

Stadium or Bridge : A Note on the Diplomatic Rivalry between China and Taiwan in Central America

Tatsuji Hayakawa¹

Abstract

Panama broke diplomatic ties with Taiwan to establish those with China in June 2017, 10 years after Costa Rica did so, leaving only 19 countries plus the Vatican that still recognize officially Taiwan. Many such countries are located in Central America, to which Taiwan has paid special and strategic attention. Central American countries that recognize Taiwan appreciate and still need Taiwan's active assistance. While Costa Rica and Panama need less of such aids, it is unlikely that the other countries in Central America would prefer to switch diplomatic recognition in the immediate future.

Costa Rica's anticipated gains from trade with and investment from China have not materialized yet, while its benefit is seen in tourism. It is necessary to step up Costa Rica's prominent exports to China. Costa Rica also needs to develop the capacity to export in large quantity to China and to overcome the high initial cost of starting business with China. As China exported manufacturing products and imported raw materials from South America, China has often run bilateral trade surpluses with Latin American and Caribbean countries. China's investment in Latin America has also increased, reflecting various infrastructure projects. China's foreign direct investment in Latin America has lately become diverse. China's investment in Central America may increase.

With or without diplomatic relationship, China and Taiwan have been engaged in trade, commerce, and investment with many other countries. If such practices change in the future, then the diplomatic recognition issue will become more important not just geopolitically but also economically.

Key words: Central America, diplomatic recognition, trade, FDI

1 Background

A territory is considered as an independent state when it is recognized officially by other states as such. Thus, diplomatic recognition is fundamental for a place to exist as a state. After the Sino-Japanese War,

¹ Faculty of Economics, Fukuyama University, E-mail: thayakawa@fuec.fukuyama-u.ac.jp

China (the Qing dynasty) ceded Taiwan to Japan in 1895. While Taiwan was ruled by Japan, the Republic of China (ROC) was founded in the mainland in 1912. Following Japan's surrender to the Allies in 1945, the ROC gained control of Taiwan. Through the subsequent Chinese Civil War, the People's Republic of China (PRC) was established in the mainland in 1949, and the government of the ROC fled to Taiwan. The ROC represented China at the United Nations (UN) until 1971, when the PRC replaced the ROC as a member of the UN.

Following President Nixon's historical visit to the PRC in February 1972, the US broke diplomatic ties with Taiwan and established full diplomatic relations with the PRC in 1979. As for Japan, Prime Minister Tanaka visited China in 1972. Japan established a diplomatic relation with the PRC instead of the ROC. Even though the formal relation was abolished, Taiwan has maintained strong ties with the US and Japan. Regarding the diplomatic relations, many other countries have followed this pattern of switching recognition from the ROC to the PRC, while maintaining commercial ties with Taiwan.

Just like the case of the UN, the PRC replaced the ROC as a member of the International Monetary Fund (IMF) and the World Bank in 1980. In this context, the pragmatic arrangement reached within the Asian Development Bank (ADB) is worth noting. Taiwan was a founding member of the ADB established in 1966. Following the PRC's entry into the IMF and the Word Bank, negotiations continued in the ADB led by then ADB president Fujioka. As a result, the PRC joined the ADB in February 1986. Unlike the pattern followed by the UN, IMF, and the World Bank, Taiwan remained as a member of the ADB called "Taipei, China."²

After an African country São Tomé and Príncipe broke diplomatic ties with Taiwan in December 2016 and then Panama followed suit in June 2017, only 19 countries plus the Vatican still recognize officially Taiwan as summarized in Table 1. Many such countries are located in Central America including Belize, El Salvador, Guatemala, Honduras, and Nicaragua as well as the Caribbean region that includes the Dominican Republic.

Table 1 List of states with full diplomatic relations with Taiwan (in September 2017)

Region	State
Africa	Burkina Faso, Swaziland
Europe	Holy See (for the Vatican City)
Oceania	Kiribati, Marshall Islands, Nauru, Palau, Solomon Islands, Tuvalu
Caribbean	Dominican Republic, Haiti, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines
Central America	Belize, El Salvador, Guatemala, Honduras, Nicaragua
South America	Paraguay

Source: Compiled by the author

² See McCawley (2017). "Hong Kong, China" has remained a member of the ADB since 1969.

2 Costa Rica and Panama

The case of Central America is of particular interest. Taiwan has paid special and strategic attention to this region. After 60 years of diplomatic ties with Taiwan, Costa Rica broke the diplomatic relationship to bring a new one with China in June 2007. Costa Rica's then president Oscar Arias, recipient of the Nobel Peace Prize in 1987, helped push the switch of diplomatic recognition based on his fairly global vision. Although it is not a large country, Costa Rica prefers to play a role as a key country, envisaging a member of the Organization for Economic Co-operation and Development (OECD) in the near future. While Taiwan has been a friendly country in Central America as discussed below, the economic size of China became far larger than that of Taiwan. Anticipating larger gains from trade, investment, and tourism, Costa Rica followed the pattern of many other countries as a logical move.

Upon Costa Rica's switch of recognition in 2007, a number of bilateral agreements with China were established. Probably as a gesture of gratitude, China offered a donation of a modern, first-class stadium. Costa Rica's 35,000-seat National Stadium (Figure 1) was completed in 2011 by a Chinese company bringing 800 Chinese workers. After establishing the diplomatic relationship, the free trade agreement (FTA) between Costa Rica and China was negotiated relatively fast and signed in April 2010, coming into effect in August 2011. In fact, China needed to have a diplomatic relationship with Costa Rica in order to establish a bilateral FTA, and China does not establish diplomatic ties with countries that have those with Taiwan.

Figure 1 National Stadium, San José, Costa Rica



Source: The author

As for Panama, with its recent expansion of the Panama Canal, it has a unique advantage of functioning as an important regional hub that connects both the Atlantic and Pacific Oceans. Besides logistics, Panama has developed its services sector including finance on the back of complete dollarization. The economic activities of China became quite active in Panama, which has remained on friendly terms with both China and Taiwan. The FTA between Taiwan and Panama was signed in August 2003 and came into effect in January 2004.

In addition to the services sector including finance, the expansion of the Panama Canal may provide China with new business opportunities regarding port operations and the development of the nearby Colón area by the Caribbean Sea. If the number of tourists from China increases, investment in tourism such as casino resorts may become attractive. This is less so in Costa Rica, where more emphasis is placed on eco-tourism.

3 Taiwan in Central America

Taiwan has been very active in the region of Central America. The region is important for Taiwan, as it includes countries that still maintain diplomatic ties with Taiwan. Taiwan's President Tsai Ing-wen visited Honduras, Nicaragua, El Salvador, and Guatemala in January 2017.

One may think that such a switch may not be necessary in practice. After Costa Rica switched recognition, many Central American countries strengthened their economic relationship with China without losing Taiwan's economic aid. The economic ties between Central America and China expanded naturally as the Chinese economy grew in a robust manner. The embassy of China in Costa Rica is useful in promoting China's more active involvement in the Central American region. The existence of the Chinese embassy in Costa Rica may have facilitated Panama's recent decision of switching recognition. The embassy of China in Panama was inaugurated in September 2017.

In view of the economic and development cooperation, it remains appealing to maintain ties with Taiwan, as it is a very generous partner of Central American countries. However, in terms of trade and commerce, China appears far more attractive as seen in the case of Costa Rica's switch.

Taiwan maintains non-reimbursable economic cooperation agreements with countries including El Salvador, Guatemala, Honduras, Nicaragua, the Dominican Republic, as well as regional financial organizations such as the Central Bank for Economic Integration (CABEI) headquartered in Honduras.³

³ Taiwan joined CABEI as a partner in November 1992.

Taiwan's generous cooperation covers a wide range of activities including the construction of infrastructure, assistance for women entrepreneurs, promotion of coffee production, etc. Central American countries have been receiving a substantial amount of such non-reimbursable economic cooperation from Taiwan.

It is well known and appreciated in Costa Rica that Taiwan financed an important bridge spanning the Tempisque River in the province of Guanacaste, "Taiwan Friendship Bridge," (Figure 2) completed mainly by a Taiwanese company and Costa Rican workers and engineers in 2003. This bridge is quite useful in facilitating traffic to and from the capital San José.⁴ Taiwan also constructed or financed many government buildings in Nicaragua and El Salvador.

Figure 2 Taiwan Friendship Bridge, Río Tempisque, Costa Rica



Source: "Puente del Tempisque resiste pese a una década sin cuidados," *La Nación*, el 15 de marzo de 2013.

http://www.nacion.com/nacional/comunidades/Puente-Tempisque-resiste-decada-cuidados_0_1329467053.html

Taiwan's role in the region goes beyond financing. Taiwan is a permanent observer within the Central American Parliament located in Guatemala. It is also an extra-regional observer within the SICA (Central American Integration System) located in El Salvador.

Central American countries appreciate Taiwan's active assistance toward Central America's integration and related cooperation efforts. For Costa Rica and Panama, that are relatively more advanced economically in the region, the importance of such cooperation has declined. This can explain why the two countries

⁴ Guanacaste has a number of popular beaches frequented by local and international tourists.

decided to switch diplomatic recognition and also why it is not easy for the other Central America countries to break diplomatic ties with generous Taiwan. Although Costa Rica and Panama followed the path taken by many other countries, it is unlikely that the countries in Central America that have diplomatic relationship with Taiwan would prefer to switch diplomatic recognition in the immediate future.

4 Costa Rica after the switch of diplomatic recognition

Since the switch of diplomatic recognition in 2007, Costa Rica's export to China has declined, while Costa Rica's import from China has increased steadily, expanding Costa Rica's bilateral trade deficit.⁵ Costa Rica had succeeded in diversifying its exports from such traditional commodities as coffee, bananas, beef, and sugar to include electronics, medical equipment, and business services.⁶ The decreasing trend of Costa Rica's export to China was partly explained by INTEL's decision to terminate production in Costa Rica in 2014, 17 years after the entry. China has become the second most important import origin for Costa Rica only behind the US. The imports from China mainly consist of manufactured products such as electronics, textiles, and motorcycles, that still maintain price competitiveness. The import of cement from China has increased since 2015.⁷

On the other hand, Costa Rica's export to and import from Taiwan have been less affected by the switch of recognition, although the amount of trade with Taiwan is significantly smaller than that with China. That said, Costa Rica's bilateral trade deficit with Taiwan has been increasing lately.

Foreign direct investment (FDI) from China to Costa Rica has mostly increased since 2007, yet very little investment was recorded in 2015 and 2016, possibly reflecting China's economic slowdown.⁸ China's proposed infrastructure investment in oil refinery and roads has not materialized. The amount of Taiwan's investment to Costa Rica has been insignificant. The effect of Costa Rica's switch of recognition is not seen.

The number of tourists arriving from China has been increasing notably since 2007, while that from Taiwan has been declining, according to the Costa Rica Tourism Board (ICT). The income generated from tourists from each follows a similar trend. The switch of recognition has a positive effect on the tourism

⁵ Trade data are from the Foreign Trade Corporation of Costa Rica (PROCOMER).

⁶ See Trejos (2009).

⁷ "Importación de cemento creció nueve veces en dos años," *El Financiero*, 12-18 de agosto del 2017.

⁸ FDI data are from the Central Bank of Costa Rica.

revenue. The same pattern may be observed in Panama from now on.

Costa Rica's anticipated gains from trade with and investment from China have not materialized yet, while its benefit is seen in tourism. It is necessary to step up Costa Rica's prominent exports to China, including agricultural products. Since China is a huge market, the capacity to export in large quantity is a challenge for Costa Rica. The export of medical devices, that have been attracting FDI into Costa Rica, could increase going forward.⁹ Another challenge for Costa Rican exporters is the high initial cost of starting business with China, caused by the distance, language, etc. Overcoming this can be beneficial in the long run.

While the modern National Stadium, constructed fast by Chinese, is a symbol of positive image of China, Costa Ricans tend to feel that the switch of recognition has led to much stronger Chinese influences in the country. Chinese tourists have been increasing in number, so have Chinese small businesses such as retails and restaurants even in rural areas. The increasing presence of China in Central America reflects the diminishing roles played by the US in the region, although the US remains the most important trading partner for Costa Rica, facilitated by the Dominican Republic-Central America FTA (CAFTA-DR) that took effect for Costa Rica and the US in January 2009.

5 China in Latin America

In the 2000s, China began to import South American commodities such as minerals, soy, and oil. By 2016, China became the most important export destination for South America and the second most important for Latin America and the Caribbean.¹⁰ It was natural that the PRC was granted entry into the Inter-American Development Bank as a non-regional member country in 2008.

At the same time, Latin America is an attractive market for China, that often runs bilateral trade surpluses. According to ECLAC (2015), only Chile (US\$4.2 billion), Brazil (US\$3.3 billion), and Venezuela (US\$2.2 billion) recorded a trade surplus with China among Latin America and the Caribbean in 2014. Mexico (US\$60.3 billion), Colombia (US\$6.2 billion), and Argentina (US\$6.1 billion) had the largest bilateral trade deficit in 2014, even though they can export raw materials to China. This pattern explains huge gains from trade for China through its manufacturing exports. In addition to Mexico, China often runs trade surpluses

⁹ Murakami and Hernández (2016) point out that in Costa Rica FDI destination sectors such as medical equipment tend to be highly export-oriented.

¹⁰ See Lima and Pellandra (2017) and Zhao (2017).

with Central America and the Caribbean. Costa Rica ran a bilateral trade deficit of US\$ 1.4 billion with China in 2014.

China's investment in Latin America has become significant since 2010. This reflects infrastructure projects including oil pipelines and refineries, transport, hydro-electronic power, etc. China's FDI in Latin America has lately become diverse, expanding from energy and raw materials to manufacturing, utilities, and real estate. China's investment in Central America, which is not so rich in natural resources as South America, may increase as the focus shifts away from energy and raw materials.

6 Does it really matter?

Even without a diplomatic relationship with Taiwan, countries can have an active exchange in trade, commerce, and investment, as seen from the cases of Japan and the US notably. Citizens of Japan and the US have no problem in finding ways to do business, visit, work and live with visas in Taiwan. Taiwan's government is looking for ways to build stronger, although unofficial, ties with friendly countries.¹¹

As is often the case with such a large country as China, a simplistic view may not explain the reality. Taiwan has invested a lot in mainland China, so it is important for China from a viewpoint of economy and development. This gives China an incentive to seek a balance in its geopolitical strategy toward Taiwan.

Taiwan with its population of 23.4 million is unique in that it is the largest entity outside the UN. There are no practical problems for countries not recognizing Taiwan officially to do business with Taiwan. Likewise, the formal recognition may not be so important for China to trade with and invest in Central America without working out a bilateral FTA. If such practices change in the future, then the diplomatic recognition issue will become more important not only geopolitically but also economically.

References

- "China persuades Panama to break diplomatic ties with Taiwan," *The Economist*, June 17-23 2017, P24.
- Economic Commission for Latin America and the Caribbean (ECLAC) (2015), *Latin America and the Caribbean and China: Towards a new era in economic cooperation*, Santiago, Chile.
- "Importación de cemento creció nueve veces en dos años," *El Financiero*, 12-18 de agosto del 2017.

¹¹ "China persuades Panama to break diplomatic ties with Taiwan," *The Economist*, June 17-23 2017, P24.

- Lima, José Durán and Andrea Pellandra (2017), “La irrupción de China y su impacto sobre la estructura productiva y comercial en América Latina y el Caribe,” CEPAL – Serie Comercio Internacional N0 131, February 2017, Santiago, Chile.
- McCawley, Peter (2017), *Banking on the Future of Asia and the Pacific: 50 Years of the Asian Development Bank*, Asian Development Bank, Manila, Philippines.
- Murakami, Yoshimichi and René A. Hernández (2016), “Revealing the spillover effects of foreign direct investment on offshore services in Costa Rica,” in René A. Hernández, Alfredo Hualde, Nanno Mulder, and Pierre Sauvé, eds, *Innovation and internationalization of Latin American services*, ECLAC, Santiago, Chile.
- Trejos, Alberto (2009), “Country Role Models for Development Success: The Case of Costa Rica,” *Research Paper* No. 2009/54, United Nations University-World Institute for Development Economics Research, November 2009, Helsinki, Finland.
- Zhao, Yanan (2017), “Can Latin America’s Engagement with China Deepen?” <https://blogs.iadb.org/ideasmatter/2017/08/23/can-latin-americas-engagement-china-deepen/>