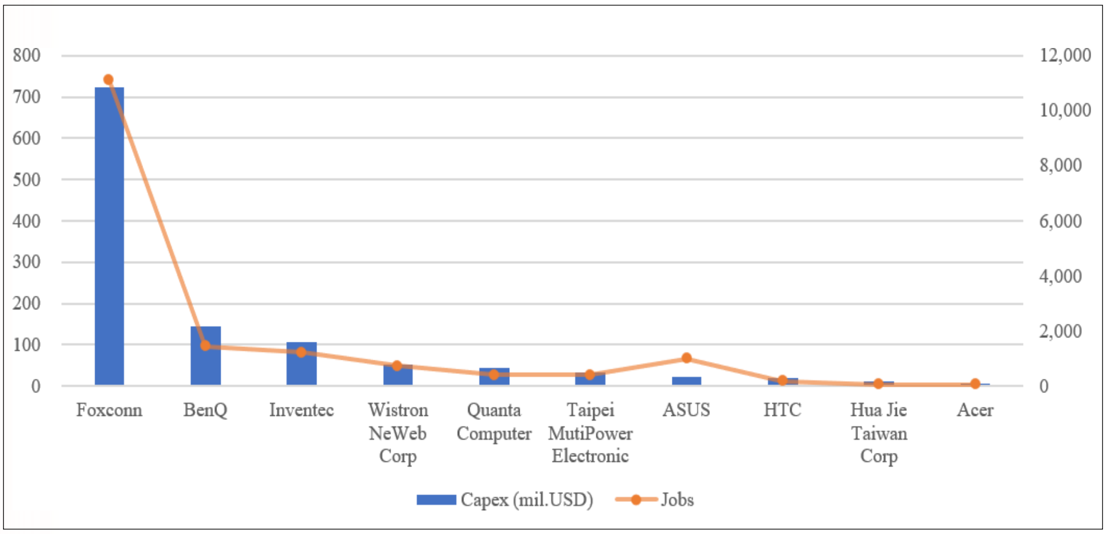
The CEE countries have been through the processes of democratic transition, economic transformation and integration into the European Union over the last three decades. Many CEE countries have become FDI (foreign direct investment) destinations for MNEs. The main advantages of the CEE countries were their competitive workforce and geographic proximity to European markets, while also exhibiting significant variations amongst them (Szent-Iványi, 2017).

With changes in industrial patterns, cheap labor costs are no longer the sole consideration for companies when choosing manufacturing locations. Traditional supply chains are evolving to follow a trend of "short-chains," from so-called "off-shoring" to "near-shoring." The Savills Nearshoring Index (Savills Research, 2020) serves as an indicator for the suitability of near-shore outsourcing for countries worldwide by comprehensively considering the figures in three different areas. It includes manufacturing labor costs, electricity costs, as well as infrastructure and trade openness.

The Czech Republic and Hungary ranked first and second, respectively, among EU member states in 2020. The Czech Republic became first choice with its excellent infrastructure, mature manufacturing bases and appropriate input costs. In 2019, Czech exports accounted for 74% of annual GDP, with Foxconn the second-largest exporter after only Skoda. Also, Hungary has a highly educated, skilled labor force with relatively low labor costs, making it another popular location for near-shore outsourcing.

According to the statistics on Taiwan's direct investment in the Czech Republic (fDi Markets, 2018), Taiwan's investment has been distributed in eight Czech regions, mainly in Prague, Central Bohemia, and South Moravia. The top ten Taiwanese companies contributed US$1.169 billion dollars of capital expenditure and created 16,605 jobs. Foxconn alone made 13 investments, with a capital expenditure of more than US$720 million dollars and the creation of more than 10,000 jobs. It was followed by BenQ, which had three projects, and Inventec with four projects, as outlined in Figure 8.1. For more recent developments, in response to the surging demand for cloud services and rising concerns about information security, Foxconn, Inventec, Wistron, and Wiwynn have all added production lines for servers and motherboards in the Czech Republic to increase the proportion of production outside China.

Figure 8.1 Top ten Taiwanese investors in the Czech Republic



Source: Own compilation based on fDi Markets

8.2.2 The Development of Foxconn's Regional Operations Center

Foxconn started with a brownfield investment in the Czech Republic in 2000 and utilized localization strategies to develop its EMEA (Europe, the Middle East, and Africa) regional center. Foxconn purchased land and buildings from the bankrupt enterprise, HTT Tesla, in Pardubice. This transaction was the first major direct foreign investment in the electronics industry in Pardubice. Foxconn soon became a key foreign investor in the Czech Republic and neighboring CEE countries. Foxconn expanded its production capacities in Kutná Hora in 2007 with tax incentives from the Czech government. It further established a data processing service center in Prague for cloud services in 2015. The company currently has three factories and 12 subsidiaries in the Czech Republic, one factory and four subsidiaries in Hungary, and one factory and one subsidiary in Slovakia, with the key investments shown in Figure 8.2.

Foxconn's rapid growth in the Czech Republic is closely related to its localization strategy in Europe, which aims for the integration of part suppliers and proximity to major customers and seeks benefits from the EU free trade zone. In line with this expansion strategy, Foxconn acquired or established strategic alliances with key European component manufacturers. In addition, some Foxconn customers moved their factories (such as HP's factory near Glasgow, UK) to the Czech Republic in order to improve efficiency. These accomplishments allowed Foxconn to build an operational center for the region with Pardubice as a logistics hub.

In terms of employment, there are two major channels for Foxconn's employees in the Czech Republic: a permanent contract directly with Foxconn, or employment through temporary worker agencies (Rutvica, 2014). Managers are mainly Czech, Chinese, and Scottish, aged between 40 and 50, on long-term contracts. Most production line supervisors with technical backgrounds are Czech and Slovak, aged between 30 and 40. In addition, the majority of production line workers employed via temporary worker agencies are from other CEE countries, such as Slovakia, Poland, Romania and Bulgaria and aged between 20 and 35.

According to an interview with a Czech labor union leader, Taiwanese companies create eight times more jobs than Chinese companies, with value added about 60% higher.[3] Taiwanese investments can also benefit smaller Czech parts suppliers. Although a positive influence on employment has been observed, several labor issues, such as workplace culture and flexible labor use, remain challenging for Foxconn according to a comparative study examining the company's production regimes in China and the Czech Republic (Pun et al., 2020).

8.2.3 China's Actions and Chinese Companies' Investments in CEE

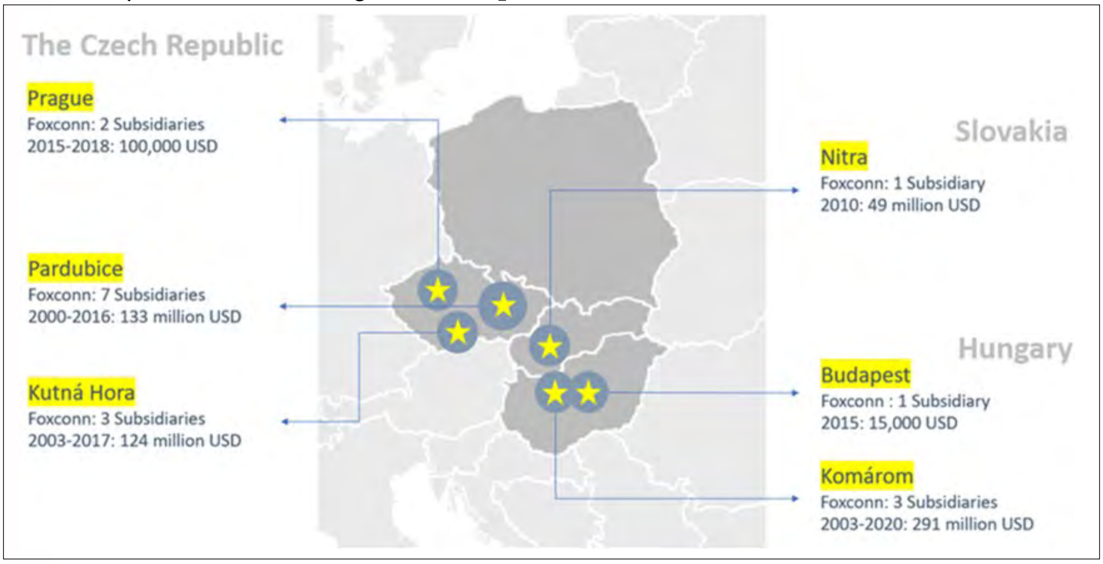
According to Matura (2021), Chinese levels of FDI in the CEE countries are modest, not comparable with Germany, the United States or other Asian countries such as Japan and South Korea. Nonetheless, it is difficult to identify the real amount of Chinese investment in the region as figures from different sources (e.g., national government agencies, Chinese embassies, and national banks) are rarely consistent.

Loans constitute a significant part of China's CEE investments. Nearly 80% of its infrastructure-related projects are located in non-EU member countries of the western Balkans. Of these projects, 75-85% of the cost is financed by Chinese loans, leading to significant debts compared to these countries' GDPs. For example, the percentages are 18% of GDP in Montenegro, 12% in Serbia, 10% in Bosnia-Herzegovina and 7% in North- Macedonia.

In the case of the Czech Republic, during bilateral visits by presidents Miloš Zeman and Xi Jinping between 2015 and 2016, seventeen agreements for eight billion euros in new Chinese investments in the Czech Republic were signed. CEFC China Energy was the biggest Chinese investor, accounting for US$510 million (AEI, 2021). Its CEO, Jianming Ye, was appointed as Zeman's personal advisor. However, CEFC China Energy got into financial and political trouble in 2018 and was saddled with 450 million euros in unpaid debts in the Czech Republic.[4] Its investments were taken over by China's CITIC Bank International. China's investment in the country reached its peak at 350 million dollars in 2018. CEFC declared bankruptcy in March 2020.

Figure 8.2 General information on Foxconn's investments in CEE countries

a) Facility locations and registered Capital



Source: Hon Hai Annual Reports (2002-2020)

b) Main activities and job opportunities

Country	Locations	Main Activities	Job Opportunities
Czechia	Pardubice	1. Computer & monitor manufacturing and component assembly 2. Communication technologies product manufacturing 3. Repairs, purchasing and logistics 4. Metal chassis and plastic element manufacturing 5. Small factory solution 6. Computer system design	11,095
	Kutnå Hora	1. Server manufacturing and assembly 2. Service center for repairs 3. Data processing and hosting	
	Prague	1. Data processing and hosting 2. Solution for charging infrastructure	
	Komårom	Electronic and telecommunication equipment manufacturing	
Hungary	Budapest	1. Intellectual property monetization 2. Management consulting	1,085
Slovakia	Nitra	1. TV production 2. Circuit board printing	1,410

Source: Own compilation based on reviewed literature

8.2.4 The Opportunities and Prospects for Taiwanese Hi-Tech Companies in CEE

In 2015, the president of Foxconn, Terry Gou, signed an MOU with the Czech Prime Minister, Bohuslav Sobotka, and promised an investment of about US$116 million by 2018, focusing on a partnership to promote automation, research, and data centers. Foxconn has thereby expanded its core investments in CEE from manufacturing activities to operations and businesses based on technology and innovation. According to the annual financial reports of the Hon Hai Group, seven technology-based subsidiaries were established in the Czech Republic after 2015, as shown in Table 8.1. Furthermore, Foxconn ranked among the top ten most significant investors in 2015 and 2016. Some US$154 million was invested, and 2,677 new jobs were created in Pardubice within these two years (CzechInvest, 2015, 2016).

Table 8.1 Foxconn's Technology-based subsidiaries in the Czech Republic

Company Name	Main Activities
Foxconn 4Tech s.r.o.	Industry 4.0
Foxconn DRC s.r.o.	Computer Systems Design
Foxconn Europe Digital Solutions s.r.o.	Metal products manufacturing
VaultDX s.r.o.	Software, infromation technology consulting, Data processing and hosting
Trade DX, s.r.o.	Desgin and manufacture of servers, solid state drives and cloud data center-level swtiches
SafeDX s.r.o.	Data processing and hosting
FITA Energy Solutions a.s.	Solution for charging infrastructure

Source: Hon Hai Annual Reports (2015-2020)

The Czech Republic's ambition to develop data centers and Industry 4.0 technologies aligns with Taiwan's strengths in information science, communication technology and smart machinery. Cooperation between the two countries provides an excellent basis for mutually beneficial outcomes. In particular, intensive foreign investment in CEE countries has led to a severe labor shortage and an urgent need for smart manufacturing and related technologies. Much business potential can be expected (TAITRA, 2018).

For further collaboration, four typical international cooperation models, including service agreements, joint research projects, intellectual property rights and technology transfers, and joint ventures are all in place between the Czech Republic and Taiwan. In particular, the DELTA Program, managed by the Technology Agency of the Czech Republic (TACR), is a multinational joint research project aiming to facilitate cooperation in applied research and experimental development. As a cooperative agency for the initiative, Taiwan's Ministry of Science and Technology drew attention to ten Taiwanese projects that were selected from 2017 to 2020.[5] The subsequent DELTA 2 Program, for 2020 to 2025, has been included in the A-plus Industrial Innovation R&D Program of Taiwan's Ministry of Economic Affairs, with the key areas of next-generation communication, innovative IoT applications, smart manufacturing, and high-end medical material.

In recent years, bilateral investment forums, business matchmaking meetings, and summits of city leaders have become important interactions between Taiwan and CEE countries. Moreover, there are growing numbers of joint ventures with the Czech Republic, such as the SafeDX data center established in Prague in 2015 by Foxconn and the Czech investment group KKCG. More frequent technical exchanges and business collaborations between Taiwan and CEE countries can be expected.

In conclusion, Foxconn's global strategy has led to the evolution of the EMS industry and its facilities and operations in CEE have highlighted the economic benefits of hi-tech companies' investments. The major events are illustrated in the following timeline. The revenue growth of Foxconn in CEE indicates that Foxconn's move has led to positive results for the company, as shown in Figure 8.3.

20 Years of Foxconn in CEE countries

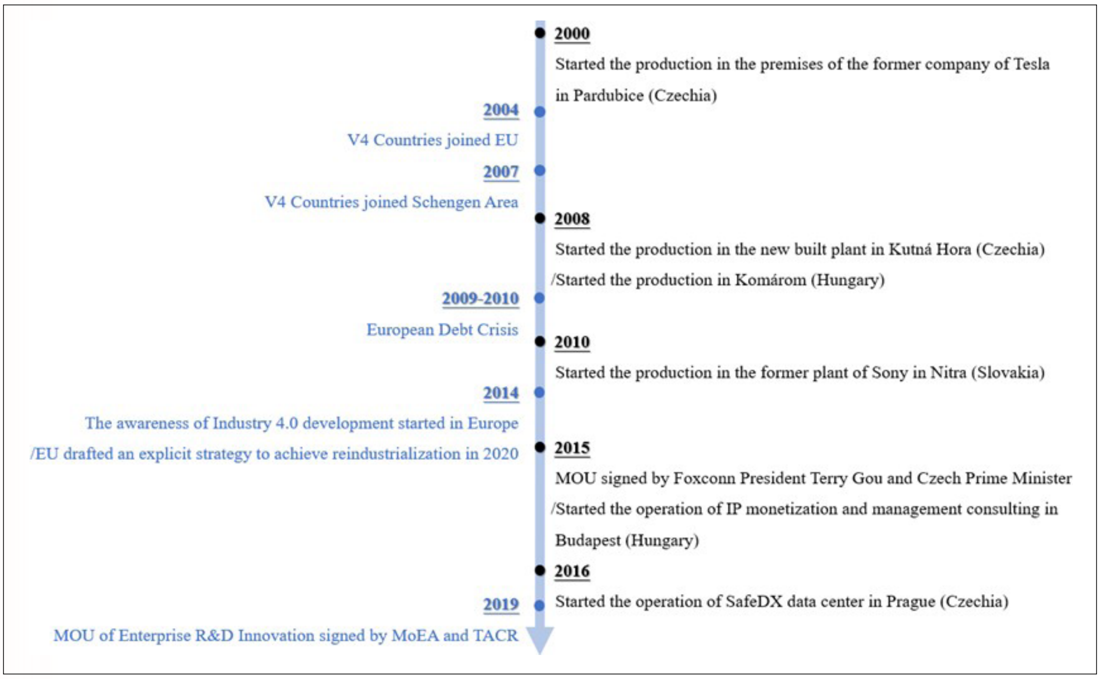
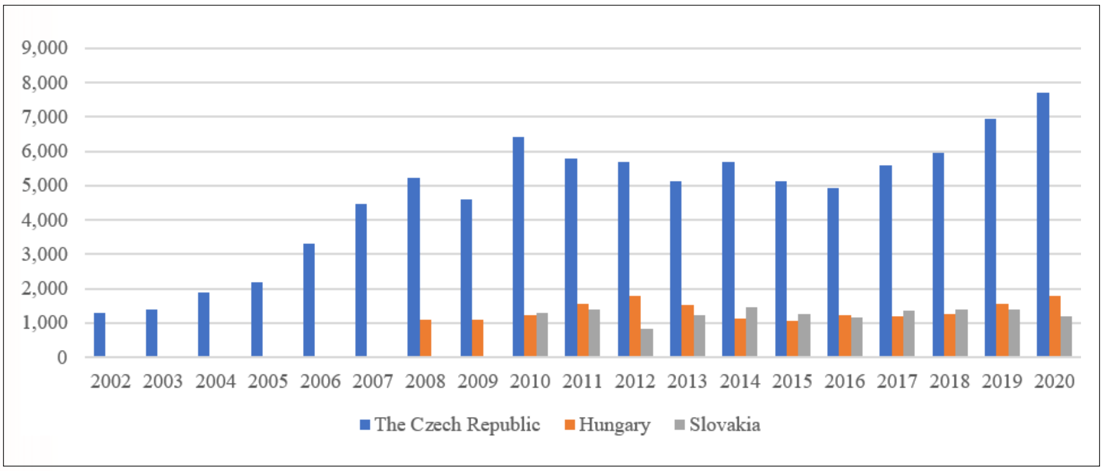


FIGURE 8.3 FOXCONN'S REVENUE IN CEE BY YEAR (2002-2020) (IN$ MIL)



Source: Hon Hai Annual Reports (2002-2020)

8.3 Taiwanese EMS Companies' Investments in Southeast and South Asia

8.3.1 Alignment with Taiwan's New Southbound Policy

The intensification of the US-China trade and technology war after 2018 has driven many MNEs to relocate their production sites in China to Southeast Asia and South Asia, which are the key areas for the New Southbound Policy of the Taiwan government (NSP).[6]

The trade relationship between Taiwan and the NSP countries has been steadily growing. Trade data for the sub-region of ASEAN and the major recipients of investment from Taiwan's EMS companies are summarized in Table 8.2. Taiwan's bilateral trade values generally show some positive development after 2016, the launching year of the NSP, especially for ASEAN and India. According to ASEAN statistics, Taiwan was among ASEAN's top ten trading partners in 2019, ranked 7th and 9th for imports and exports, respectively (ASEAN, 2020a).

TABLE 8.2 TAIWANESE NSP-RELATED TRADE RELATIONSHIPS, 2010-2019 (IN $MIL)

	ASEAN		Vietnam	
	Trade	CAGR	Trade	CAGR
2010-2015	70,845 - 79,251	1.89%	8,815 - 11,986	5.25%
2016-2019	78,433 - 88,904	3.18%	12,259 - 16,054	6.97%
	Thailand		**India**	
	Trade	CAGR	Trade	CAGR
2010-2015	9,117 - 9,597	0.86%	6,465 - 4,811	-4.81%
2016-2019	9,308 - 9,771	1.22%	5,006 - 5,797	3.74%

Source: Bureau of Foreign Trade, Ministry of Economic Affairs, Taiwan

For overall inward FDI flows to ASEAN, Singapore has been the country receiving the most. It is followed by Indonesia and Viet Nam with an annual amount of about US$20 and US$15 billion dollars respectively for the past three years. The inward FDI for Thailand, Malaysia, and the Philippines are also significant, but there is serious fluctuation, with some peaks of more than US$10 billion dollars per year (ASEAN, 2020a). Manufacturing is now the largest sector, from less than 13.4% in 2012 to 35% in 2019 (ASEAN, 2020b).

Taiwan was ranked 10th in terms of ASEAN's inbound investors in 2019 (ASEAN, 2020a). Taiwanese investments, concentrated in Vietnam and Thailand, have been dominated by the electronics manufacturing industry. According to the Investment Commission, Ministry of Economic Affairs, Taiwan, the investment amounts in 2019 for ASEAN, Vietnam, Thailand and India were $2,404, $915, $328, and $70 million US dollars respectively. In particular, due to the US-China trade and technology war and rising production costs in China, Foxconn and the so-called big five EMS companies (Qunta, Compal, Wistron, Pegatron, and Inventec) have all accelerated the relocation of production capacity from China to Vietnam and Thailand.

At the same time, Taiwanese investments in China have substantially decreased. The average annual investment amount fell from US$12.03 billion for 2010 to 2015 to US$7.89 billion for 2016 to 2019. The share of Taiwan's overall outbound investments fell from 66.15% to 40.98% over the period, according to the Investment Commission at the Ministry of Economic Affairs, Taiwan.

As for Chinese investments in ASEAN, China was ranked sixth for FDI in ASEAN in 2019 (ASEAN, 2020a). According to ASEAN figures, most investments were made by state-owned enterprises, mainly in real estate, commercial services and construction industries (ASEAN, 2021).

For Taiwan's outward investments, there has long been a serious concentration in China, accounting 84% in 2010 against 6% for ASEAN, according to the Investment Commission, Ministry of Economic Affairs, Taiwan. However, mainly owing to the recent investments of Taiwanese EMS companies in Southeast Asia, the shares for China and ASEAN were 32% vs. 31% for 2021. The three countries - Vietnam, Thailand, and India - receiving the most significant investments from Taiwan's high-tech companies are assessed in the following subsections.

8.3.2 Vietnam

8.3.2.1 FDI Policy and the Business Environment in Vietnam

According to Vietnamese investment laws adopted in 2015, investments in specific industries can enjoy two to four years of corporate income tax reduction, including those in high-tech electronic components, semiconductor technology and computer software (ITRI, 2020). Although Vietnam's corporate income tax reduction is smaller than in Thailand and other ASEAN countries, Vietnam has the largest number of free trade agreements, including the CPTPP and agreements with the EU, the UK, and other large economies (KPMG, 2021). In addition, a relatively low minimum wage compared with Thailand[7] and geographical proximity to China make it very attractive to Taiwanese companies.

Taiwan and China are both major source countries for Vietnam's inward investment. By the end of 2020, Taiwan was ranked fourth, with an accumulated investment of

$33.7 billion, while Chinese investment in Vietnam reached $18.4 billion, ranked seventh. South Korea, Japan and Singapore are the top three countries, with investments ranging from 56 to 70 billion US dollars.[8]

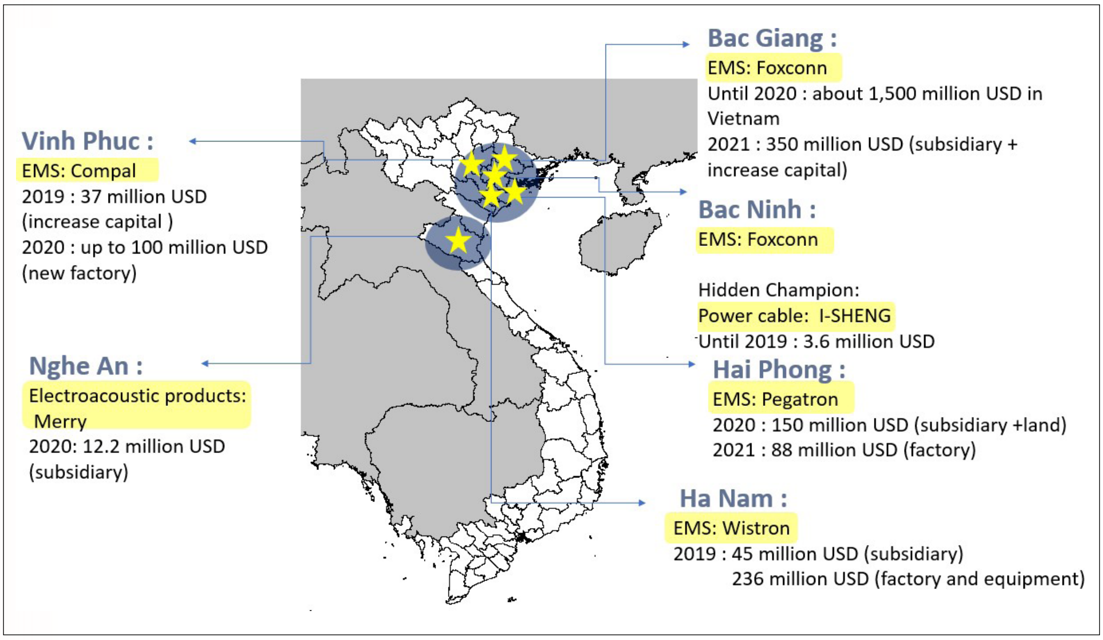
Although Vietnam has attracted a lot of foreign investment in recent years, complete supply chains and good technical skills are still lacking. Therefore, the Vietnamese government launched a new version of its investment promotion law in 2020, focusing on products or services that facilitate the formation of industrial value chains that support the establishment of innovative research and development centers (ITRI, 2020).

8.3.2.2 Taiwan's Electronics Investments and their Impact on Vietnam

The major investments of Taiwanese EMS companies are summarized in Figure 8.4, including Foxconn and the big five. In addition, several so-called hidden champions[9] from Taiwan for electronic parts and components have made substantial investments. For example, I-sheng, with an early investment dating from 2007, is the world's largest power cable supplier, and Merry is a world leader in acoustic components.

Taiwanese companies have earned a better reputation in Vietnam than their counterparts from China. According to a survey of 120 Vietnamese executives (TAEF, 2020), Taiwanese companies tend to be positively evaluated in Vietnam, ranked second only to those from Japan. In addition, 80.8% of respondents believed that Taiwanese companies could provide employment opportunities and 54.2% expected investment capital.

Figure 8.4 Major electronics investments by Taiwanese companies in Vietnam



Source: Own compilation based on company reports and MOPS (Market Observation Post System)

On the other hand, according to another survey, China is seen in ASEAN as powerful but also perturbing (Yusof Ishak Institute, 2020). 76.3% of Vietnamese and 86.5% of Thai respondents agreed that China is Southeast Asia's most influential economic power. However, 80.2% and 75.9% of the respondents in Vietnam and Thailand were concerned about China's growing economic influence, contrasting with only 22.2% and 40% worried about US economic influence.

8.3.3 Thailand

8.3.3.1 FDI Policy and the Business Environment in Thailand

Thailand has a relatively sound business environment. Among 190 economies, Thailand was ranked 21st in 2019 for ease of doing business, based on indices including tax, power supply, and dealing with permits (World Bank, 2020). Amongst other Asian countries attractive to investors, China and Vietnam were ranked 31st and 70th, respectively.

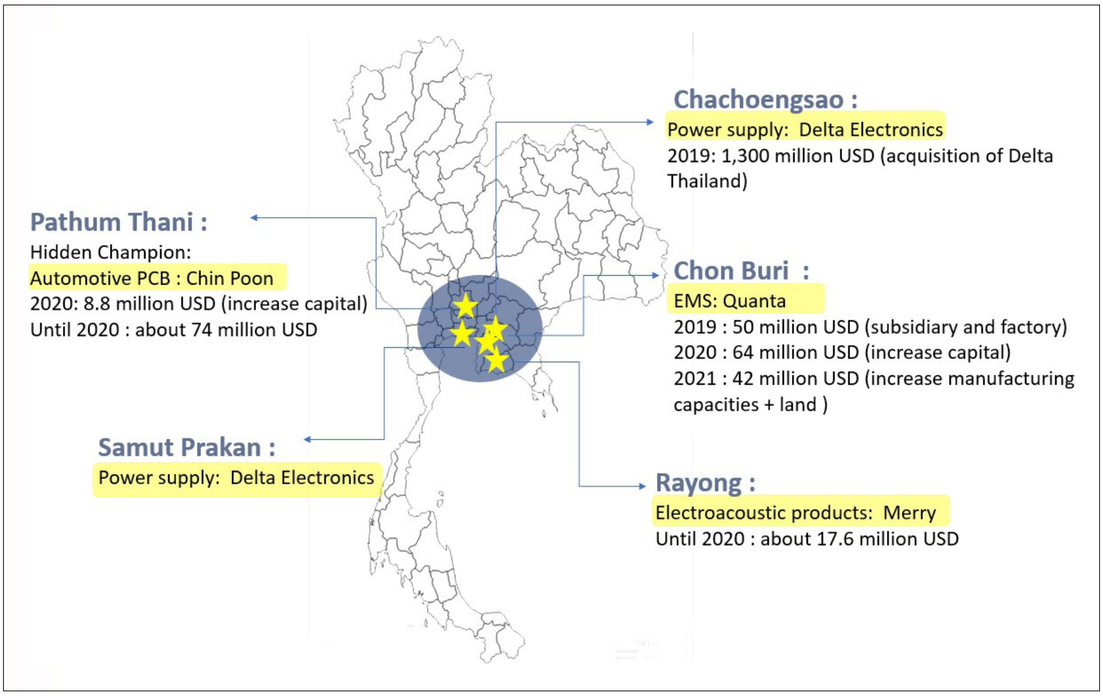
For approved investment amounts in Thailand within the period of 2016 to 2020, the annual averages were about $1.4 billion and $400 million for China and Taiwan respectively, indicating a more substantial economic influence from China. Nonetheless, Taiwan is still a significant investor in Thailand, ranked fifth in 2020 (Thailand BOI, 2021).

Thailand's government has refined its policies for promoting investment. Starting from 2015, corporate income tax can be exempt for up to eight years for specific industries. In addition, for investment in a few industries in the Eastern Economic Corridor (EEC), corporate income tax exemption can be extended up to 13 years. Launched in 2016, Thailand 4.0 is one of the most important components of its drive for industrial transformation, from traditional manufacturing to innovation-oriented technologies, such as biotechnology, digital technology, nanotechnology and advanced materials (ITRI, 2020).

8.3.3.2 Taiwan's Electronics Investments and their Impact on Thailand

As summarized in Figure 8.5, the large-scale investments of Taiwanese electronics companies in Thailand are concentrated near the Bangkok metropolitan area. For example, Quanta has invested more than $156 million in Chon Buri Province, one of the selected provinces for the EEC initiative. Foxconn also signed an agreement for a joint venture with PTT Public Company Limited in September 2021. The investment is worth between one and two billion dollars for a plan to build manufacturing sites for electric vehicles, most likely in the EEC area as well.[10]

Figure 8.5 Major electronics investments by Taiwanese companies in Thailand



Source: Own compilation based on companies reports and MOPS (Market Observation Post System)

Thailand is now second only to China in hosting production sites for Taiwan's printed circuit board (PCB) industry, a world leader with one-third of global output in 2020.[11] Chin-Poon, APEX, and APCB are the best-known PCB companies, focusing on consumer electronics and automotive applications.

8.3.4 India

8.3.4.1 FDI Policy and the Business Environment in India

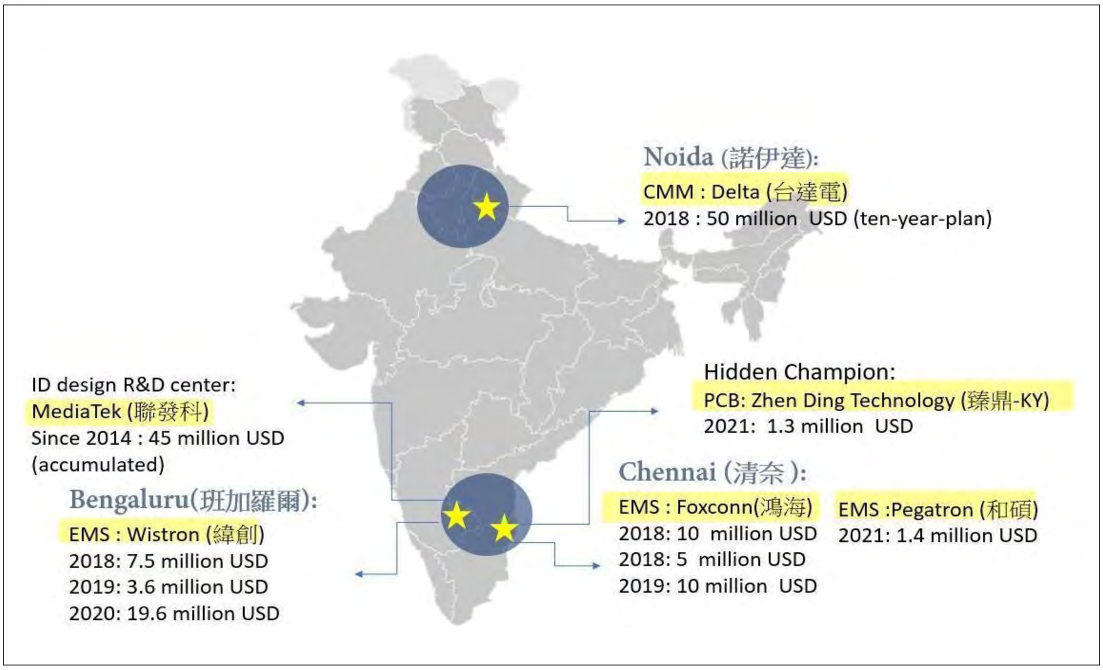
The Indian government's current policies are heavily focused on the mobile industry. To position India as a global center, the government launched the NPE (National Policy on Electronics) in 2019 and other prominent initiatives, such as PLI (Production Linked Incentive), SPECS (Scheme for Promotion of Manufacturing of Electronic Components and Semiconductors), and EMC 2.0 (Modified Electronics Manufacturing Clusters Scheme), as highlighted by ITRI (2020). In particular, based on the PLI policy, a financial incentive of approximately US$5.45 billion has been provided for five years to promote domestic electronic manufacturing investment and enhance electronics value chains.[12] In addition, the PMP (Phased Manufacturing Program) has been implemented in stages since 2015 with a tariff policy restricting the import of smartphones from China and promoting the concept of "Made in India."

8.3.4.2 Taiwan's Electronics Investments and their Impact on India

As the second-largest mobile communication market globally, India has vast business potential given its large population and low penetration rate of mobile devices. Along with Apple's shift of supply chains from China to India, Taiwanese EMS companies, such as Foxconn, Wistron, and Pegatron, began to gain ground in India's mobile device manufacturing business. According to the Investment Commission at the

Taiwanese Ministry of Economic Affairs, more than one hundred investments have been made by Taiwanese companies in India[13] and these companies have gradually formed more complete supply chains. The key EMS-related investments are depicted in Figure 8.6.

Figure 8.6 Taiwanese Companies' major investment in India for mobile devices



Source: Own compilation based on company reports and MOPS (Market Observation Post System)

As shown in Figure 8.6, Foxconn has invested the most in India, given Apple's intention to relocate 7-10% of its production capacity in China to India.[14] After selling its factory in Kunshan, China, Wistron began to shift its mobile device business to India, in cooperation with India's Optiemus Electronics.[15] Pegatron planned to build a new factory with mass-production to begin in 2021, with job opportunities estimated at about 14,000. [15] Pegatron also signed an MOU with Tamil Nadu to accelerate its subsequent arrangements in India. These three leading Taiwanese EMS companies have participated in India's PLI programs with the planned investment of hundreds of millions of dollars in the next five to six years. All three companies are involved in the financial reward program.

8.3.5 Prospects for Bilateral Collaboration Development under the NSP

The New Southbound Policy is aimed at establishing a "sense of economic community" and creating a new cooperation model that is mutually beneficial. As a result, various action plans have been implemented. For example, the Taiwanese government has adopted three major credit guarantee funds to finance overseas development and has signed new versions of bilateral investment agreements to enhance the protection of Taiwanese companies.

For NSP-related countries, the initiative has also led to significant job creation. The statistics for the three selected countries are summarized in Table 8.3. In many cases, Taiwanese companies offer higher than the national minimum wages in these countries.

Table 8.3 Job creation by Taiwan's electronics companies in three NSP countries

Location	Northern Vietnam				Central Vietnam	Southern Vietnam
Company	Foxconn	Compal	UMEC	PHIHONG	Merry	AOET
Main Business	EMS	EMS	Power Supply	Power Supply	Acoustic Components	Optical Lens
Employee	53000	5623	1000	705	1462	500-1000
Wage Ratio	1.33	1.36	-	-	1.14	-

Location	Thailand				India		
Company	Quanta	Merry	Delta	APEX	Foxconn	Wistron	Pegatron
Main Business	EMS	Acoustic Components	Power Supply	PCB	EMS	EMS	EMS
Employee	1928	672	13801	7363	25000-50000 (expected)	1000 (estimated)	14000 (expected)
Wage Ratio	1	1	1.3	-	-	-	-

Source: Companies' CSR Report (wage ratio = company wage / local minimum wage)

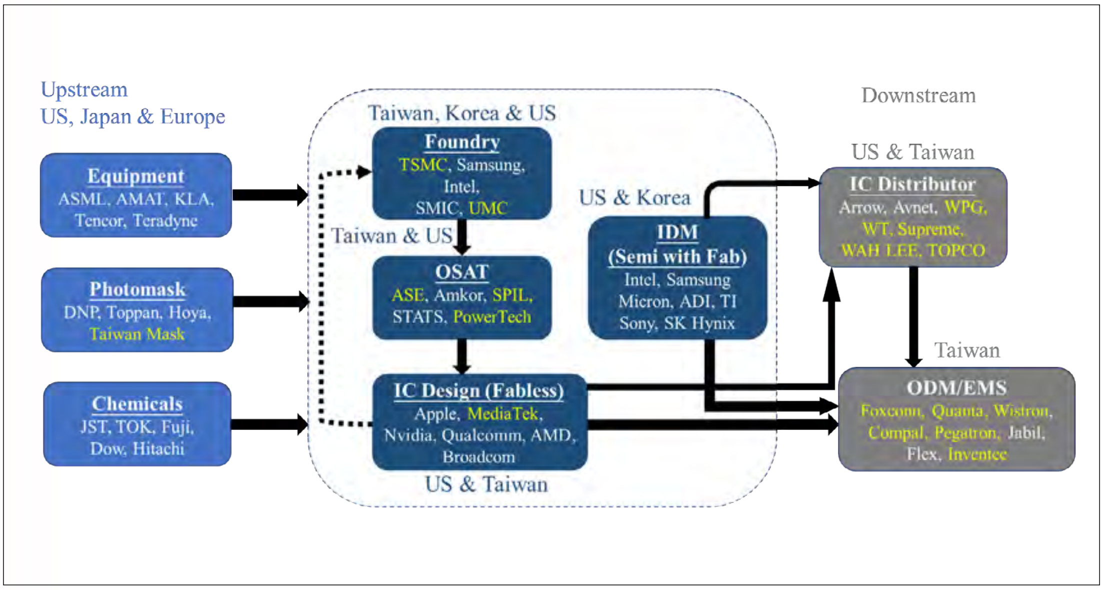
To further strengthen bilateral relationships, Taiwan also committed to hosting more international students from the 18 NSP countries, with the percentage of total inbound students growing from 27.65% in 2016 to 56.47% in 2020. Vietnam has sent the most international students, accounting for 17.8% (17,534 students) of total inbound students in 2020 compared to a share of only 4.3% in 2016.[16]

8.4 Global Impact of Taiwan's Semiconductor Foundry Services

8.4.1 Development of Semiconductor Foundry Services

The semiconductor foundry business model, pioneered by TSMC in the late 1980s, has outgrown the overall semiconductor market over the last several decades. In particular, given the emerging trend of fabless semiconductor businesses (e.g., Qualcomm, Broadcom, Nvidia, MediaTek, and AMD), many companies now rely on foundries for chip manufacturing. The rising fab costs have incentivized vertically-integrated IDMs (integrated device manufacturers, such as NXP, Analog Devices, and Maxim) to go fab-lite. In addition, the OSAT (Outsourced Semiconductor Assembly and Test) companies, focusing on so-called backend processes, are an essential part of IC supply chains. In terms of upstream partners, the equipment makers are crucial for advancing fabrication technologies and productivity. In addition, support from the companies for photomasks and chemicals is a prerequisite for efficient fabrication processes. The finished ICs are distributed by major channel players or moved to the downstream manufacturing service providers for inclusion in a wide range of products. The players in the global semiconductor industry are summarized in Figure 8.7, with Taiwanese companies highlighted.

Figure 8.7 Supply Chains and the global Semiconductor industry



Source: Own compilation based on Morgan Stanley Research and Digitimes

TSMC held 55% of the global market in foundry services in 2020 and the top five players represented over 85% of global foundry revenue (Samsung 17%, UMC 7%, GobalFoundry 4%, SMIC 5%). Driven by strong demand for both mature and advanced technologies, and Intel's potential outsourcing, the new addressable market (TAM) for foundries is very promising.

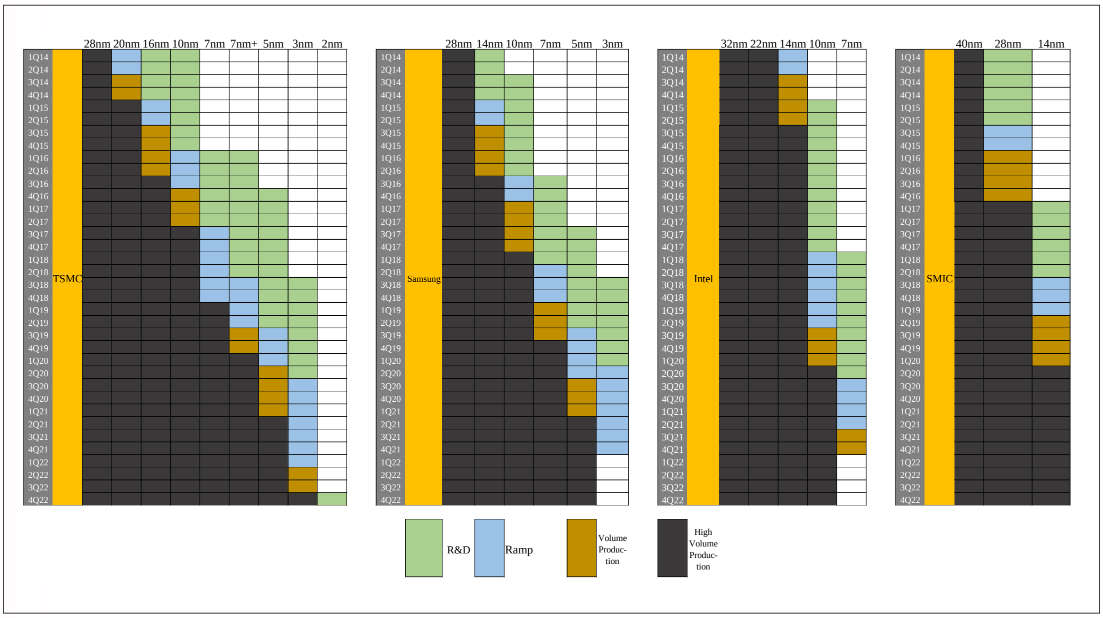
In particular, companies are restricted in the acquisition of ICs requiring advanced processes (below 28nm). The key players are limited to TSMC and Samsung, with some future potential for Intel. TSMC is the clear leader, with a technology advantage leading to most of the growth of the TAM. Lu et al. (2021) forecast that TSMC's 3nm revenue will reach $2.0 billion in 2022 and $12.4 in 2023, accounting for 10% of the overall foundry TAM in 2023. In addition, revenue from 5nm/4nm will be $16.5 billion and $19.7 billion in 2022 and 2023. In other words, TSMC's most advanced technologies may command 25% of the global market for foundry services by 2023. Samsung will hold a steady market share over the long term given its status as the only second source for advanced processes. Intel's market share impact will diminish by 2023, and its future ups and downs will depend on its process technology and service capability development.

The rest of the players are mostly fighting an uphill battle due to a lack of leading-edge technology, the critical area responsible for substantial growth. As a result, most companies have gradually lost share over the last ten years. GlobalFoundries lost the biggest share after AMD moved to TSMC in 2019 for the 7nm process.

8.4.2 *TSMC's Global Competitiveness*

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. As highlighted in Figure 8.8, the leading technological specifications and the comprehensive technology profile have further sustained its leading position. It may not be an easy task for Samsung, the only player also with available advanced processes, to gain market share from TSMC and, at the same time, it has to defend against Intel's potential entry. Its opportunity depends on its production yield improvement for advanced processes and the successful transition to the GAA (Gate All Around) technology for 3nm. Finally, Intel would first need to demonstrate to its customer base that it is indeed capable of providing industry-leading process technology (i.e., at least positioned in line with TSMC and Samsung). The largest Chinese foundry company, SMIC, has fallen behind the competition by at least one generation.

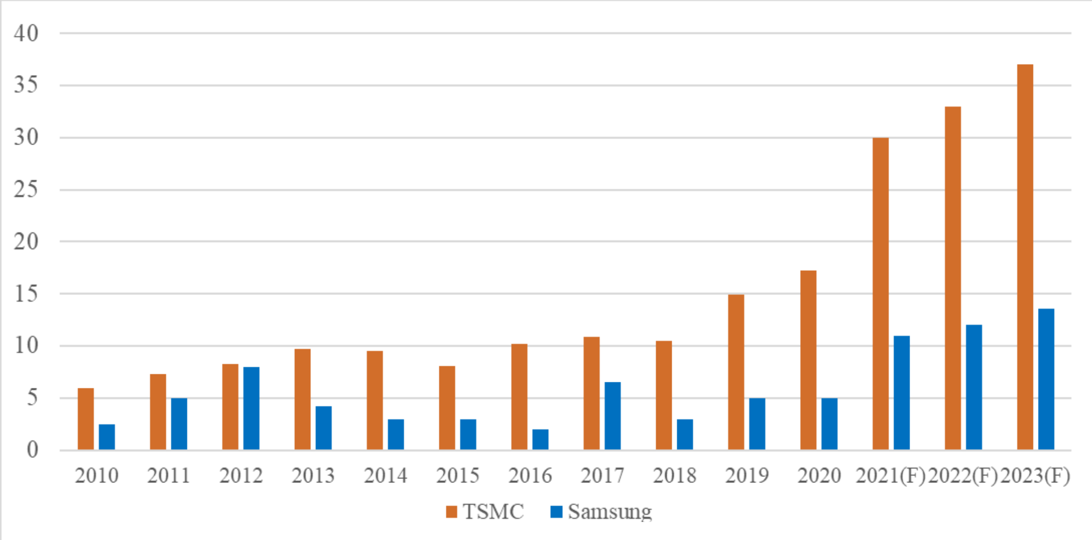
Figure 8.8 Progress of Advanced processes for major foundry services providers



Source: Figures based on the data of Goldman Sachs Global Investment Research

To further ensure its long-term advantages, TSMC announced it will spend $100 billion on capacity expansion in 2021-2023 to cope with the expected stronger and longer semiconductor sector cycle, mainly driven by 5G/HPC/AI/Automotive. The move also aims to regain customers' trust in the foundry service provider's determination to address the capacity shortage issue. Capital intensity reached 55% in 2021, much higher than the average in the last seven years of 35%. Meanwhile, significant capital investments are also expected for other foundry companies; however, they are not comparable with TSMC's aggressive capacity expansion. The capital expenditures of TSMC and Samsung after 2010 are presented in Figure 8.9 to illustrate the increasing gap.

Figure 8.9 Elevated foundry capital expenditure, TSMC VS. Samsung (in $bn)



Source: Compilation based on TSMC reports and Goldman Sachs Global Investment Research

8.4.3 Overseas Investments of Taiwan's Foundry Industry

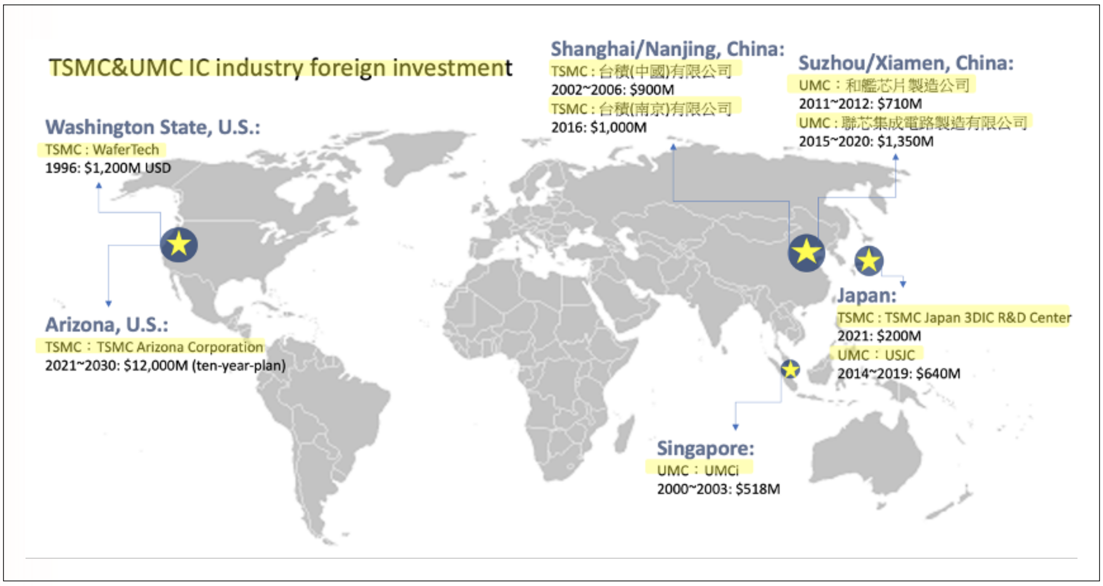
Given the highly efficient cluster in Taiwan, Taiwanese semiconductor companies have been relatively conservative in making foreign investments, as summarized in Figure 8.10. Reflecting this situation, 97% of TSMC's long-term assets ($57 billion) remain in Taiwan, including all of its most advanced fabs. In addition, 90% of its 56,800 staff, more than half with an advanced degree, are based in Taiwan.

TSMC made a formal statement at its institutional investors' conference on July 15, 2020, about building chip manufacturing facilities in foreign countries. Three guidelines were reiterated, namely: customer demand, operational efficiency and cost economy. First, customer demand must be foreseeable for five to ten years. In addition, a sound semiconductor cluster is required in the local area for the potential site under consideration to keep up operational efficiency. Finally, the various components of fixed costs, such as water, electricity, land, and tax rates, should be reduced, probably through substantial incentive programs.

8.4.4 Global Engagement and the Future Prospects for Taiwan's Semiconductor Industry

The US took steps aimed at restoring its leadership in semiconductor manufacturing when it passed the CHIPS (Creating Helpful Incentives to Produce Semiconductors) for America Act.[17] Federal incentives were increased to enable advanced research and development, secure reliable supply chains and ensure long-term national security and economic competitiveness.

Figure 8.10 Historical and potential investments by Taiwan's Foundry Services



Source: Compilation based on TSMC and UMC reports

In response to the act, TSMC announced on May 15, 2020, that it was planning to build a fab in Arizona, utilizing its most advanced 5nm technology. Construction was scheduled to start in 2021, with production foreseen to begin by 2024. TSMC's total spending on the project will be approximately $12 billion from 2021 to 2029. TSMC believes the fab will enable leading US companies to fabricate cutting-edge semiconductor products within the US, including military-related chips.[18]

Japan has an almost monopoly position in the market for semiconductor equipment and materials that are required for many chip manufacturing processes. The Japanese government has been trying to cooperate with foreign foundry service providers, such as TSMC, to further strengthen its advantages in developing even more innovative manufacturing equipment and materials.[19] This intention has led to an existing joint 3DIC R&D center in Japan. In addition, TSMC also announced on October 14, 2021, that it would build a fab in Kyushu, Japan, in 2022. The facility will utilize the relatively mature 22/28 nm special processes and will start production before 2025. The new company JSAM (Advanced Semiconductor Manufacturing, Inc.) will be a joint venture with Sony. It is estimated that the Japanese government will provide more than $3.5 billion in financial support.

Germany, France, the Netherlands, and 17 other European Union countries signed the "Declaration: A European Initiative on Processors and semiconductor technologies." They are planning to invest 145 billion euros in the design and production of customized processors and semiconductors in the next two to three years, and at the same time strive to introduce the 2nm advanced manufacturing process in the hope of increasing their global share of wafer production from the current 10% to 20% by 2030. At the moment, no firm response has been made by TSMC to this proposal.

For China, currently in the 14th Five-Year Plan, RMB 10 trillion (about US$1.6 trillion) will be invested to support the development of the third-generation semiconductor industry. China intends to build its own semiconductor ecosystem without any involvement from the West or from Japan, Korea, and Taiwan. However, Chan et al. (2019) pointed out that Chinese fabs are still heavily dependent on equipment and material from foreign companies.

Broader and deeper global engagement by Taiwan's semiconductor industry seems inevitable. TSMC's recipe is not something Chinese companies can replicate. The key ingredient is trust. With the company slogan of "everyone's foundry," TSMC has built a remarkable ecosystem of trusted partners that share their intellectual property to build their proprietary chips. At the same time, leading manufacturing equipment companies, such as ASML and Applied Materials, have been TSMC's close partners that have jointly extended the limitations of Moore's Law[20] multiple times, through offering cutting-edge chip-making tools. TSMC's aim is to continue to play a pivotal role in maintaining the platform's integrity and momentum.

8.5 Conclusions and Implications

The chapter focuses on the real-world trade and investment of Taiwan's high-tech industries and their dominant global role. The countries under investigation are different from those with a tendency to switch diplomatic relations between Taiwan and China, as discussed in previous chapters. However, the countries without diplomatic ties are still crucial for developing Taiwan's foreign relations. The first part addresses the subsector of the EMS industry, with a long history of production in China, and analyzes its investments and operations in two geographic areas, Central and Eastern Europe (including the Czech Republic and Hungary) and Southeastern and South Asia (including Vietnam, Thailand, and India). The second part is related to the semiconductor industry, sometimes referred to as the Silicon Shield for Taiwan because of its geostrategic importance. In particular, the company in focus is the leading global foundry service provider, TSMC, which has received global attention due to the worldwide chip shortage.

To better support the global expansion of Taiwanese high-tech companies and relate it to progress in foreign relations, the Taiwanese government needs to align its strategies and policies with business decisions made by the private sector. Its approach has been dramatically different from the one adopted by China, which utilizes the resources of national agencies, state-owned enterprises as well as malleable private companies. Although the diplomatic relationship between Taiwan and other countries was not a decisive factor in many high-tech companies' past investments (e.g., Foxconn's presence in the Czech Republic), partnership and synergy between the Taiwanese government and high-tech industries could be a key for future success.

Most countries receiving investments from Taiwan's high-tech sector are set on progressing from the manufacture of finished goods to technological development. Their development strategies fit well with Taiwan's strength in technology. Therefore, the Taiwanese government and such governments could launch joint programs to facilitate technological cooperation and transfer, which would help the transformation of industries and enhance the position of Taiwanese EMS companies against global competitors. Several existing collaboration programs between CEE countries and Taiwan serve as a good starting point to implement future projects that emphasize the application and commercialization of technologies.

Investment by Taiwanese EMS companies in South and Southeast Asia has been surging lately due to the trade and technology war between the US and China and the launch of Taiwan's New South Bound Policy. Nonetheless, China's critical role as the "world's factory" is unlikely to be challenged in the near term, given that restructuring supply chains for any EMS company is challenging. The joint development of science-based industry parks is a practical approach by Taiwan to develop relationships with other governments that want to develop their electronics industries, particularly given the opportunities arising from US-China tension. Such a move also offers valuable support to Taiwanese EMS companies keen on building industry clusters overseas. Taiwan's New South Bound Policy is a useful existing platform.

The Taiwanese government has done very little to enhance relations through ODA with countries where it lacks diplomatic ties. Given the globally dominant power of Taiwanese EMS companies, the Taiwanese government could provide ODA resources to support digital infrastructure projects, leading to more solid relations than can be achieved by the private sector alone.

For the semiconductor foundry service, Taiwanese companies' advantages are clear and are expected to be maintained for some time. In particular, with unprecedented levels of investment ($100 billion in three years), TSMC will continue to dominate the market in advanced manufacturing technologies. Given the highly interactive ecosystem, Taiwanese semiconductor companies need to expand their operations in foreign countries even though the local cluster has been highly efficient. Concern over the economic and national security implications of semiconductor supply chains has been expressed by many countries. Meanwhile, many governments have tightened controls regulating dual-use exports, such as the US regime under the Export Control Reform Act[21] of 2018 (ECRA). Therefore, the Taiwanese government needs to work actively with other governments to resolve the current chip shortage crisis, harmonize the future operations of semiconductor supply chains and facilitate the formation of a global semiconductor alliance. The two recent investments by TSMC in the US and Japan are good examples of a joint effort by government and private companies.

To sustain industrial advantages, especially for the advanced manufacturing technologies of foundry services, the Taiwanese government needs to support the local semiconductor cluster's continuous growth by hosting more advanced manufacturing facilities and attracting more expertise and capital. The strategies and policies should aim to maintain the integrity and momentum of the semiconductor manufacturing platform based in Taiwan to serve the various players of the global semiconductor ecosystem.

Notes

[1] https://www.digitimes.com/news/a20210816VL202.html

[2] https://reurl.cc/Zjxgj6

[3] https://money.udn.com/money/story/5599/5850822?from=edn_search_result

[4] https://www.osw.waw.pl/en/publikacje/analyses/2018-06-06/chinese-investments-czech-republic-changing-expansion-model-0

[5] Taiwanese-Czech joint R&D call for proposals 2021 webinar
[6] New Southbound Policy, Executive Yuan, Taiwan

[7] https://www.aseanbriefing.com/news/minimum-wages-in-asean-for-2021/

[8] https://www.roc-taiwan.org/vn/post/20705.html

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[10] https://www.foxconn.com/en-us/press-center/press-releases/latest-news/679

[11] https://www.tpca.org.tw/Message/MessageView?id=9786&mid=283

[12] https://www.investindia.gov.in/zh-tw/schemes-for-electronics-manufacturing

[13] https://www.taitraesource.com/total01asp?AreaID=00&CountryID=IN&tItem=w02

[14] https://www.bnext.com.tw/article/61679/apple-iphone-12-india

[15] https://news.cnyes.com/news/id/4709692

[16] https://news.cnyes.com/news/id/4567542

[17] https://stats.moe.gov.tw/statedu/chart.aspx?pvalue=36

[18] https://www.aip.org/fyi/federal-science-bill-tracker/116th/creating-helpful-incentives- produce-semiconductors-chips

[19] https://asia.nikkei.com/Business/Tech/Semiconductors/TSMC-in-Arizona-Why-Taiwan-s-chip-titan-is-betting-on-the-desert

[20] Initially named after Gordon Moore, the co-founder of Fairchild Semiconductor and Intel, Moore's law is the observed trend that the density of transistors in ICs doubles about every two years.

[21] https://www.congress.gov/bill/115th-congress/house-bill/5040

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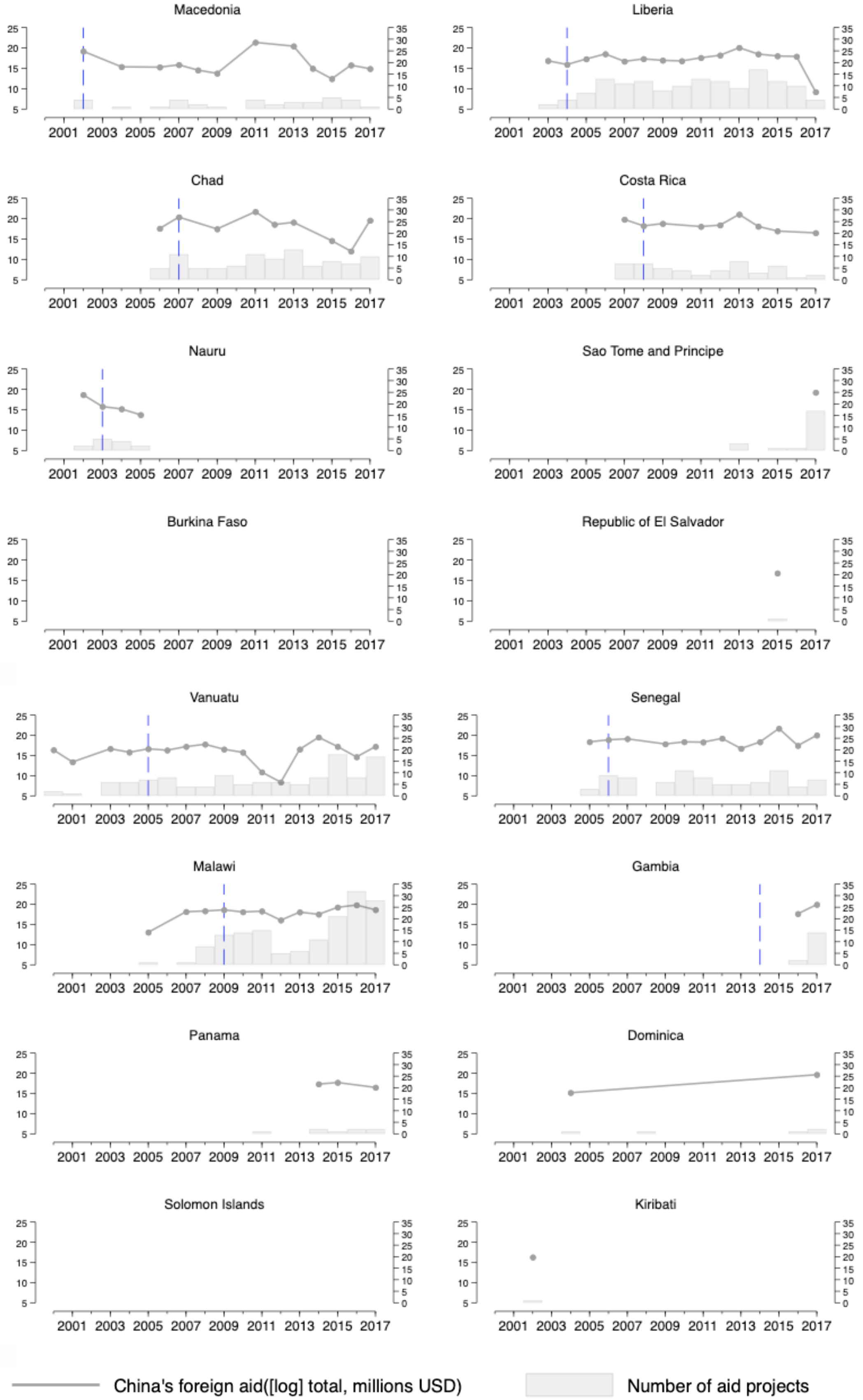
List of Annexes

ANNEX 2.1 Chinese Aid to Formal Diplomatic Partners of Taiwan, 2000-2017



ANNEX 2.2 Regression Models for the Role of Chinese Aid in Recipient Countries

Model Specification: In this chapter, we use regression models to estimate the effects of Chinese aid on political and social outcomes in recipient countries. In our regression models, we use the amount of China's foreign aid as the key independent variable to explain the dependent variables (i.e., political and social outcomes). As a country's political and social outcomes may also be influenced by other variables, we also include additional variables in our regression models to control for their influences on the dependent variables. The set of control variables include a country's ODA from other countries, GDP per capita, economic growth, population size, endowment of natural resources (as % of GDP) and political stability. The data on these variables are taken from the World Development Indicators collected by the World Bank. The data on political stability is taken from the Worldwide Governance Indicators (also developed by the World Bank). We log-transform GDP per capita and population density to address any skewing of both variables. Including these additional variables in our models partials out their confounding effects on the dependent variables and enables us to better estimate the relationship between Chinese aid and political and social outcomes.

As all of our dependent variables are continuous, we estimate two-way fixed-effects regression models to account for unobserved heterogeneity at the unit and time levels. In other words, our statistical models consider the roles of country and year-specific factors that are not fully captured by the set of independent variables. We cluster standard errors at country level to account for heteroscedasticity. We lag all independent variables for one year to avoid simultaneity between them and the dependent variables.

Estimation Results. ANNEXES 2.3 and 2.4 report our estimation results for models with different dependent variables that measure political and social aspects. The numbers in both tables indicate the estimated coefficients and their standard errors (in parentheses). Specifically, a coefficient of a variable indicates the direction and magnitude of the relationship between the variable and the dependent variable. A positive number for a coefficient indicates that the explanatory variable is positively related to the dependent variable. The standard error indicates the level of uncertainty of the estimated coefficient. A larger standard error refers to more uncertainty and makes the estimated coefficient less statistically significant with a larger p-value. Whenever there is a cross or star sign (i.e., † or *) next to the estimated coefficient, it means that the coefficient is statistically different from 0 with a p-value smaller than 0.1, 0.05, 0.01, or 0.001.

As shown in ANNEX 2.3, the variable *Chinese Aid* is statistically significant at $p < 0.1$ after we include other control variables. Specifically, a country receiving more Chinese aid would have lower democratic development (Model 1), rule of law (Model 2), freedom of expression (Model 3), and gender equality (Model 4). Model 5 suggests that a country receiving more Chinese aid would have more corruption. It should be noted that the variable Other ODA &Aid is statistically insignificant except in Model 1, where it has a positive sign. In other words, receiving ODA from other countries is less correlated with recipient countries' political outcomes than receiving Chinese aid.

ANNEX 2.4 reports models that investigate the effect of Chinese aid on social aspects. As shown in ANNEX 2.4, the variable *Chinese Aid* is statistically insignificant in Models 6 and 7, suggesting that Chinese aid has no substantive effects on life expectancy and death rates in recipient countries. Model 8 shows that a country receiving more aid from China has lower enrollment rates for primary education. Models 9 and 10 suggest that Chinese aid will have no substantive effect on male employment but is negatively related to female employment. Thus, Chinese aid has no significant effects on public health but negatively impacts education and female employment in recipient countries.

In summary, most of our hypotheses regarding the relationships between Chinese aid and recipient countries' political and social outcomes are supported by the empirical data analyzed in the models in ANNEX 2.3 and 2.4.

Readers may wonder whether our results are driven by reversed causality. For instance, it might be the case that countries with a low level of democratic development are more likely to receive Chinese aid. Similarly, corrupt politicians might be more likely to receive aid from China because OECD countries would impose conditionality on their aid disbursement whereas China would not. To address this issue of endogeneity, we estimate two-stage instrument-variable (IV) regression models. The main intellectual advantage of IV regression models is that researchers can use an "instrument" that is related to the key explanatory variable but unrelated (i.e., exogenous) to the dependent variable. By utilizing such relationships, researchers can use the IV to predict the key explanatory variable (i.e., China's aid) in the first-stage regression, and then use the predicted value in the second-stage regression to estimate its relationship with the outcome variable (i.e. political and social indicators). Because the IV is unrelated to the outcome variable, using the independent variable predicted by the IV in the first-stage regression avoids the issue of reversed causality (Bun & Harrison, 2019).

In this chapter, We follow previous studies and use the interaction of China's annual steel production with the recipient country's probability of receiving Chinese aid (Dreher et al., 2021; Ping et al., 2022). The insight of using this interaction term as an instrument of Chinese aid is twofold. First, China offers aid to other countries based on the surplus of its steel production, because it exports its surplus steel production to build infrastructure in recipient countries. Second, a country's probability of receiving aid from China is also determined by other variables both specific to themselves and exogenous to China' steel production, such as their own production of crude steel (which is included in the first-stage estimation in our models). As a result, the interaction term between China's steel production and a recipient country's probability of receiving aid from China would be conditionally exogenous to the dependent variables and satisfies the exclusion restriction as a valid instrument in our model specification.

We report the results of instrumental-variable regression models in Table 1.3. Our key findings in ANNEXES 2.3 and 2.4, except that of Model 8 on the enrollment rate of primary education, remain unchanged and statistically significant in the models that address the issue of endogeneity. Please note that the F statistic in the first stage of these models are slightly higher than the conventional critical value (i.e. 10), so our instrument is not a weak one. In other words, results in ANNEXES 2.5 reconfirm that

Chinese aid undermines recipient countries' democratic development, rule of law, freedom of expression, gender political equality in the lower chamber and enrollment in primary school. It also induces corruption. It should be noted that ODA & Aid from other countries have different signs from Chinese Aid on the dependent variables in ANNEX 2.4 (except in Models 14 and 17), suggesting that *Chinese Aid* has the opposite effect on many political and social aspects.

ANNEX 2.3 Chinese Foreign Aid and Political Outcomes in Recipient Countries

	Model 1	Model 2	Model 3	Model 4	Model 5
Chinese Aid	-0.006*	-0.005†	-0.007*	-0.045*	0.006*
	(0.002)	(0.003)	(0.003)	(0.022)	(0.003)
Other ODA & Aid	0.027*	0.019	0.024	-0.065	-0.018
	(0.010)	(0.012)	(0.016)	(0.085)	(0.012)
GDP Per Capita	-0.011	0.027	-0.026	-0.382	-0.041
	(0.039)	(0.049)	(0.073)	(0.387)	(0.053)
GDP Growth	0.001	0.000	0.000	0.003	0.000
	(0.000)	(0.000)	(0.000)	(0.003)	(0.000)
Population	0.033	-0.091	-0.067	-1.426*	0.126
	(0.075)	(0.078)	(0.097)	(0.700)	(0.078)
Natural Resources	-0.000	0.000	-0.000	-0.000	-0.000
	(0.001)	(0.000)	(0.001)	(0.007)	(0.000)
Political Stability	0.015	-0.006	0.000	0.022	0.015
	(0.018)	(0.016)	(0.023)	(0.119)	(0.016)
Constant	-0.080	0.241	0.657	11.052*	0.780
	(0.546)	(0.553)	(0.856)	(4.553)	(0.577)
Country Dummy	Yes	Yes	Yes	Yes	Yes
Year Dummy	Yes	Yes	Yes	Yes	Yes
No. of Countries	117	117	117	117	117
No. of Observations	1,563	1,563	1,563	1,563	1,563

Note: The dependent variables (DV) in Model 1 to 5 are electoral democracy, rule of law, freedom of expression, lower chamber gender quotas, and regime corruption, respectively. Robust standard errors clustered at the country level are reported in parentheses. † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

ANNEX 2.4 Chinese Foreign Aid and Social Outcomes in Recipient Countries

	Model 6	Model 7	Model 8	Model 9	Model 10
Chinese Aid	0.031	-0.040	-0.462*	-0.011	-0.147†
	(0.055)	(0.036)	(0.216)	(0.072)	(0.088)
Other ODA & Aid	0.358*	-0.278**	1.517†	-0.158	-0.207
	(0.153)	(0.102)	(0.848)	(0.211)	(0.279)
GDP Per Capita	1.023	0.241	-5.745	1.425	-1.744
	(1.051)	(0.713)	(5.513)	(1.278)	(1.438)
GDP Growth	0.009	-0.008	0.213*	-0.004	0.004
	(0.015)	(0.010)	(0.086)	(0.013)	(0.013)
Population	10.209***	-10.141***	25.392†	-2.309	-8.552*
	(2.456)	(1.908)	(14.118)	(2.731)	(3.350)
Natural Resources	0.008	-0.004	-0.070	-0.034	-0.015
	(0.012)	(0.008)	(0.093)	(0.027)	(0.027)
Political Stability	0.619*	-0.373*	1.744	-0.138	0.009
	(0.244)	(0.175)	(1.536)	(0.324)	(0.349)
Constant	10.401	52.656***	19.673	70.754***	100.457***
	(15.423)	(11.095)	(71.553)	(16.364)	(21.155)
Country Dummy	Yes	Yes	Yes	Yes	Yes
Year Dummy	Yes	Yes	Yes	Yes	Yes
No. of Countries	117	117	107	114	114
No. of Observations	1,563	1,563	1,240	1,516	1,516

Note: The dependent variables (DV) in Model 6 to 10 are life expectancy, crude death rate, primary school enrollment rate, male employment to population ratio and female employment to population ratio, respectively. Robust standard errors clustered at the country level are reported in parentheses. † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

ANNEX 2.5 Addressing the Issue of Reversed Causality

	Model 11	Model 12	Model 13	Model 14	Model 15	Model 16	Model 17
Chinese Aid	-0.035***	-0.012*	-0.040**	-0.303***	0.012*	-0.363	-1.244***
	(0.009)	(0.005)	(0.012)	(0.076)	(0.005)	(0.548)	(0.300)
Other ODA & Aid	0.029***	0.018***	0.027***	-0.004	-0.019***	1.499**	-0.043
	(0.005)	(0.005)	(0.007)	(0.049)	(0.005)	(0.481)	(0.186)
GDP Per Capita	-0.011	0.021	-0.033	-0.269	-0.036	-5.782*	-1.070
	(0.019)	(0.021)	(0.030)	(0.220)	(0.023)	(2.877)	(0.881)
GDP Growth	0.001	0.000	0.000	0.004	-0.000	0.211**	0.004
	(0.001)	(0.000)	(0.001)	(0.005)	(0.000)	(0.065)	(0.012)
Population	-0.029	-0.120**	-0.144**	-1.401***	0.143***	25.368***	-8.641***
	(0.043)	(0.039)	(0.051)	(0.376)	(0.043)	(6.502)	(1.673)
Natural Resources	-0.000	0.000	-0.000	-0.000	-0.000	-0.070	-0.013
	(0.000)	(0.000)	(0.001)	(0.005)	(0.000)	(0.067)	(0.017)
Political Stability	0.022**	-0.004	0.007	0.035	0.014*	1.746*	0.106
	(0.008)	(0.007)	(0.010)	(0.068)	(0.007)	(0.805)	(0.223)
Country Dummy	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year Dummy	Yes	Yes	Yes	Yes	Yes	Yes	Yes
First-Stage F	14.41***	14.41***	14.41***	14.41***	14.41***	14.66***	13.99***
No. of Countries	114	114	114	114	114	107	114
No. of Observations	1,542	1,542	1,542	1,542	1,542	1,240	1,516

Note: The dependent variables (DV) in Model 1 to 5 are electoral democracy, rule of law, freedom of expression, lower chamber gender quotas, regime corruption, primary school enrollment rates and female employment to population ratios, respectively. Robust standard errors are reported in brackets. † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

ANNEX 3.1 The Difference-in-Differences Methodology

The Difference-in-Differences model, developed by Card and Krueger (1994), was first used to analyze the impact of an increase in the minimum wage in New Jersey in 1980 on the employment of fast-food store employees. It used Pennsylvania as a control group to compare the results before and after 1980. According to Card and Krueger, "On April 1, 1992, New Jersey increased its minimum wage to $5.05 per hour, the highest minimum wage in the United States, but the neighboring state of Pennsylvania did not follow suit and kept its minimum wage at $4.25. The New Jersey–Pennsylvania comparison can be used to assess the employment impact of (changes in the) minimum wage."

Employment in Fast-Food Restaurant (in full-time equivalents)

	Before NJ increased the minimum wage	After NJ increased the minimum wage	Difference
New Jersey	20.4	21	0.6
Pennsylvania	23.3	21.2	-2.1
Difference	2.9	0.2	***DID=2.7***
Difference-in-Differences	***2.7***		

Source: David Card and Kruger, "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania," *American Economic Review* (September 1994), Table 3.

The above table summarizes the main results of their study. The finding is that employment in New Jersey fast-food restaurants grew rather than declined compared to Pennsylvania's. Fast food restaurants in New Jersey hired 0.6 more workers after the minimum wage increase than they had before. On the other hand, employment in Pennsylvania outlets declined by 2.1 workers. The Difference-in-Differences method concludes that a rise in the minimum wage led to an increase of 2.7 workers in the average fast-food outlet.

This methodology was well received and is now widely used in various fields where researchers wish to evaluate performance before and after an event. There are several reasons for using this measurement methodology: (1) Endogeneity problems can be avoided to a large extent. For instance, some policies or events are generally exogenous relative to economic entities. (2) The traditional method of evaluating the effect of a policy or event is typically to set a dummy variable for the occurrence of an event and then run the regression. In contrast to the simple "before and after" method, in which all change in the outcome is ascribed to the policy, the DID model nets out changes in the outcome in a control group. Thus, the DID model is more scientific because it allows separation of the policy's impact from co-occurring general trends, leading to a more accurate estimation of the effects of the event. (3) The principles and models of DID are straight forward and easy to understand and use. (4) It is a suitable method for our subject countries. In the initial stage of this study, we explored the possibility of using the synthetic control method (SCM), another approach for estimating the impact of a treatment on a single unit. However, counterfactual countries could not be successfully built under the SCM approach.

The main purpose of DID is to deal with the possible impact of unobservable factors on the overall economy. If we simply use the traditional regression model to explore the changes in the overall economy before and after the severance of diplomatic relations, without comparison with a control group, it is impossible to determine if the overall economy of the country we are observing was changed by other factors. The DID model solves the above-mentioned problems.

To apply the DID method, the two countries —the treated country and the control country — must be independent of each other, such that in the aftermath of the event in question one will not affect the other. That is to say, the occurrence of the event is an exogenous matter. In such cases the DID method can be used to assess the magnitude of the impact. In addition, the chosen control group must be similar in relevant ways to the experimental country. For example, region, income level, population, and culture all fall within our consideration to avoid introducing differences due to other factors.

The DID regression model is as follows:
$Y_{it}=\alpha+\gamma D_t+\beta X_{it}+\mu_i+\varepsilon_{it}$ *(1)*

where D_t is a dummy variable for the observation period. The year of the event is the interruption year (T_0). The period before the interruption year is denoted as P_0, and after the interruption year denoted P_1 After the interruption year (P_1) is denoted D_t=1. Before the interruption year (P_0) is denoted D_t = 0. X_{it} is for the countries in our modeling pool. The treated country has dummy variable X_{it}=1, and the control country is assigned the dummy X_{it}=0. Herein μ_i is an unobservable country characteristic. Therefore, before breaking off diplomatic relations (P_0), the treated country and the control country do not differ, so X_{it}= 0. After breaking off diplomatic relations (P_1), the treated country is denoted X_{it}=1, while the control country keeps the designation X_{it}=0. Since equation (1) can be differenced when panel data are available (that is, the post-period minus the pre-period), μ_i can be eliminated and the following equation is obtained:

$\Delta Y_i=\gamma+\beta X_{ip1}+\Delta\varepsilon_i$ (2)

where ΔY_i is the DID result, and β , namely the degree of economic impact on the country after the severance of diplomatic relations, which we get after differencing ΔY_i over the countries, is the DID estimate that we want to observe.

In addition, we also illustrate the DID trend, which adopts each DID value (ΔY_i) per year and draw the curve to realize the changes of the DID result in our empirical period.

ANNEX 3.2 DID Results for Africa

Treated country	Year	Control countries	DID	P>|t|
Burkina Faso	2006	Mozambique	- 0.171	0.014**
Central African Republic	1998	Madagascar	0.020	**0.574**
Chad	2006	Guinea-Bissau	0.358	0.000***
Eswatini	2006	Tunisia	0.013	**0.767**
Gambia	2006	Guinea-Bissau	- 0.109	0.000***
	2013	Guinea-Bissau	- 0.135	0.000***
Malawi	2006	Niger	0.115	0.002***
	2008	Niger	0.017	0.000***
São Tomé and Príncipe	2006	Ghana	- 0.104	0.094*
	2016	Ghana	- 0.121	0.076*
Senegal	2006	Zambia	- 0.306	0.000***
South Africa	1998	Botswana	- 0.172	0.001***

*Inference: *** p<0.01; ** p<0.05; * p<0.1
**Observation Period of Central African Republic is 1991-2019.

ANNEX 3.3 DID Trend in Africa

Malawi vs Niger		
Year	DID	P > | t |
1999	0.091	0.015**
2000	0.074	0.070*
2001	0.056	0.206
2002	0.081	0.080*
2003	0.105	0.022**
2004	0.114	0.009***
2005	0.111	0.007***
2006	0.115	0.002***
2007	0.122	0.001***
2008	0.117	0.000***
2009	0.112	0.001***
2010	0.097	0.003***
2011	0.084	0.016**
2012	0.065	0.059*
2013	0.059	0.086*
2014	0.052	0.135
2015	0.044	0.227
2016	0.036	0.336
2017	0.032	0.388
2018	0.027	0.461
2019	0.029	0.401

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

S. Aftica vs. Botswana		
Year	DID	P > | t |
1991	-0.264	0.000***
1992	-0.232	0.000***
1993	-0.209	0.000***
1994	-0.199	0.000***
1995	-0.195	0.000***
1996	-0.187	0.000***
1997	-0.182	0.000***
1998	-0.172	0.001***
1999	-0.166	0.001***
2000	-0.153	0.002***
2001	-0.147	0.003***
2002	-0.147	0.002***
2003	-0.145	0.002***
2004	-0.144	0.002***
2005	-0.147	0.001***
2006	-0.153	0.000***
2007	-0.158	0.000***
2008	-0.162	0.001***
2009	-0.165	0.001***
2010	-0.181	0.000***
2011	-0.192	0.000***
2012	-0.201	0.000***
2013	-0.211	0.000***
2014	-0.207	0.000***
2015	-0.198	0.000***
2016	-0.21	0.000***
2017	-0.213	0.000***
2018	-0.215	0.000***
2019	-0.218	0.000***

ANNEX 3.4 DID results for Central and Eastern Europe

Treated country	Year	Control countries		
			DID	P > | t |
Albania	2012	Turkey	0.028	0.744
Bosnia and Herzegovina	2012	Turkey	- 0.035	0.663
Bulgaria	2012	Turkey	- 0.019	0,824
Croatia	2012	Turkey	- 0.262	0.000***
Czechia	2012	Turkey	- 0.178	0.011**
Estonia	2012	Turkey	- 0.086	0.297
Hungary	2012	Turkey	- 0.190	0.007***
Latvia	2012	Turkey	- 0.005	0.959
Lithuania	2012	Turkey	- 0.078	0.405
Montenegro	2012	Turkey	- 0.129	0.071
North Macedonia	2012	Turkey	- 0.107	0.110
Poland	2012	Turkey	- 0.008	0.914
Romania	2012	Turkey	- 0.020	0.826
Serbia	2012	Turkey	- 0.080	0.319
Slovakia	2012	Turkey	- 0.036	0.646
Slovenia	2012	Turkey	- 0.261	0.00***

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

ANNEX 3.5 DID Trend for Central and Eastern Europe

Czech Rep. vs. Turkey			Hungary vs. Turkey		
Year	DID	P > | t |	Year	DID	P > | t |
2000	-0.037	0.547	2000	-0.042	0.478
2001	-0.033	0.609	2001	-0.042	0.518
2002	-0.075	0.236	2002	-0.088	0.166
2003	-0.091	0.124	2003	-0.117	0.061*
2004	-0.103	0.072*	2004	-0.14	0.025**
2005	-0.107	0.072*	2005	-0.153	0.020**
2006	-0.109	0.090*	2006	-0.161	0.023**
2007	-0.115	0.102	2007	-0.168	0.027**
2008	-0.125	0.098*	2008	-0.171	0.030**
2009	-0.141	0.071*	2009	-0.18	0.025**
2010	-0.161	0.029**	2010	-0.191	0.011**
2011	-0.175	0.013**	2011	-0.195	0.006***
2012	-0.178	0.011**	2012	-0.19	0.007***
2013	-0.177	0.010***	2013	-0.179	0.009***
2014	-0.164	0.015**	2014	-0.161	0.016***
2015	-0.15	0.022**	2015	-0.46	0.026**
2016	-0.138	0.033**	2016	-0.13	0.049**
2017	-0.127	0.039**	2017	-0.113	0.073*
2018	-0.111	0.073*	2018	-0.083	0.174
2019	-0.094	0.134	2019	-0.053	0.377

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

ANNEX 3.6 DID Results for Latin America and the Caribbean

Treated country	Break Year	Control_1		
		Control Country	DID	P > | t |
Antigua and Barbuda	2013	Panama	-0.488	0.000***
Argentina	2013	Saint Vincent and the Grenadines	0.014	0.803
Bahamas	2013	St. Kitts and Nevis	-0.180	0.000***
Barbados	2013	St. Kitts and Nevis	-0.110	0.000***
Belize	2013	Bolivia	-0.296	0.000***
Bolivia	2013	Belize	0.296	0.000***
Brazil	2013	Saint Vincent and the Grenadines	0.003	0.953
Chile	2013	Panama	-0.213	0.005***
Colombia	2013	Paraguay	0.007	0.886
Costa Rica	2007	Panama	- 0.195	0.006***
	2013	Panama	- 0.209	0.007***
Cuba	2013	Dominican Republic	- 0.023	0.781
Dominica	2004	Dominican Republic	- 0.146	0.008***
	2013	Dominican Republic	- 0.264	0.000***
Dominican Republic	2013	Mexico	0.277	0.000***
Ecuador	2013	Paraguay	- 0.082	0.075*
El Salvador	2013	Suriname	- 0.007	0.893
Grenada	2005	Panama	- 0.283	0.000***
	2013	Panama	- 0.328	0.000***
Guatemala	2013	Suriname	- 0.001	0.984
Guyana	2013	Dominican Republic	- 0.076	0.244
Haiti	2013	Bolivia	- 0.223	0.000***
Honduras	2013	Bolivia	- 0.140	0.003***
Jamaica	2013	Paraguay	- 0.298	0.000***
Mexico	2013	Dominican Republic	- 0.277	0.000***
Nicaragua	2013	Bolivia	- 0.061	0.180
Panama	2013	Antigua and Barbuda	0.488	0.000***
Prarguay	2013	Colombia	- 0.007	0.886
Peru	2013	Saint Vincent and the Grenadines	0.282	0.000***
Saint Kitts and Nevis	2013	Uruguay	- 0.254	0.000***

Treated country	Break Year	Control_1		
		Control Country	DID	P > | t |
Saint Lucia	2007	Guyana	-0.190	0.000***
	2013	Guyana	-0.229	0.000***
Saint Vincent and the Grenadines	2013	Brazil	-0.003	0.953
Suriname	2013	Guatemala	0.001	0.984
Trinidad and Tobago	2013	St. Kitts and Nevis	0.022	0.733
Uruguay	2013	St. Kitts and Nevis	0.254	0.000***
Venezuela	2013	Panama	-0.295	0.000***

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

ANNEX 3.7 DID Trend for Latin America and the Caribbean

Costa Rica vs Panama			Dominica vs Dominican Republic		
Year	DID	P > | t |	Year	DID	P > | t |
2001	-0.016	0.174	2001	-0.139	0.015**
2002	-0.129	0.097*	2002	-0.142	0.012**
2003	-0.149	0.050**	2003	-0.124	0.028**
2004	-0.168	0.023**	2004	-0.146	0.008***
2005	-0.179	0.014**	2005	-0.169	0.001***
2006	-0.186	0.008***	2006	-0.173	0.001***
2007	-0.195	0.006***	2007	-0.174	0.002***
2008	-0.201	0.008***	2008	-0.179	0.003***
2009	-0.202	0.013**	2009	-0.198	0.002***
2010	-0.205	0.010***	2010	-0.219	0.001***
2011	-0.213	0.005***	2011	-0.232	0.001***
2012	-0.213	0.005***	2012	-0.247	0.000***
2013	-0.209	0.007***	2013	-0.264	0.000***
2014	-0.2	0.011**	2014	-0.279	0.000***
2015	-0.191	0.016**	2015	-0.303	0.000***
2016	-0.181	0.023**	2016	-0.318	0.000***
2017	-0.174	0.027**	2017	-0.346	0.000***
			2018	-0.349	0.000***

Grenada vs Panama		
Year	DID	P > | t |
2001	-0.195	0.009***
2002	-0.201	0.007***
2003	-0.223	0.002***
2004	-0.264	0.001***
2005	-0.283	0.000***
2006	-0.323	0.000***
2007	-0.341	0.000***
2008	-0.356	0.000***
2009	-0.364	0.000***
2010	-0.367	0.000***
2011	-0.367	0.000***
2012	-0.356	0.000***
2013	-0.328	0.000***
2014	-0.293	0.000***
2015	-0.269	0.001***
2016	-0.252	0.001***
2017	-0.237	0.002***

Guatemala vs Suriname		
Year	DID	P > | t |
2001	-0.159	0.000***
2002	-0.151	0.000***
2003	-0.153	0.000***
2004	-0.145	0.000***
2005	-0.128	0.002***
2006	-0.112	0.008***
2007	-0.099	0.023**
2008	-0.09	0.050*
2009	-0.081	0.090*
2010	-0.067	0.158
2011	-0.049	0.308
2012	-0.026	0.596
2013	-0.001	0.984
2014	0.027	0.578
2015	0.053	0.266
2016	0.068	0.152
2017	0.064	0.161
2018	0.056	0.187

St. Lucia vs Guyana		
Year	DID	P > | t |
2001	-0.155	0.001***
2002	-0.126	0.010**
2003	-0.114	0.016**
2004	-0.124	0.007***
2005	-0.146	0.002***
2006	-0.168	0.000***
2007	-0.190	0.000***
2008	-0.199	0.000***
2009	-0.215	0.000***
2010	-0.219	0.000***
2011	-0.222	0.000***
2012	-0.229	0.000***
2013	-0.229	0.000***
2014	-0.218	0.000***
2015	-0.211	0.000***
2016	-0.202	0.000***
2017	-0.198	0.000***
2018	-0.208	0.000***
2019	-0.200	0.000***

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

ANNEX 3.8 DID Results for Oceania

Treated country	Break Year	Control_1		
		Control Country	DID	P > | t |
Fiji	2006	NCL	-0.019	0.837
Marshall	1998	FSM	0.013	0.869
Micronesia	2006	Tuvalu	-0.465	0.000***
Palau	2006	Cook ISL	-0.320	0.026**
Papua New Guinea	2006	El Salvador	-0.03	0.823
Samoa	2006	Tuvalu	0.293	0.026**
Solomon	2006	Samoa	-0.482	0.000***
Tonga	1998	Tuvalu	-0.327	0.067*
Tuvalu	2006	FSM	0.458	0.000***
Vanuatu	2006	New Caledonia	-0.047	0.485

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

ANNEX 3.9 DID Trend for Oceania

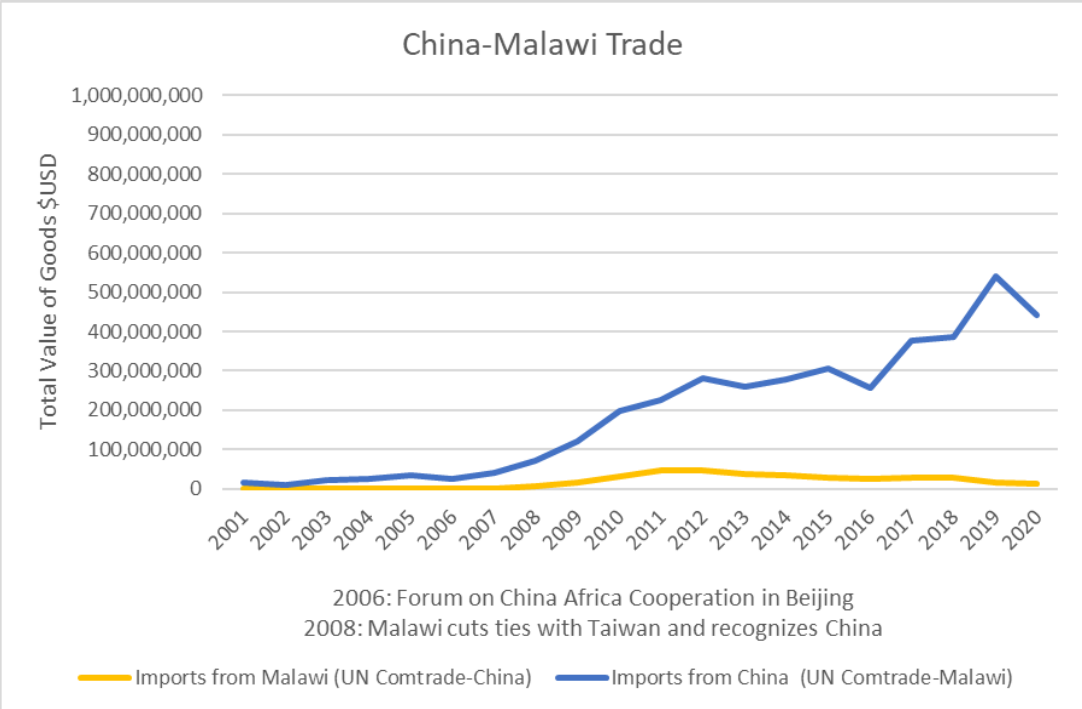
Tuvalu vs. FSM		
Year	DID	P > | t |
1971	-0.543	0.000***
1972	-0.541	0.000***
1973	-0.532	0.000***
1974	-0.503	0.007***
1975	-0.437	0.035**
1976	-0.384	0.059*
1977	-0.338	0.081*
1978	-0.289	0.117
1979	-0.241	0.174
1980	-0.191	0.269
1981	-0.149	0.375
1982	-0.105	0.528
1983	-0.041	0.803
1984	0.015	0.926
1985	0.056	0.715
1986	0.13	0.386
1987	0.188	0.198
1988	0.229	0.108
1989	0.248	0.084*
1990	0.263	0.067*
1991	0.273	0.061*
1992	0.286	0.053*
1993	0.3	0.046**
1994	0.33	0.028**
1995	0.348	0.022**
1996	0.347	0.016**
1997	0.381	0.013**
1998	0.386	0.011**
1999	0.4	0.008***
2000	0.412	0.006***
2001	0.431	0.004***
2002	0.459	0.002***
2003	0.478	0.001***
2004	0.487	0.001***
2005	0.482	0.001***
2006	0.485	0.001***
2007	0.488	0.000***
2008	0.479	0.001***
2009	0.463	0.001***
2010	0.471	0.001***

Tuvalu vs. FSM		
Year	DID	P > | t |
1971	1.03	0.000***
1972	1.023	0.000***
1973	1.007	0.000***
1974	0.964	0.000***
1975	0.893	0.000***
1976	0.853	0.000***
1977	0.835	0.000***
1978	0.791	0.000***
1979	0.737	0.000***
1980	0.688	0.001***
1981	0.618	0.002***
1982	0.563	0.005***
1983	0.489	0.014**
1984	0.427	0.028**
1985	0.379	0.045**
1986	0.33	0.065*
1987	0.288	0.094*
1988	0.248	0.138
1989	0.213	0.213
1990	0.182	0.296
1991	0.158	0.372
1992	0.125	0.494
1993	0.097	0.6
1994	0.062	0.739
1995	0.038	0.838
1996	0.012	0.95
1997	-0.015	0.938
1998	-0.033	0.861
1999	-0.045	0.812
2000	-0.054	0.772
2001	-0.061	0.74
2002	-0.061	0.731
2003	-0.055	0.749
2004	-0.046	0.783
2005	-0.036	0.83
2006	-0.034	0.837
2007	-0.037	0.817
2008	-0.028	0.86
2009	-0.019	0.908
2010	-0.016	0.92

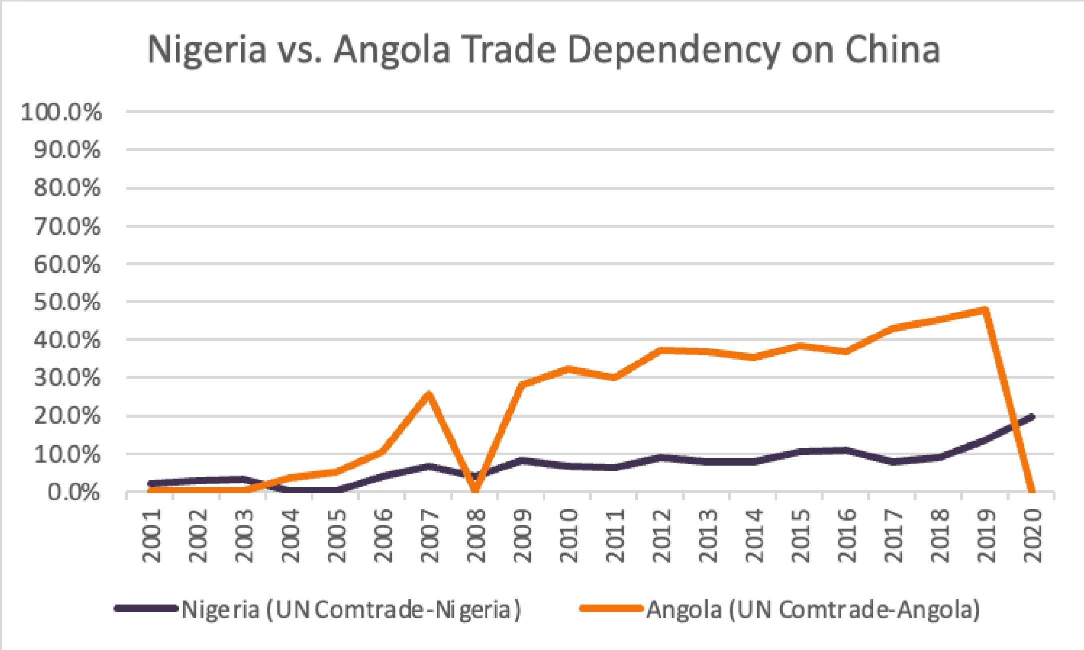
Tuvalu vs. FSM			Tonga vs. Tuvalu		
Year	DID	P > | t |	Year	DID	P > | t |
2011	0.471	0.001***	2011	-0.013	0.935
2012	0.452	0.001***	2012	-0.007	0.964
2013	0.445	0.002***	2013	-0.017	0.918
2014	0.433	0.003***	2014	-0.024	0.885
2015	0.424	0.005***	2015	-0.035	0.835
2016	0.426	0.003***	2016	-0.05	0.763
2017	0.409	0.004***	2017	-0.049	0.761
2018	0.383	0.006***	2018	-0.045	0.783
2019	0.369	0.008***	2019	-0.025	0.877

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

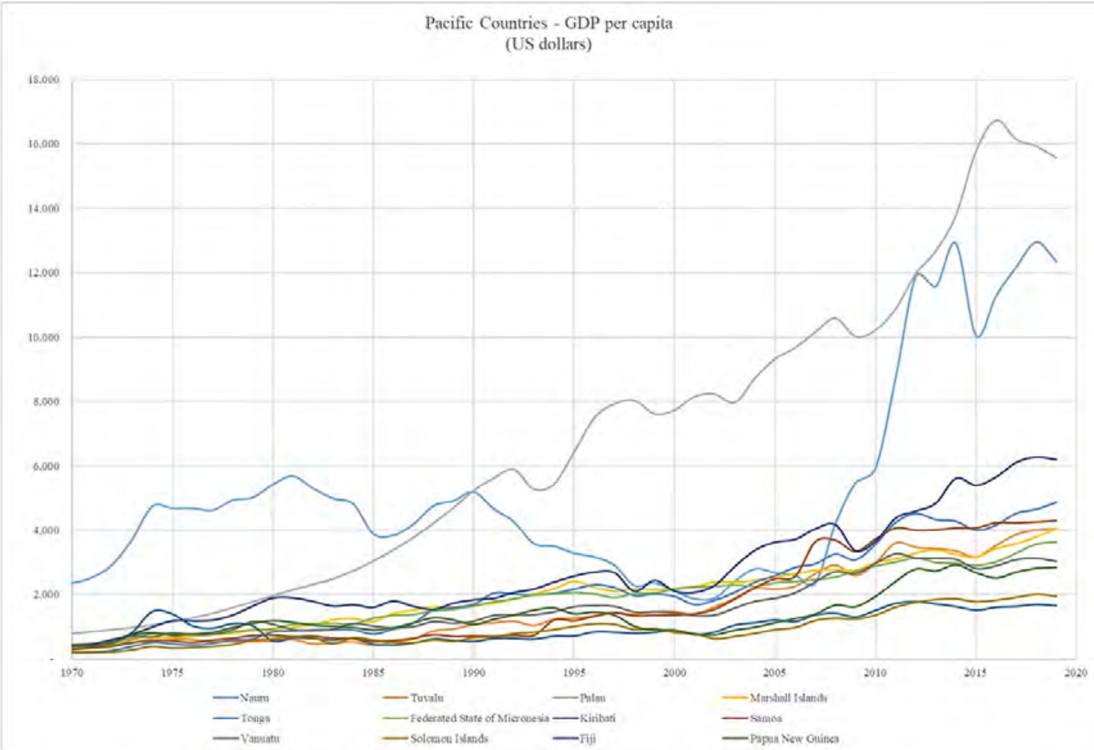
ANNEX 5.1 China-Malawi Trade



ANNEX 5.2 Nigeria vs. Angola Trade



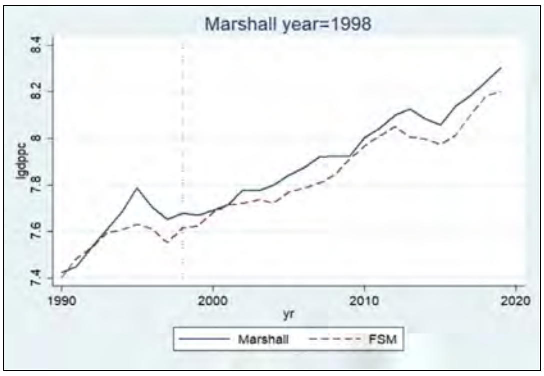
ANNEX 6.1 GDP per capita of Pacific Countries



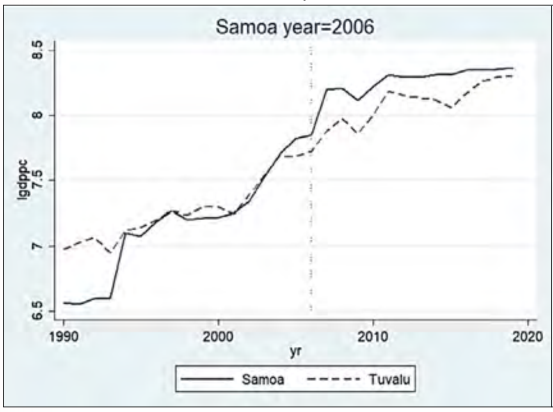
Source: UNdata.

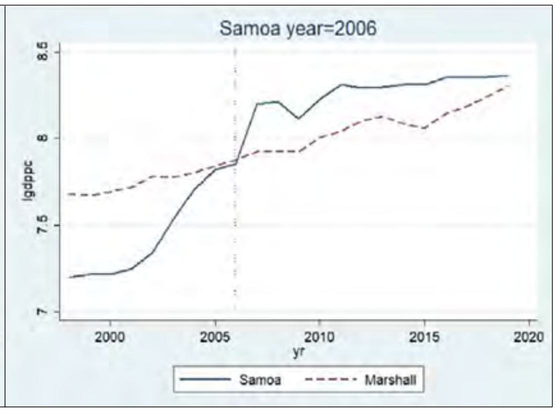
ANNEX 6.2 DID Analysis: Tuvalu VS. FSM

ANNEX 6.3 DID Analysis: Marshall Islands VS. FSM

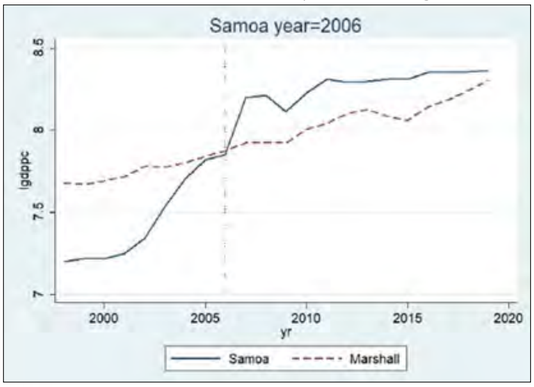


ANNEX 6.4 DID Analysis: Samoa VS. Tuvalu; Samoa VS. Marshall Islands

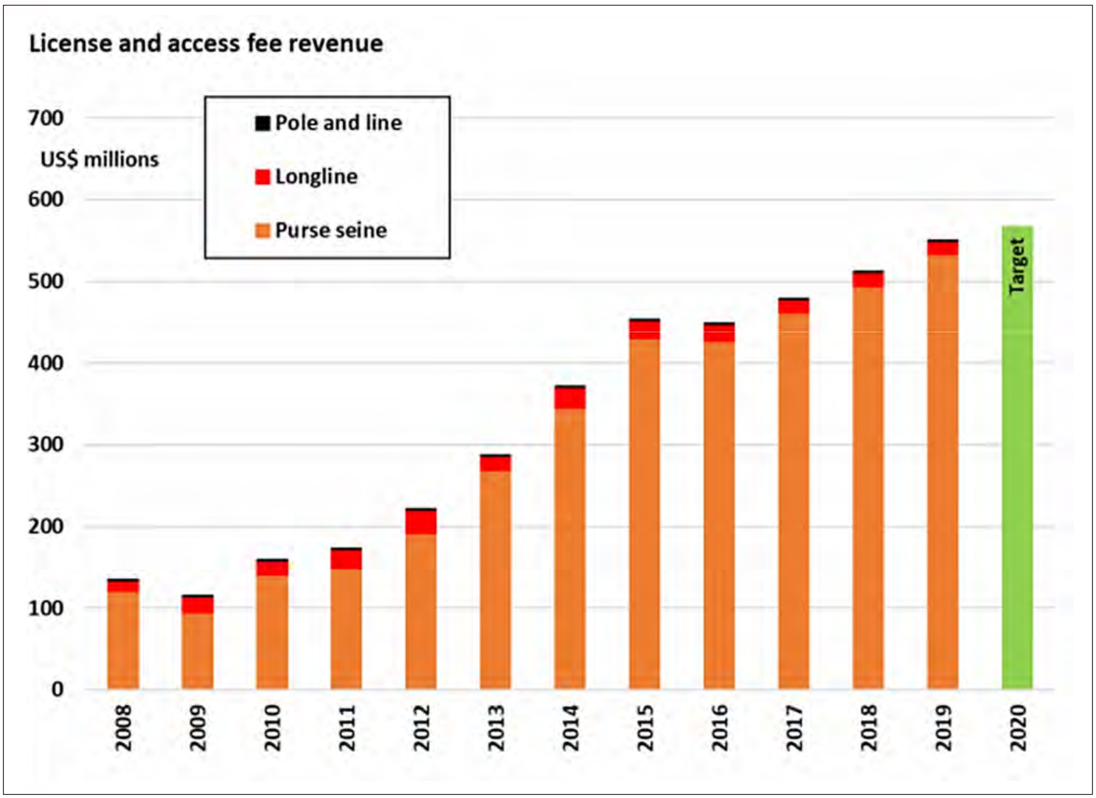




ANNEX 6.5 DID Analysis: Tonga VS. Tuvalu

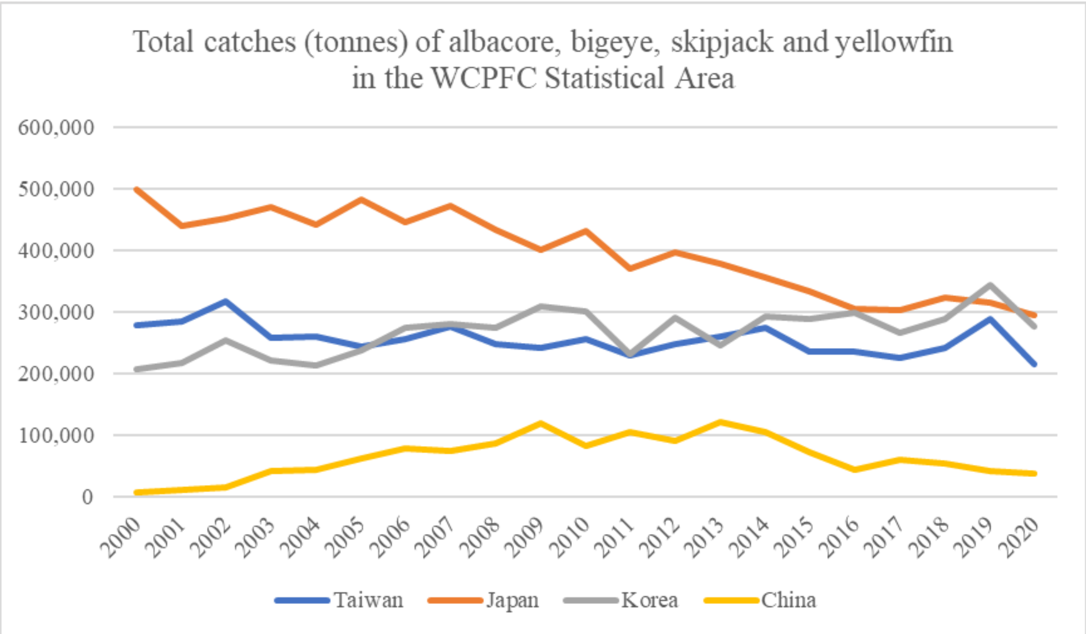


ANNEX 6.6 Revenues of Pacific Countries from Fishing Licenses and Access Fees from 2008 to 2019



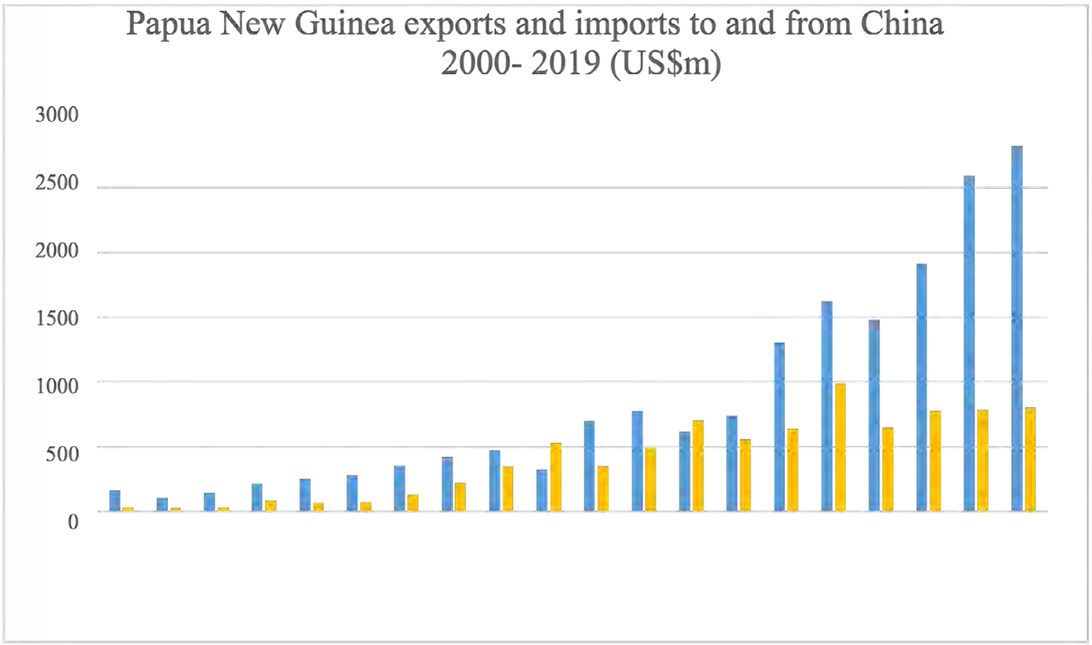
Source: Forum Fisheries Agency 2020

ANNEX 6.7 Total Catch (Tonnes) by Taiwan of albacore, bigeye, skipjack and yellowfin in the WCPFC Statistical Area



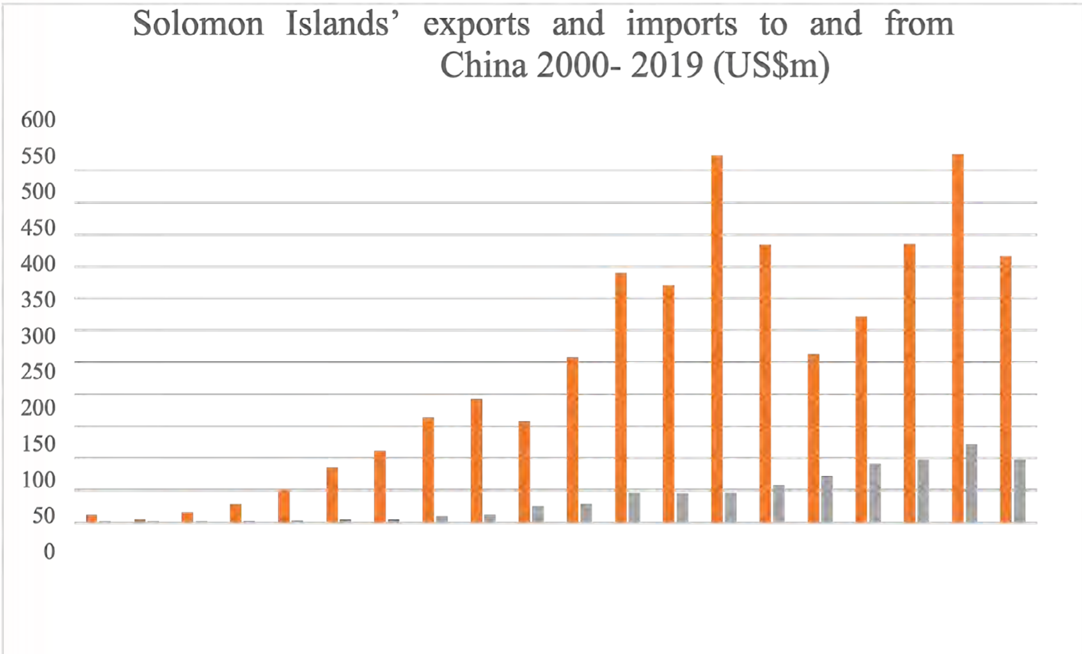
Source: WCPFC 2021

ANNEX 6.8 Papua New Guinea's Exports and Imports to and from China 2000-2019 (US$M)



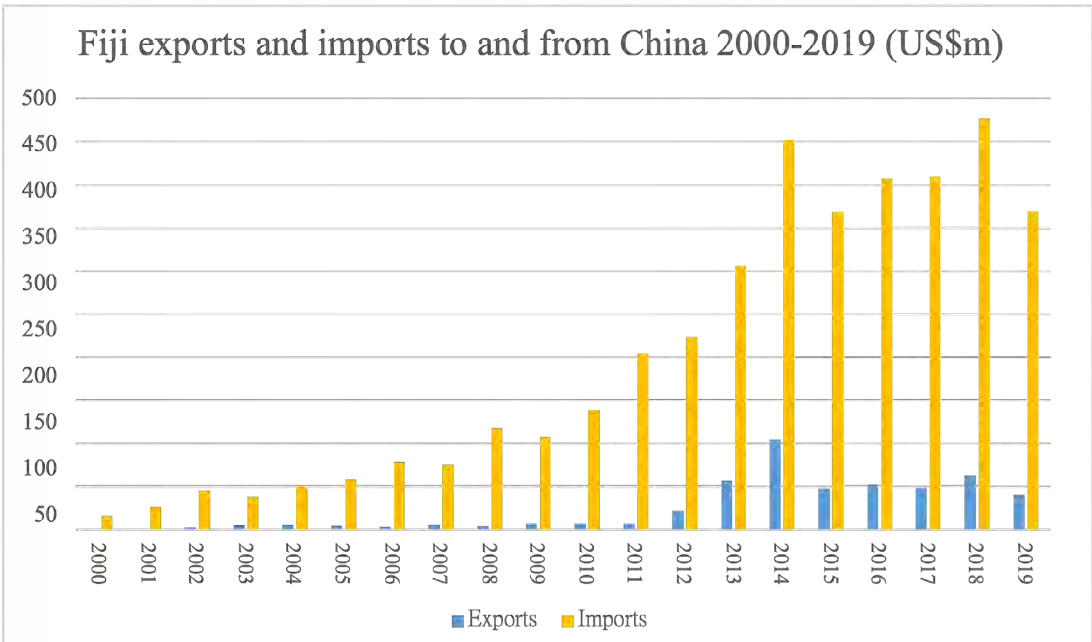
Source: The Observatory of Economic Complexity.

ANNEX 6.9 Solomon Islands' Exports and Imports to and from China 2000-2009 (US$M)



Source: The Observatory of Economic Complexity.

ANNEX 6.10 Fiji's Exports and Imports to and from China 2000-2009 (US$M)



Source: The Observatory of Economic Complexity

ANNEX 7.1 Chinese FDI in CEE3 - stock and as a percentage of total FDI, OECD statistics, 2013–2020, million USD

		2013		2014		2015		2016		2017		2018		2019		2020	
		I	U	I	U	I	U	I	U	I	U	I	U	I	U	I	U
CZ	M USD	-9	136	-13	204	268	371	665	794	691	1101	687	1012	705	1501	759	1512
	%	-	0.1	-	0.2	0.2	0.3	0.5	0.6	0.4	0.6	0.4	0.6	0.4	0.9	0.4	0.8
HU	M USD	93	..	86	1268	99	1952	176	1934	212	1989	62	2564	-54	2786	461	..
	%	0.04	-	0.04	0.6	0.05	1.0	0.1	0.8	0.1	0.8	0.03	1.4	-	1.2	0.1	-
PL	M USD	110	641	179	502	218	928	177	707	230	848	318	935	205	1223	286	1241
	%	0.05	0.3	0.1	0.2	0.1	0.5	0.1	0.4	0.1	0.4	0.1	0.4	0.1	0.5	0.1	0.5

M USD - in million USD; % - percentage share; I - immediate; U - ultimate; not available; - not applicable
Source: own compilation based on data from OECD

ANNEX 7.2 Taiwanese FDI in CEE3 - stock and as a percentage of total FDI, OECD statistics, 2013–2020, million USD

		2013		2014		2015		2016		2017		2018		2019		2020	
		I	U	I	U	I	U	I	U	I	U	I	U	I	U	I	U
CZ	M USD	89	385	38	456	5	421	214	555	279	834	75	798	20	918	80	980
	%	0.07	0.3	0.03	0.4	0.004	0.4	0.2	0.4	0.2	0.5	0.05	0.5	0.01	0.5	0.04	0.5
HU	M USD	73	..	92	295	58	208	96	300	48	979	-147	1196	60	1521	49	..
	%	0.03	-	0.04	0.1	0.03	0.1	0.04	0.1	0.02	0.4	-	0.7	0.02	0.6	0.01	-
PL	M USD	24	263	15	288	30	296	35	234	31	268	54	282	57	268	60	119
	%	0.01	0.1	0.01	0.1	0.01	0.2	0.02	0.1	0.01	0.1	0.02	0.1	0.02	0.1	0.02	0.05

M USD - in million USD; % - percentage share; I - immediate; U - ultimate; not available; - not applicable
Source: own compilation based on data from OECD

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