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 five 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 February 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 up to Jan. 2022	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.[2] 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/.

[4] The failed projects include: 1) the high-speed train from Mexico City to Queretaro, which was canceled in 2014 due to conflicts of interest between President Peña Nieto and Mexican companies associated with the China Railway Construction Corporation (CRCC). 2) The Dragon Mart commercial project was canceled in 2015 because of environmental damage in Quintana Roo state. 3) The hydroelectric dam Chicoasen II was granted to a Chinese- Costa Rican company Sinohydro on the outskirts of Tuxtla Gutierrez, Chiapas, which was partially suspended in 2016 because of disputes with labor unions, landowners and suppliers. 4) The Mayan train, which included the participation of the China Communication Construction Company.

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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