The Final Frontier: China, Taiwan, and the United States in Strategic Competition for Central America

Robert A. Portada III¹ · Steve B. Lem¹ · Uttam Paudel¹

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Abstract

China's rise as a global power corresponded with a diminution of Taiwanese diplomacy, which has left Central America as the last region to host a continuous bloc of countries that recognize the ROC. In this article, we argue that China's success in gaining diplomatic recognition from Taiwan's former allies has largely resulted from China's economic policy, specifically its promises of large-scale infrastructure projects and the integration of Central American economies with Chinese markets. However, there are limits to how far China has advanced in gaining full recognition from the region. The competing political and economic interests of China, Taiwan, the United States, and the Central American countries themselves, continue to influence patterns of diplomatic switching. More specifically, we argue that the threat of punitive measures from the United States combined with a turn in Taiwanese diplomacy toward assistance efforts to combat Covid-19 may deter future switching in the short to medium-term. Our analysis offers case studies of four Central American countries (Costa Rica, Panama, El Salvador and Nicaragua) to illustrate the multi-year processes by which China's economic strategy leads to diplomatic switching and examine the paths ahead for the remaining holdouts facing the prospect of economic and political penalties by the United States.

Keywords Taiwanese recognition · Dollar diplomacy · Chinese investments in Central America

✉ Steve B. Lem
lem@kutztown.edu

Robert A. Portada, III
portada@kutztown.edu

Uttam Paudel
upaud761@live.kutztown.edu

¹ Department of Political Science & Public Administration, Kutztown University of Pennsylvania, 15200 Kutztown Road, Kutztown, PA 19530, USA

Introduction

The defining shift in the global balance of power in the twenty-first century is the rise of China as a peer competitor to the United States. As China grows closer to superpower status, many scholars (and Chinese leaders themselves) acknowledge that China's ultimate foreign policy goal, and the primary sign that it will have achieved the status it covets, is the reclamation of sovereignty over Taiwan. [1–4] After Kiribati and the Solomon Islands both broke diplomatic relations with Taiwan and recognized China in September 2019, Taiwan is now recognized by only 15 states, mostly countries in Central America and the micro-states in the Pacific and the Caribbean.¹

A central component of China's strategy to reclaim sovereignty over Taiwan has been to forge economic relationships with the countries that still recognize the Republic of China (ROC) to incentivize them to switch diplomatic recognition to the People's Republic of China (PRC).² Indeed, several authors have examined the diminution of Taiwanese diplomacy in the context of China's rise, while many others have documented the evolution of China's infrastructure investment strategy across the global south [2, 5–9].

In this study, we ask two fundamental questions. First, what components of China's economic strategy influence Central American countries to switch diplomatic recognition from Taiwan to China? China's efforts to gain diplomatic recognition from Taiwan's remaining allies in Central America is rooted in incentives related to large-scale infrastructure projects and expectations of trade benefits derived from access to Chinese markets. Chinese trade and investment overshadow corresponding economic initiatives from Taiwan, though they do not match levels of overall trade and aid Central American countries maintain with the United States.

Second, and perhaps more puzzling, why do several Central American countries remain allies of Taiwan, despite the promise of lucrative rewards for switching recognition to China? The answer to this question is much more complex. We argue that the competing political and economic interests of China, Taiwan, the United States, and the Central American countries themselves, continue to influence patterns of diplomatic switching. Changeover in administrations bring different ideologies and policy objectives to the highest political offices in Taiwan, the United States, and across Central America, which can keep countries allied to Taipei. For example, there were no instances of switching during the period of "détente" between China and Taiwan, when the Kuomintang under Ma Ying-jeou held the presidency of Taiwan from 2008 to 2016.

Détente during these years also meant that the Obama administration did not have to formulate a policy to prevent diplomatic switching. However, instances of switching resumed shortly after the election of the Democratic Progressive Party leader Tsai Ing-wen as Taiwan's president in 2016, placing the issue squarely on the table for the then newly-inaugurated Trump administration. In response to Panama and El Salvador's recognition of the PRC in 2017 and 2018 respectively, the Trump administration has

¹ As of December 2019, Taiwan is recognized by Belize, Eswatini, Guatemala, Haiti, Honduras, the Marshall Islands, Nauru, Nicaragua, Palau, Paraguay, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Tuvalu, and the Vatican.

² We use the Republic of China (ROC) and People's Republic of China (PRC) interchangeably with Taiwan and China, respectively.

shifted toward greater emphasis on imposing economic and political penalties in an effort to punish and deter future switching.

The nature of the different economic interests of China, the United States, and Taiwan in Central America are such that Taiwan and the United States do not envision and have not coordinated a comprehensive investment strategy to compete with China. Critically, the United States, while offering copious amounts of foreign aid, does not compete with China in infrastructure investment, choosing instead to focus on manufacturing capacities, service, and finance. Taiwan, in turn, has been forced to attempt to compete with China in the development sphere, though Taiwan cannot match China in the scale of its infrastructure projects, nor can Taiwan offer access to markets as large as China's. But the Covid-19 pandemic has offered rare opportunities for Taiwan to demonstrate its efficiency and reliability as a provider of equipment and cooperation around disease prevention. Simultaneously, the Trump administration in 2020 signed legislation threatening punitive measures against countries that switch recognition from Taipei to Beijing. These conditions make it such that the spectrum of efforts on the part of China, the United States, and Taiwan to influence Central American diplomacy may not be entirely conducive to Chinese interests, despite its run of recent successes.

Competition for Taiwanese Recognition in Central America

Since it was ousted from the UN in 1971, the ROC has had mixed success maintaining formal diplomatic recognition. However, it has been remarkably robust in Central America, where Cold War politics kept military dictatorships in Taiwan and across Central America in mutual embrace (see Table 1). The proximity of these largely agrarian economies to the United States created conditions of dependency on US trade and foreign aid across the twentieth Century, and the civil wars of the 1980s further increased the impoverishment of Central America countries and their vulnerability to the neoliberal policies of the Washington Consensus. By funneling trade and aid fueled

Table 1 Diplomatic Recognition of Taiwan in Central America, 1972–2019

Country	Recognition of Taiwan
Belize	1990–Present
Costa Rica	1950–2007
El Salvador	1961–2018
Guatemala	1955–Present
Honduras	1965–Present
Mexico	*
Nicaragua	1955–1985, 1992–Present
Panama	1954–2017

Dates reflect first full year of recognition as coded by Rich (2009) [11]

*country did not formally recognize Taiwan during the time period

by its economic growth, the ROC maintained a strategy of “dollar diplomacy” with its Central American allies well into the twenty-first century.[10]

Much of the pre-2000s scholarship corroborates observations that Taiwan’s “hand-some foreign aid programs” could “buy” or “rent” diplomatic ties with small and developing countries indefinitely. [12–14] In Central America, aside from funneling cash into anonymous bank accounts to purchase the goodwill of various political leaders, Taiwan actively groomed the elites by identifying high-potential bureaucrats and military officers and developed ties with them for long term sympathies.³ For instance, Guatemalan President Alfonso Portillo admitted in United States Federal Court in 2014 that he had received \$2.5 million in bribes from Taiwan between 1999 and 2002 in exchange for continuing diplomatic recognition.[15] Frequent high-level official exchange visits were similarly used to strengthen bilateral ties. Still, Taiwan garnered a degree of public sympathy as a trusted ally, thanks to its active involvement in disaster relief efforts and community-based disaster prevention initiatives. Taiwan also enjoyed a reputation as a “listening donor” that was attentive to the needs of the community and cultivated an image as an “enviable model for rapid economic, technological and industrial development.”[16]

China’s Push for Recognition

Maintaining allies through dollar diplomacy, however, proved increasingly difficult for Taiwan. In the last decades of the twentieth century, China transformed itself from a developing power to a regional hegemon with global ambitions. One of the more pronounced manifestations of this ascent was the rise in Chinese financial commitments around the world. Chinese financial undertakings differ substantially from the similar undertakings of its OECD partners in the global south.[17, 18] While traditional financial contributions from the West typically favor humanitarian efforts and development aid defined by the UN’s Sustainable Development Goals, foreign aid from China is centered on the promotion of South-South cooperation and mutual respect for sovereignty.[19, 20] Scholarly discussions of Chinese foreign investments often revolve around China’s infrastructure projects across the global south,[21, 22].⁴ no political strings attached aid arrangements^{5,6,7} and its pursuit of bilateral trade deals. [23–26]

Across regions like Latin America and Africa, Chinese-funded infrastructure projects are designed as “win-win” bilateral deals meant to contribute to the development and modernization of the host country,[27] create a positive public perception of China amongst local populations,⁸ and facilitate Chinese access to raw materials[28, 29].⁹ These projects are often funded by Chinese state agencies, investment banks, or private

³ Erikson and Chen, China, Taiwan, and the Battle for Latin America, 73–4.

⁴ Wise, The Americas.

⁵ Bader, *China*, Autocratic Patron? An Empirical Investigation of China as a Factor in Autocratic Survival.

⁶ Dreher and Fuchs, Rogue aid? An empirical analysis of China’s aid allocation.

⁷ Broich, Do authoritarian regimes receive more Chinese development finance than democratic ones? Empirical evidence for Africa.

⁸ Will, China’s Stadium Diplomacy.

⁹ Stallings, Chinese Foreign Aid to Latin America: Winning Friends and Influencing People?

companies, handled by Chinese contractors (e.g., construction companies), and have an expressed purpose of furthering bilateral trade.

Furthermore, Chinese investment comes without the political requirements attached to the contributions of their peer donors. For example, Chin (2012) discusses how, in 2004, China gave a \$2 billion-dollar loan to Angola with no political stipulations after persuading Angola to refuse the same amount of aid by the World Bank.[30] Chinese foreign finance is unique not only in its emphasis on mutual benefits but also in the way it is structured. Instead of a single agency that manages trade and aid, China has a repertoire of policy and commercial banks, functional ministries, provincial governments and state-owned enterprises.^{10,11} In addition, Strange et al. (2017) discuss how the Chinese government does not release comprehensive information about its financial commitments for “a variety of domestic political and administrative reasons,” in part informed by disinterest in complying with Western (OECD-DAC) standards.¹² Stallings (2017) further notes that China considers foreign aid to be a state secret.¹³

Nevertheless, Chinese foreign aid in Latin America is best seen as an accompaniment to China’s larger economic goals of gaining access to raw materials, as well as one specific political goal: advancing the “One-China” policy among Taiwan’s remaining allies in the Western Hemisphere.¹⁴ China does not provide direct foreign aid to countries that recognize the ROC, so that China has embedded a carrot and stick approach to its policy on foreign aid by winning over friends with gifts and withholding aid to countries that recognize Taipei.¹⁵ However, despite Chinese interest in resource extraction writ large in Latin America, the countries of Central America are not endowed with the kind of energy and agricultural resources (e.g. petroleum, soybeans) that China covets. As such, China’s interest in Central America is even more squarely concentrated on the political goal of gaining diplomatic recognition.[31, 32]

Taiwan has simply been unable to match China’s economic strategy. Whereas the Taiwanese economy grew relative to China’s through most of the 1980s, its growth started to stall by the end of that decade. This, in turn, has enabled China to utilize its economic clout to lure countries’ diplomatic allegiances. Uruguay’s switch from the ROC to the PRC is an early example of this phenomenon. From 1983 to 1986, China doubled its trade volumes from 22 to 56 million USD. The following year, China purchased \$46 million in Uruguay’s wool – more than seven times of Taiwan’s.[33] This trend continued through the 1990s and 2000s, culminating in Taipei giving up trying to match or outspend Beijing after nine countries switched allegiances between 2000 and 2008.[34].¹⁶ In 2008, the Kuomintang under Ma Ying-jeou won Taiwan’s presidential election and negotiated a policy of détente with China, with both countries agreeing not to poach each other’s allies, while building greater economic interdependence and integration.[35]

¹⁰ Zhang and Smith, China’s foreign aid system: structure, agencies, and identities.

¹¹ Hameiri and Jones, China challenges global governance? Chinese international development finance and the AIIB.

¹² Strange et al., Tracking Underreported Financial Flows: China’s Development Finance and the Aid–Conflict Nexus Revisited, 938

¹³ Stallings, Chinese Foreign Aid to Latin America: Winning Friends and Influencing People?, 69.

¹⁴ Stallings, Chinese Foreign Aid to Latin America: Winning Friends and Influencing People?, 70.

¹⁵ Stallings, Chinese Foreign Aid to Latin America: Winning Friends and Influencing People?, 78.

¹⁶ Harold, Morris, and Ma, *Countering China’s Efforts to Isolate Taiwan Diplomatically in Latin America and the Caribbean: The Role of Development Assistance and Disaster Relief*.

According to Peralta (2010), Taiwan's cooperation programs do not compare with those of large donors like the European Union or the United States, but they are "comparatively 'soft' when it comes to their conditions."^[36] Taiwan's bilateral cooperation is focused on technical support (e.g. on areas like farming) and substantial financial support in the form of donations and credits with soft conditions, related to infrastructure, development, and natural disaster relief. Détente, however, lulled Taiwan into a period of relative inactivity and constrained its international maneuvers whilst China continued to accelerate its financial commitments to potential switchers. The policy of détente ended when the Democratic Progressive Party leader Tsai Ing-wen assumed the Taiwanese presidency in May 2016. After President Trump took a congratulatory phone call from Tsai Ing-wen upon his election later in 2016, Beijing resumed its coordination of diplomatic switches, encroaching on the final frontier of Taiwan's "international living space."¹⁷

As noted by several scholars,^{18,19} Central American countries that maintain relationships with Taiwan do so at the cost of developing stronger links with China's increasingly powerful market. Peralta (2010) notes that by 2006, Central American exports to China were five times as much as to Taiwan, and Central America collectively imported four times as much from China as from Taiwan.²⁰ However, though Taiwan's importance as a trading partner pales in comparison to China, many of Taipei's Central American allies continue to remain loyal to the ROC.

A Counterbalance to China?: The Role of the United States

Several recent studies focus on the crucial role that Taiwan plays in the formulation of Chinese foreign policy.^{21,22} [37] Additional scholarship has further examined the increased Chinese presence in Latin America and the Caribbean.^{[38].^{23,24,25}}

However, a puzzling question remains largely unaddressed in existing scholarship: given China's international and economic influence, why do holdouts remain that continue to recognize Taiwan and have not yet switched to the PRC? If China can easily "buy" loyalty by delivering on infrastructure development and opening its markets, there must be an additional force at work preventing holdout countries from declaring their commitment to Beijing. We posit that the United States' economic and political policies designed to combat China's strategy in the region should also be considered, especially given that the scholarship on the China-Taiwan relationship often ignores or underestimates the issue of Taiwanese diplomatic recognition in the China-United States relationship. [39-41]

¹⁷ The term "international living space" refers to the countries that still maintain official diplomatic relations with Taiwan (Harold, Morris and Ma 2019, 2).

¹⁸ Peralta, *Central America between Two Dragons*.

¹⁹ Stallings, *Chinese Foreign Aid to Latin America: Winning Friends and Influencing People?*, 69.

²⁰ Peralta, *Central America between Two Dragons*, 174.

²¹ Erikson and Chen, *China, Taiwan, and the Battle for Latin America*.

²² Harold, Morris, and Ma, *Countering China's Efforts to Isolate Taiwan Diplomatically in Latin America and the Caribbean: The Role of Development Assistance and Disaster Relief*.

²³ Peralta, *Central America between Two Dragons*.

²⁴ Koleski and Blivas, *China's Engagement with Latin America and the Caribbean*.

²⁵ Wise, *The Americas*.

Despite changing its official diplomatic recognition from Taipei to Beijing in 1979, the United States simultaneously established strong unofficial relations with Taiwan. Through the Taiwan Relations Act, the United States explicitly committed itself to preserve and promote “commercial, cultural, and other relations” between the two countries, as well as provide military aid to enable Taiwan to maintain “sufficient self-defense capabilities.”²⁶ The commitment to provide arms to Taiwan has remained consistent across multiple presidential administrations, and the Taiwan Relations Act is repeatedly invoked to support sales of military hardware. For example, in August 2019, the Trump administration agreed to send 66 new Block 70 combat aircraft in a package totaling \$8 billion, the fourth and largest package of arms sales to Taiwan since Trump was elected president. The Obama administration had previously approved arms sales packages totaling \$14 billion, and the Bush administration pushed sales totaling \$15 billion.^[42]

Concurrently, the United States continued to support diplomatic recognition of Taiwan in the Central America, the Caribbean, and the Asia Pacific. However, the economic tools the United States has employed to prevent diplomatic switching to the PRC have been less comprehensive and less consistent than its military packages to Taiwan. For example, during the Bush administration, as Dominica, Grenada, and Costa Rica switched diplomatic recognition to the PRC, the United States negotiated and signed CAFTA-DR, a free trade agreement that sought to further cement the United States as the economic lynchpin of participating members, including Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic. However, CAFTA-DR itself had little effect on China’s advancement in the region. Costa Rica switched recognition to the PRC during the Bush administration and faced no penalties, as CAFTA-DR protected Costa Rica’s trade status with the American economy. The Dominican Republic and El Salvador later switched recognition to China as well.

Chinese economic relations with Central American countries are limited by a lack of Chinese demand for Central American products. As discussed in Avendaño and Dayton-Johnson (2017), Central American countries have not benefitted from booming Chinese demand for raw materials; in fact, cheap Chinese manufactured goods have created competition for the Central American manufacturing sector and “low-sophistication” goods that dominate the region.²⁷ Central American countries have thus remained dependent on the US market for export. The signing of CAFTA-DR served to further codify and streamline existing patterns and relationships, not transform them.

Wise (2020) documents the division of labor that has taken shape from American and Chinese involvement in Central America and the broader region. Chinese economic participation is focused on raw materials, and their extraction and transport, capturing a combined 80% of Chinese FDI in 2017.²⁸ United States participation is focused on manufacturing and services – only 10% of US FDI went to raw materials in the same year.²⁹ This segmentation of the USA-China-Latin America triangle makes American trade policy significant for Central American countries as their dominant trading partner, but not as an economic challenge to Chinese interests. Still, the paucity of

²⁶ Taiwan Relations Act (Public Law 96–8, 22 U.S.C. 3301).

²⁷ Avendaño, and Dayton-Johnson, *Central America, China and the US: What prospects for development?*, 212.

²⁸ Wise, *The Americas*, 291.

²⁹ Wise, *The Americas*, 291.

raw materials coveted by China in Central America means that Chinese efforts are almost exclusively politically-motivated in Central America. Central America is in the unique role of offering very little tangible economic gain for China, yet substantial political gains, as China moves closer to universal recognition of the One-China policy.

Until the Trump administration, the United States had not taken direct actions specifically to prevent or punish diplomatic switching. But in response to diplomatic switching of Panama in 2017, and of the Dominican Republic and El Salvador in 2018, the United States pulled its top diplomats to those countries and Secretary of State Mike Pompeo repeatedly warned Central American countries about the consequences of abandoning Taiwan. However, pulling diplomats did not prevent this succession of switches. Then in March 2020, President Trump signed the TAIPEI Act (Taiwan Allies International Protection and Enhancement Initiative) aimed at defending Taiwan's few remaining allies from Beijing's advances by threatening punitive measures for diplomatic switching. Section 5(a.3) of the TAIPEI Act allows the United States to consider "altering its economic, security, and diplomatic engagement with nations that take serious or significant actions to undermine the security or prosperity of Taiwan."

With the TAIPEI Act, the Trump administration has signaled a shift in United States policy toward economic and political penalties to punish and deter future switching. The Trump administration's general policy position against free trade imperils existing trade relationships with the remaining holdouts in Central America, together with threats to cancel foreign aid. This posture has placed new pressures on countries considering their response to Chinese advances on diplomatic switching.

A resurgence in Taiwan's international positioning following the outbreak of the Covid-19 pandemic combined with nationalist posturing in a United States has put a bright spotlight on the issue of diplomatic switching, in an age that threatens a return to Cold War global dynamics. As argued below, this unique set of circumstances may well delay further switching, with a great deal of weight depending on the political and economic outcome for any country that attempts the first switch. The mixed record of economic performance for those countries that have switched in recent years may provide further warning signs for the remaining holdouts.

An Analysis of Central America

The intersection of Chinese, Taiwanese, American, and national politics play out differently across Central America, but some general patterns are evident. Figure 1 shows total trade levels between the United States, China, Taiwan and Central America from 1999 to 2019. As discussed above, Central American access to Chinese markets has greatly increased over the past twenty years, but trade with Taiwan has simply not been able to match this level of growth. Still, despite China's inroads into the Central American economy, trade with the PRC is still dwarfed by the value of the American market where trade volumes are four to five times larger.

Systematic analysis of aid data in the region is more difficult. Taiwan stopped reporting the amount of aid it provides individual countries in 2011 and does not provide assistance to countries that recognize the PRC. Likewise,

Fig. 1 **Note:** Data are from International Monetary Fund Direction of Trade Statistics. The figure includes the Central American countries listed in Table 1 that recognized Taiwan during the study window.

China does not disclose its aid data, which is often veiled behind state-owned banks and businesses. Therefore, to provide a rough snapshot of aid to Central America, we rely on the College of William & Mary's AidData project, which systematically reports Taiwanese aid data from 1991 to 2011 and Chinese aid data from 2000 to 2014. Their project collects Taiwanese aid data from Taiwan's International Development and Cooperation Fund (IDCF). Chinese aid data are meticulously collected from publicly available sources including government documents and news sources, although the project likely under-reports Chinese disbursements due to the PRC's secretive nature when it comes to foreign assistance. United States aid data are readily available from the USAid website.

The sketch from the aid data in Fig. 2 portrays a similar picture as trade. China has made significant inroads into Central America via its aid packages compared to Taiwan, but its efforts still trail behind the United States. If Washington were to sanction Central American countries for switching diplomatic recognition to the PRC, the economic costs through market access and aid could be quite high.

In the rest of this section, we analyze how the political and economic dynamics behind diplomatic switching in four Central American countries: Costa Rica, Panama, El Salvador, and Nicaragua. These case studies analyze Chinese engagements with Central American countries, focusing on infrastructure projects, with special attention to the responses of Taiwan and the United States amidst these switches. Comparative analysis of these cases allows for speculation as to what may take place in the prospective case of Nicaragua and other holdouts in the region.

Fig. 2 **Note:** US data reflect non-military and non-administrative aid from USAID Foreign Aid Explorer. Data. For Taiwan and China are from William & Mary's AidData project. The figure includes the Central American countries listed in Table 1 that recognized Taiwan during the study window.

The Centerpiece: Costa Rica

Action on Taiwan under the Bush administration was devoted exclusively to procuring arms deals with Taiwan rather than challenging Beijing in the diplomatic realm. The United States did not directly oppose diplomatic switches when they occurred, though Central American countries had been the targets of the Bush administration's own efforts to promote free trade through CAFTA-DR. The Bush administration placed its hopes on CAFTA-DR to enable the region to survive "the China boom with a viable manufacturing sector."^[43] However, CAFTA-DR carried no deterrent against countries signing their own free trade deals with China, nor were there any diplomatic penalties imposed on them.

A blossoming relationship between the China and Costa Rica developed in the early 2000s as Chinese businesses courted the Costa Rican agricultural sector, in particular the coffee and beef industries. In 2007, China chose Costa Rica as the first Central American country to organize a switch in recognition.^[44] In June of that year, Costa Rican President Oscar Arias broke his country's six-decade long friendship with Taiwan with the announcement that Costa Rica would establish diplomatic relations with China. President Arias defended the step as an act of "elemental realism, an awakening to the global context we are forced to deal with."^[45–47]

It would later emerge from a secret June 2007 memo, released following the orders from the Constitutional Chamber of the Supreme Court (Sala IV), that China promised to donate \$130 million in aid and buy \$300 million in state bonds in exchange for

diplomatic recognition. Responding to journalists, the finance minister Guillermo Zúñiga reported that China had bought half of the promised bonds in January.[48, 49] Still, these revelations did not result in a public outcry or pose a threat to Sino-Tico relations. On the contrary, the relationship continued to improve. Costa Rican exports to China rose to \$848.2 million in 2007, a 52% increase from the 2006 figure of \$558.3 million.

Despite the global financial crisis of 2008, Chinese trade and investment in Costa Rica showed no signs of decline. Indeed, microprocessors manufactured in Costa Rica would enter the Chinese and American markets and become an export unique in Central America.³⁰ With the increase in bilateral trade, negotiations for a free trade agreement began in earnest in early 2009, with both parties eager to sign a deal that would bring more than just economic benefits. Costa Rica won Chinese support for a non-permanent member seat on the United Nations Security Council.[50, 51] The relationship with China continued to flourish thanks to numerous projects such as the \$395 million highway that links San José to the Caribbean port of Limón, a \$100 million stadium, a \$83 million technology park, and \$1 million to Chinatown in San José.[52, 53] In August of 2011, following two years of negotiations, the countries finally reached a free trade agreement that was announced with great fanfare.

The 2013 visit by Chinese President Xi Jinping to Costa Rica marked the culmination of the Sino-Tico friendship. During his stay, President Xi signed 13 bilateral agreements worth about \$2 billion, including a \$1.5 billion upgrade of an oil refinery, opening up credit for 50,000 solar panels to enhance the public transport system, \$25 million for a police academy, and a delivery of 8400 computers to public school students. After meeting with his Costa Rican counterpart President Laura Chinchilla, President Xi commented that the friendship between their countries “could well become a model of cooperation between countries of different sizes and national conditions.”[54, 55]

Nevertheless, for the first five years of the free trade agreement from 2011 to 16, Costa Rican exports to China declined at an average rate of −16% whereas its imports from China increased at an annual average of 14%. While the free trade agreement has allowed over 90% of all Costa Rican exports to enter the Chinese market without tariff, it has also facilitated a massive influx of Chinese manufactured goods.³¹ It is, however, misleading to attribute all of this to aggressive Chinese business practices that flood countries with cheap finished products. As Alexander Mora, the Costa Rican Trade Minister responded in January 2015, Costa Rica’s inability to take advantage of the Chinese market is complicated by a range of factors “including distance, inexperience with the country and its business norms, and rigorous regulations.”[56]

Likewise, Chinese infrastructure projects in the country have attracted both praise and criticism. DeHart (2018) details how the initial enthusiasm that surrounded three high profile Chinese projects—the National Stadium, the Moin Refinery, and the Highway Expansion of Route 32—have been marred with controversies regarding the top down, *quid pro quo* practices that shun local partnership. Aside from allegations of corruption, these projects have raised questions of national sovereignty, with the

³⁰ Avendaño, and Dayton-Johnson, *Central America, China and the US: What prospects for development?*, 189.

³¹ DeHart, *China-Costa Rica Infrastructure Projects: Laying the Groundwork for Development?*, 8.

locals alluding the project to a “Trojan Horse.”³² Costa Rica, as the first target of diplomatic switching in Central America, offers an extended record of the lessons of diplomatic switching, with a mixed record on economic outcomes as well as the political and popular challenges toward infrastructure projects.

The Gateway: Panama

Prior to switching diplomatic recognition to the PRC, Panama boasted the friendliest relations with Taiwan, even co-sponsoring Taiwan’s bid in the fall of 2001 to join the United Nations.^[57] Panama carries enormous strategic and economic significance as two-thirds of ships to or from the United States pass through the Panama Canal.^[58] For China, friendship with Panama establishes a Chinese presence closer to its rival’s sensitive chokepoint.

In the 1990s and early 2000s, Panama was richly rewarded by Taiwan. Between 1997 and 2002 alone, Taiwan invested \$450 million in development projects in Panama.³³ In 2002, Taiwan flew in 1000 prospective businesspeople at the government’s expense and offered to teach them Spanish. Taiwanese businesses such as the Evergreen Group, whose investments included a \$100 million Atlantic port terminal, had a formidable presence in Panama and poured large sums into their ventures.³⁴

Following the acquisition of Hong Kong in 1997, China approached Panama with deals aimed at fostering cooperation between Panama and Hong Kong, which was then the most important port in China.^[59] Still, compared to the \$450 million of Taiwanese investment from 1997 to 2002, Chinese investments amounted to just \$200 million in this period. However, the growing importance of the Chinese economy was becoming increasingly evident; during the same period, Panama’s annual imports and exports to China grew by an average of 59% and 281% compared to –2% and 77% for Taiwan. Despite these burgeoning economic ties, Chinese officials were hesitant to accept Panama’s overtures of switching diplomatic relations. In fact, a cable published on Wikileaks in 2011 revealed that China rejected then-President Ricardo Martinelli’s 2009 offer of diplomatic recognition in order not to undermine China’s improving ties with Taiwan.^[60]

May 2016 brought two major changes that would ultimately lead to Panama’s abandonment of Taipei in favor of Beijing. The election of Tsai Ing-wen as the President of Taiwan signaled the end of détente with China. Despite a visit to Panama President Tsai praised the “stable friendship that characterize[d] the Taiwan-Panama relationship,”^[61] a much bigger and more financially lucrative deal between Panama and China was already underway.

After more than a decade of planning and development, the Panama Canal expansion project was scheduled to begin commercial operations in June 2016 and bring larger ships between the Atlantic and Pacific. Prior to its opening, the Landbridge Group, a Chinese state-owned company, signed a \$900 million deal for control of Margarita Island Port, the largest port in Panama. In return for their investments, China gained access to a geopolitically important trade hub in the Western hemisphere.

³² DeHart, *China-Costa Rica Infrastructure Projects: Laying the Groundwork for Development?*, 9.

³³ Hua, *China, Taiwan wage economic, political battle in Panama /China, Taiwan wage economic battle.*

³⁴ Hua, *China, Taiwan wage economic, political battle in Panama /China, Taiwan wage economic battle.*

Unsurprisingly, Panama cut ties with Taiwan a year later. Panama became the first Latin American country to participate in the Belt and Road Initiative (BRI) and accepted a \$500 million renminbi-denominated “Panda” bond.[62, 63]

After Panama announced its recognition of Beijing in 2017, the Panama-China relationship continued to expand. By May of 2019, Panama had signed 48 bilateral memoranda of understanding (MoU) and other agreements with China, covering free trade, infrastructure development, tourism, cultural exchange, journalist training, and judicial cooperation.³⁵ During President Xi’s state visit to the country in 2018, Panama welcomed Chinese investments and contracts for a port, convention center, and a new \$1.4 billion bridge over the canal.[64] Panama also signed 19 cooperation agreements that included an extradition agreement and an undisclosed amount of non-reimbursable aid in trade, infrastructure, and other areas.[65] Subsequently, exports from Panama, ranging from beef to copper, slowly found their way into Chinese markets.[66]

Still, bilateral relations remained delicate as Panama played a balancing act between Washington and Beijing. In November 2018, leaked reports informed the Panamanian press about the Valera government’s decision to cede a property on the Amador Causeway to China to build its embassy. Washington vehemently opposed the decision since the property overlooks the canal’s Pacific end and was a former home to United States admirals. Seeing the Chinese flag in a property that once symbolized American dominance was as disagreeable to US officials as it was for ordinary Panamanians, who did not want a foreign flag flying in the strategically important Amador causeway.³⁶ Besides, the location would have given China a prime monitoring post to track American military vessels passing through the canal.[67] Facing a public outcry and mounting pressures from the US, the Valera government cancelled the deal citing environmental reasons.³⁷

There were also disruptions in Chinese infrastructure projects.[68] Since the election of Valera’s successor, Laurentino Cortizo in May 2019, several high-profile infrastructure deals with China, including the \$4.1 billion high speed train linking Panama City with the north of the country, have been cancelled.[69] As in the case of the \$2.5 billion contract for the high-speed metro in Panama City, Chinese firms that were assured of winning all the big contracts started losing the bids to foreign firms. Likewise, the much-anticipated free trade agreement remains to be signed.³⁸

The Wakeup Call: El Salvador

In September 2018, when El Salvador broke diplomatic relations with Taiwan, the White House issued a rare statement accusing China of “apparent interference” in El Salvador and threatening to “reevaluate” US ties with El Salvador.[70] Likewise, Republican Senators Marco Rubio and Cory Gardner threatened to cut foreign aid to El Salvador.[71] Whereas the diplomatic switches of Costa Rica, Panama, and Dominican Republic were all met with tepid acknowledgements, China’s inroads into El Salvador raised alarms in Washington.

³⁵ Mendez and Alden, China in Panama: from peripheral diplomacy to grand strategy.

³⁶ Giolzetti, China’s Front Door to America’s Backyard.

³⁷ Youkee, Panama the new flashpoint in China’s growing presence in Latin America.

³⁸ Youkee, Has China’s winning streak in Panama ended?

Despite President Tsai stopping over in El Salvador, the Central American country announced its recognition of China two days later.[72, 73] While the Taiwanese foreign minister Wu cited Taiwan's refusal to fund the economically unfeasible Port of La Unión development project as the decision that triggered the switch,[74] the groundwork to diplomatic recognition had been laid steadily.

By the 2010s, El Salvador's trade with Beijing had far outpaced its trade with Taipei, and El Salvador opened its first trade office in China in 2013.[75] Animosity from the traditionally antagonistic business leaders of the conservative opposition party were addressed with promises of expanded and near monopolistic access to the Chinese markets.[76] Concerns of other sectors did not receive similar attention, as the switch was negotiated by a coterie of senior government officials without public debate, congressional approval, or disclosure of terms. Likewise, the United States was not notified of the switch until a few hours before the televised address.³⁹ It later emerged that the Salvadoran government was rewarded with \$150 million for various social projects and 3000 tons of rice for Salvadorans suffering from a devastating drought.[77].⁴⁰

Beijing also showed particular interest in remote and sparsely populated ports and islands. A few weeks prior to the diplomatic switch, a large part of the Salvadoran coastline as a Special Economic Zone (SEZ), targeted especially to Chinese investment.[78] Concerns grew in the United States that China was seeking to militarize Salvadoran ports and use them as surveillance outposts. In July 2018, US Ambassador Jean Manes warned that China could transform El Salvador's commercial shipping port, La Unión, into a "military base." [79]

On August 23, 2018, three days after El Salvador's diplomatic switch, the Chinese state-owned company Asia-Pacific Xuanhao (APX) announced its proposal to lease land around the La Unión port.[80].^{41,42} APX, a manufacturer of specialized surveillance technology, private satellite networks and commando vehicles, was also in talks to purchase the islands of Perico and Periquito.⁴³ However, the legislative assembly's vote forbidding the sale of the islands to foreign nationals was vetoed by President Cerén of the FMLN, one of only two vetoes he used since his election.⁴⁴

The intervention of Japan, however, prevented the Chinese company from getting the operating rights. The Japanese government had offered a concessional loan of \$102 million for the project, and threatened to cut the funding if the operating rights of the project went to Chinese firms.[81] Washington, with help from an ally, was able to achieve a rare reversal of fortunes.

Similarly, in the beginning, the conservative President Nayib Bukele, successor to the ex-rebel President Cerén, openly expressed skepticism regarding his country's support of China.[82] Addressing an American audience at the Heritage Foundation in March 2019, Bukele accused China of "not playing by the rules" and alluded to the use of debt traps as financial leverage.⁴⁵ Chinese Foreign Ministry spokesperson Lu

³⁹ Farah and Yates, *El Salvador's Recognition of the People's Republic of China: A Regional Context*.

⁴⁰ Gao, China-El Salvador Relationship Wobbles.

⁴¹ Farah and Yates, *El Salvador's Recognition of the People's Republic of China: A Regional Context*.

⁴² Russell, What a Controversial Deal in El Salvador Says About China's Bigger Plans.

⁴³ Quartucci, US Officials Warn El Salvador of Negotiating Ports and Island with China.

⁴⁴ Farah and Yates, *El Salvador's Recognition of the People's Republic of China: A Regional Context*.

⁴⁵ Gao, China-El Salvador Relationship Wobbles.

Kang responded that China “never threatens nor intimidates other countries,” and expressed his belief that Bukele would “independently make the right choice.”^{46,47} An investment deal was proffered that included a large sports stadium, multi-story library, water treatment plant, and tourism promotion projects.⁴⁸ Nine months later, speaking from the Great Hall of People in Beijing, Bukele lauded China’s contributions to the world and hoped for a long-lasting partnership. President Xi, in turn, praised his “strategic vision as a statesman.”^[83]

In September 2018, following El Salvador’s switch, Washington recalled its ambassadors to El Salvador, Panama, and the Dominican Republic “for consultations related to recent decisions to no longer recognize Taiwan.”^[84] While the recalls did not impact diplomatic switches that had already been made, a message was sent to the remaining holdouts: if Beijing was coming with carrots, Washington going forward would be out with sticks.

Fighting for Future Allegiances: Nicaragua

In 1985, President Daniel Ortega of the revolutionary Sandinista movement in Nicaragua switched recognition from Taipei to Beijing against the backdrop of anti-Sandinista insurgencies financed by the United States. In hindsight, Chinese offers of an interest-free \$20 million aid package with no fixed payment date, \$7 million in non-military aid, and an alleged arms deal lent support to the ideological commitments behind the decision.^[85] However, following the election of a conservative coalition led by Violeta Chamorro in 1990, Managua switched its recognition back to Taipei.^[86] Once again, this decision was driven by a combination of ideology and expected economic support from Nicaragua’s new partner.^[87]

During the early 2000s, Nicaragua benefited from its ties to Taiwan. From 2002 to 2006 Nicaraguan exports to Taiwan increased annually at an average of 180.9%, whereas import growth slowed to 5.9%. Encouraged by this beneficial imbalance of trade, Nicaraguan officials pushed for a free trade agreement with Taiwan, and inked a deal in June 2006. Through the negotiations, Taiwan continued its generous donations to both public as well as private sectors, including \$138.3 million in loans from 2000 to 2006 and \$14.3 million in aid between 2004 and 2007.^[88]

Still, the allure of Beijing’s largesse was apparent. President Ortega returned to power in the 2006 election, and criticized the previous government’s support of Taipei.⁴⁹ His regime expressed Nicaragua’s continued support of Taiwan following Costa Rica’s switch to China in 2007, but President Ortega’s interests in maintaining relations with Taipei were waning. In May 2007, at a World Health Organization vote on Taiwan’s membership, Nicaragua was mysteriously absent.⁵⁰ Furthermore, a Wikileaks cable dated June 2, 2008 revealed that, in the past two years, Beijing had repeatedly turned down Nicaragua’s offer to dump Taipei and recognize Beijing, during the détente when China was allowing “a cessation to the war between Taipei and Beijing for diplomatic recognition.”^[89]

⁴⁶ Gao, China-El Salvador Relationship Wobbles.

⁴⁷ Renteria, China Signs on for ‘Gigantic’ Investment in El Salvador Infrastructure.

⁴⁸ Renteria, China Signs on for ‘Gigantic’ Investment in El Salvador Infrastructure.

⁴⁹ Casas-Zamora, Notes on Costa Rica’s Switch from Taipei to Beijing.

⁵⁰ Mendelson Forman and Moreira. Taiwan-China Balancing Act in Latin America.

If not for President Ortega's anti-imperialist posture, Nicaragua may have been China's first target for diplomatic recognition in Central America. Détente between Taiwan and China delayed a switch for another eight years. Nicaragua could have then switched recognition alongside Panama.[90, 91] But, in January 2017, during the state visit of President Tsai to Nicaragua, President Ortega declared that Nicaragua would back Taiwanese recognition on a global scale.[92]

Why has Nicaragua stuck with Taiwan? Chinese trade and aid patterns in Nicaragua have mirrored those in both Panama and El Salvador. However, China's inability to build the long-promised Nicaragua canal, together with strategic aid from Taiwan amid tenuous economic relations with the United States, may explain why Nicaragua remains a holdout.

In June 2013, Nicaraguan President Daniel Ortega and Chinese business tycoon Wang Jing announced a deal to build a grand canal through Nicaragua linking the Atlantic and Pacific oceans at a cost of \$50 billion – three times Nicaragua's GDP (\$13.2 billion in 2018). The initial jubilation that followed the announcement was met with considerable opposition after concerns emerged regarding the project's impacts on biodiversity and the livelihoods of the local communities. Moreover, it became clear that Wang had not managed to secure the necessary funds for the project.[93] The canal, set to be completed by September 2019, never came to fruition.

Whereas China failed to complete its biggest mega-construction project in Central America, Taiwan achieved moderate success in Nicaragua by following China's playbook. Taipei has invested heavily in popular infrastructure projects—for instance, the \$46 million Dennis Martinez museum completed in October 2017—and has built a reputation for offering flexible aid.[94] As recently as in February 2019, Taiwan's loan of \$100 million provided much-needed respite to the Ortega regime as it faced widespread protests over its mismanagement of the economy. Furthermore, their engagement is not only limited to economic partnership but includes other acts of solidarity. In April 2018, Taiwan sent a "Friendship Flotilla" of three warships to Nicaragua, where crew members disembarked and presented a taekwondo demonstration. In response, the Chinese Foreign Ministry spokesman Geng Shuang rebuffed Taipei, claiming there was already a "global consensus that there is only one China." [95]

Taiwan's reliance on the United States has at times proven to be a liability in its relations with Nicaragua. In the 1980s, Taiwan was involved with the United States in funding the Contra forces. Although relations improved after the end of the civil war, the United States set precedents for canceling foreign aid to Nicaragua as early as 1992.[96] Relations with Washington continued to suffer periodic rifts since President Ortega returned to power in 2006. After the cancellation of the US foreign aid to Nicaragua in 2013, the US ambassador to Nicaragua, Phyllis Power, cited the lack of "fiscal transparency, the incapacity of the government of Nicaragua to make concrete decisions in resolving the property invasions of U.S. citizens, and especially the grave irregularities in the electoral process of [2012]" as the main reasons behind the decision.[97] But Taiwanese aid was of critical significance to Nicaragua after Ortega's return, especially in the aftermath of widespread protests in 2018, when the United States suspended foreign aid to Nicaragua and convinced two other European allies to follow suit.[98]

For the anti-imperialist rhetoric of its president and its past recognition of the PRC, it would seem Nicaragua should have switched recognition from Taipei to Beijing at some point in the last fifteen years. However, a combination of steady Taiwanese aid, American punitive measures, and a failed Chinese infrastructure project has kept Nicaragua in Taipei's camp.

Concluding Analysis

The foremost objectives of this study have been, first, to show that the rise of Chinese trade and investment in Central America is an important tool for its reunification with Taiwan, in addition to the more obvious economic and strategic advantages of expanding its footprint in the Western Hemisphere. Second, we demonstrate that limits are apparent in terms of how far China's economic strategy for gaining diplomatic recognition in Central America can go. For Taiwan, China's presence in Central America is an existential threat to its sovereignty, since it risks losing its final diplomatic frontier. The United States has also threatened punitive measures for potential switchers with new legislation signed by the Trump administration, as it seeks to hedge against further Chinese incursions in the Western Hemisphere. Finally, though some Central American countries have reaped benefits by abandoning Taiwan for China, their post-switching economic records have been mixed and some grandiose Chinese infrastructure projects have failed to come to fruition. These factors have redefined the calculus of diplomatic switching for the remaining holdouts in Central America, including Nicaragua, Guatemala, Honduras, and Belize.

For China, isolating Taiwan diplomatically was always a long-term goal, as Chinese policymakers manage diplomatic switches as an extension of economic policy. But while China pursues access to raw materials across Latin America, the resources China seeks are not available in Central America. China stands to gain critical strategic advantages by building a stronghold in the American backyard and pursuing the "One-China" policy, but such blatant geostrategic moves have now drawn the attention of the United States.

In Central America, corruption also drives the instinct to seek aid rewards from China. The lure of large-scale infrastructure projects and financial gifts in the form of Chinese aid packages creates a powerful incentive for political elites who may have short time horizons with which to hope to utilize and benefit from such packages. While trade patterns after switching show mixed results, generous infrastructure development and aid packages provide powerful incentives for office-holders to use their time in office to orchestrate a switch.

It is clear that policymakers in Taipei cannot simply rely on the continuance of their existing alliances in Central America. As the examples of Costa Rica, Panama, El Salvador show, reaffirmations of friendly relations and shared values with Taiwan continue up until the decision to switch recognition. In April 2019, during his first state visit to Taiwan and third meeting with his Taiwanese counterpart in three years, the Guatemalan President Jimmy Morales declared that "his country's support for and friendship toward Taiwan was unwavering."^[99] But Guatemala has made repeated overtures to China to attract more investment, and private businesses, trade agencies and former government officials have consistently pushed for closer bilateral ties.^[100]

As early as 2011, the Guatemalan economic ministry studied the free trade agreement between Costa Rica and China to evaluate the possibility of its own agreement with China. The Economic Vice Minister, explained the government's position by adding that "China is the world's largest market, and I believe we must focus there in the long term."^[101]

Taiwanese leaders broadly agree on engaging in capacity building programs that will reduce the propensity of countries to ask for handouts. Crucially, the outbreak of the Covid-19 pandemic in 2020 may have positioned Taiwan to reclaim some of its international prestige. Taiwan organized a sophisticated diplomatic initiative that highlights its successful preventive strategies, showcases its manufacturing capacity, and promotes the virtues of democracy as the most competent political system for combatting the pandemic. Taiwan imposed early travel restrictions and mobilized factories to deliver essential protective equipment to its own citizens, while donating masks and medical supplies around the world. Meanwhile, China earned suspicion for its heavy-handed donations mandating that recipient countries avoid identifying China as the source of the virus and refuse to join efforts to investigate cover-ups in the early stages of the spread. In addition to forming coalitions and partnerships with other countries considered first movers in the crisis, Taiwan can capitalize on soft power diplomacy by providing reliable assistance to Central American countries hard hit by Covid-19.

The multivariate causes behind changes in US foreign policy toward Central America will continue to ensure that the United States is a significant counterbalance to China's ambitions. The Trump administration has failed to form any significant diplomatic, economic, or political partnerships in Latin America, while China has steadily deepened its engagement with the region. However, on the issue of diplomatic switching, the United States has now embedded a punitive strategy into law. The TAIPEI Act constitutes the most significant piece of American legislation on Taiwan since the Taiwan Relations Act, which has kept a steady stream of military aid flowing to Taiwan since 1979. The TAIPEI Act takes the innovative approach of targeting those who may abandon Taiwan for China, albeit with unspecified punitive measures. Cancellations of foreign aid have already become part of the United States' punitive strategy in countries like Nicaragua. In 2018, after El Salvador switched its diplomatic recognition from Taiwan to China, the Florida Republican Senator Marco Rubio threatened that the United States would cancel its foreign aid to Guatemala if it followed suit.^[102] As our analysis demonstrates above, American foreign aid far outweighs levels of Chinese foreign aid (according to available data), and presents a significant piece of leverage in diplomatic contests. Nicaragua already faced cancellations of foreign aid for domestic reasons, and El Salvador and Guatemala each faced the threat of foreign aid cancellation before the TAIPEI Act was signed. Indeed, the ambiguous nature of what additional measures the United States could take against the next diplomatic switcher may be its most important deterrent.

Additionally, the pandemic has worsened the increasingly confrontational relationship between the United States and China, so much so that the prospects of a second Cold War are being openly discussed by academics and policymakers. In such a climate, encroachments into the American backyard by China will take on added significance for the Trump administration, as well as the presidential administrations to follow. It took many years before a punitive strategy manifested under an American

administration - after all, how could the United States justify punishing small countries for doing something it had already done? The Trump administration has now inserted this matter directly into its strategy to resist Chinese influence in the Western Hemisphere, making the issue of Taiwanese recognition in Central America another field of superpower competition between the United States and China.

In order to assess the impact of the TAIPEI Act, we must first learn if the threat of punitive measures is strong enough to prevent switching while the legislation is in place. Diplomatic switching may be entering a new period of détente, based on stalemate rather than mutual compromise. Panama, the Dominican Republic, and El Salvador switched early enough in the Trump administration to avoid the worst penalties. Taiwan's remaining allies would now be stepping into an unknown. Indeed, the political conditions may be such that Beijing pauses its own efforts to orchestrate any new switches.

In January 2020, thirteen years after San José switched recognition to Beijing, Secretary of State Mike Pompeo warned Costa Rican President Carlos Alvarado of "the flashy promises from the Chinese government that have often produced only debt, dependency, and even the erosion of sovereignty from some nations." Meanwhile, the Chinese embassy in Costa Rica labelled Mr. Pompeo's comments "arbitrary and without grounds."^[103] The next instance of diplomatic switching will reveal much about how Central American political actors assess what they can from China against what they might lose from the United States and Taiwan, both politically and economically. Future research must be devoted to studying the potential pitfalls in the development of Central American economies after diplomatic switching and levels of skepticism regarding the goals of Chinese investment patterns in the region. Scholarship should also study how punitive foreign policy measures like the TAIPEI Act function in American foreign policy in competition with China, and whether they become formative across multiple presidential administrations. Such findings are crucial to understanding the choices that will be made by the few remaining holdouts in the coming years and the extent to which China will have achieved its loftiest foreign policy goals.

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Robert A. Portada III received his Ph.D. from the University of Notre Dame. Dr. Portada has expertise in a variety of political science subfields, including international relations theory, modernization theory, democratization theory, revolutionary theory, and security studies. His areas of regional specialization cover many parts of the global south, including Latin America and the Caribbean, East Africa, North Africa, and the Middle East. His published work has appeared in edited volumes as well as the *Journal of Third World Studies* and the *Journal of Global South Studies*.

Steve B. Lem received his Ph.D. from Binghamton University (SUNY) and is currently an associate professor and chairperson of the Department of Political Science & Public Administration at Kutztown University of Pennsylvania. His published work has appeared in *The International Journal of Transitional Justice*, *Party Politics*, *Political Research Quarterly*, and *State Politics & Policy Quarterly*.

Uttam Paudel received his BA in political science from Kutztown University of Pennsylvania. He is interested in the subfields of international relations, political economy, and comparative politics. In particular, his research interests include proxy wars, the decline and fall of great powers, political and economic impacts of foreign aid, and the role of exogenous factors in financial systems. He has written and coauthored opinion pieces and articles that have been featured in *The Taipei Times*, *The Kathmandu Post*, *The Himalayan Times*, and *The Republica*.