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Chen Xiang & Qiang Xin

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# Small states as helpless pawns? Panama's diplomatic strategy over the Taiwan Strait

Chen Xiang

Shanghai Jiao Tong University  
Harvard University

Qiang Xin

Fudan University

**Abstract** *A traditional great power stereotype of small states is that of helpless pawns in world politics. After Panama severed its longstanding diplomatic ties with Taiwan in 2017, small state diplomacy once again came under the spotlight. By tracing Panama's convoluted diplomatic relations over the Taiwan Strait since 1949, we argue that, rather than great power competition alone, it is Panama's state capacity and its strategic calculations about external threats that account for the shifts in its relations with Taiwan and Mainland China. We further identify five strategies adopted by Panama: bandwagoning, status-seeking, issue linkages, two-sided bargaining, and diplomatic recognition. By bringing agency back into the agent-structure debate, this article shows how, as an agent, Panama has maximised its action space and sheds light on Taiwan administration's shrinking international recognition against the backdrop of the rising global influence of the People's Republic of China.*

## Introduction

Diplomatic recognition is vital for the subsistence of the administration of Taiwan—under the name of the Republic of China (ROC). As of October 2022, the number of countries retaining formal diplomatic relations with Taiwan has diminished to fourteen. All are small states, with over half being located in Central America and the Caribbean, which positions this region as a major battleground of cross-Taiwan Strait competition (Hey 2003, 2–5; Long and Urdinez 2021; Rich and Dahmer 2022). Among states that have severed their diplomatic relations with Taipei, Panama's defection in 2017 came as the great-

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est shock<sup>1</sup> to Tsai's administration. Panama was at the top of the list among Taiwan's most important diplomatic relations. Bilateral relations dated back over a century to imperial China. When the ROC was founded in 1911, Panama was one of the first nations to recognise the new republican government. When the Kuomintang (KMT)-led government lost the Chinese Civil War and fled to Taiwan in 1949, Panama maintained its bilateral relations with the ROC. Therefore, the loss of Panama's diplomatic support is symbolically important to Taiwan. What can explain the ending of this enduring and long-standing diplomatic relationship?

This paper uses primary sources and archival documents to understand the important yet underexplored relationship between Panama, Mainland China, and Taiwan since 1949. Existing scholarship has considered diplomatic shifts under the framework of cross-Taiwan Strait rivalries (van Fossen 2007), rendering it a consequence of either Taiwan's 'chequebook diplomacy' (Atkinson 2010; Taylor 2002) or Beijing's stronger global influence in pursuing its overarching goal of national reunification (Huang and James 2014; Moody 2020). The possible repercussions of US intervention—usually with a pro-Taiwan stance—have also been emphasised as an external balancing power to Beijing (Goldstein and Schriver 2001). The implicit assumption underlying the analysis of great power interactions is that countries with diplomatic ties with Taiwan—usually small states—are regarded as weak, likely to bandwagon great powers and rather passively accept the regional order shaped by stronger actors in asymmetric power relationships (Morrow 1991; Wivel 2008, 292). However, if this were true, why would only Costa Rica choose to cut ties with Taiwan in the 2000s, whereas the other six states in Central America remained unmoved in a similarly unbalanced relationship involving Mainland China and the US?

While external constraints are admittedly indispensable for state actions (Waltz 1979, 122), we argue that an exclusive focus on systemic factors is too restrictive to understand small states' foreign policy today. We view Panama as the subject rather than the mere object of international politics and emphasise how its political leaders have enjoyed 'the freedom to act creatively within the constraints of a given situation' (Browning 2006, 671; Gignoux 2016, 35). We apply the inductive process tracing method and explore how decision-makers in Panama manoeuvre around the country's status and its strategic geographical location to seek meaningful attention and respect from the US and China (Long and Urdinez 2021). In analysing critical events in the relations between Panama, Taiwan and Mainland China, we identify two factors—external threat and state capacity—that can explain the change in Panama's foreign policy. If Panama, as a weak state, faced low-level external threats from the US, it could bandwagon with the US and act smartly by supporting Taipei in exchange for foreign aid. If security threats from the US increased, Panama may seek to enhance its status in the international system by establishing relations with Beijing. If the external threat started to decrease while state capacity kept rising, Panama would no longer eagerly seek to enhance its status. It may swing

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<sup>1</sup> Taiwan's Ministry of Foreign Affairs (MoFA) stated that it was notified only 40 minutes before Panama made the decision. Minister David Lee openly criticised Panama for 'tr[ying] to hide its intentions until the last minute' (CNA 2017).

between Taipei and Beijing and wait for a higher bid. If the existing party were unable to afford the set price, Panama would sever existing relations and shift to the other party.

By introducing agency and status-seeking considerations, this paper provides an alternative explanation of Panama's foreign policy that goes beyond external structural constraints and incentives. The empirical analysis shows that Panama, as a small state, can 'punch above its weight' by adopting a selection of coping strategies within the regional constraints (Baldacchino and Wivel 2020). While admitting the leading role of external influences, we suggest that unit-level factors such as state capacity and nonmaterial considerations enable us to open the 'black box' of small states' foreign policy (Mouritzen and Wivel 2014; Gvalia, Lebanidze, and Siroky 2019; Gigueux 2016). By proposing a framework incorporating state capacity and external threats, we provide a more nuanced understanding of Panama's cross-strait diplomacy change over time.

This article proceeds as follows. First, we provide an overview of recent scholarship on small states' agency and foreign policy. Next, we trace the details of relations between Panama, Taiwan and Mainland China since 1949. Two critical junctures—the US invasion of Panama in 1989 and the handover of the Panama Canal in 1999—are identified to divide the longstanding bilateral relationship into three phases. For each phase, we use event analysis to inductively formulate our explanation. We conclude by addressing agency in the broader debates on small states' foreign policy and the implications of these debates for Taiwan's international influence.

### **Bringing agency into Panama's cross-strait policy**

Existing scholarship identifies three main factors accounting for state's diplomatic shifts over the Taiwan Strait. First are the material benefits of recognition. In this perspective, a shift in recognition occurs as a delicately rational bidding calculation on the part of both parties across the Taiwan Strait (Rich 2009; Rich and Dahmer 2022). These bids are usually packaged into various trade agreements and humanitarian aid programmes. Second, a growing body of literature highlights the density and intensity of state interactions (van Fossen 2007, 125–129). Scholars emphasise that diplomatic ties are not automatically developed but are intentionally shaped by parties across the Taiwan Strait through asymmetric political and economic cooperation (Atkinson 2010, 407; Long and Urdinez 2021). Third, some scholars regard diplomatic choice as a form of alliance overshadowed by a certain international structure (Ross 2000). In line with structural realism (or neorealism), they argue that the foreign policy related to Taiwan's affairs is primarily shaped by external factors and the preference of great powers such as the US (Rose 1998). Although these explanations offer valuable insights, they have difficulty accounting for some counterintuitive strategies adopted by countries that recognise Taiwan. For example, how can we explain Panama's intentional shift in favour of Beijing in 1989—the year of the Tiananmen Square incidents and a time in which Beijing was weakened by the Western embargo while Taipei was leading the global economic miracle?

While we agree with the primacy of the external factors in explaining ‘constraints confining all states’ (Waltz 1979, 122), we suggest that state-level factors are important for a more comprehensive understanding of Panama’s diplomatic strategies across the Taiwan Strait over time (Gvalia et al. 2013, Gvalia, Lebanidze, and Siroky 2019). Therefore, we introduce the ‘state-as-agency’ perspective to better recognise Panama’s subjective freedom of action. We define agency in two senses. First, in line with the belief that ‘anarchy is what states make of it’, we treat small states as deliberate agents able to use their power and capabilities to ‘do something’ (Dessler 1989, 452). Despite these states’ limited capacity to exert their influence, a growing body of research has proven that small states can pursue a set of coping strategies to compensate for material weakness (Baldacchino and Wivel 2020). Second, the agency is located at some level of ‘freedom of subjectivity’ (Wight 2006, 177). In this sense, small states should at least partially enjoy a ‘deliberate will for independent action’ in the face of external constraints (Berg and Vits 2020, 380). Based on this rationale, the conceptualisation of the state-as-agent allows us to recognise the ways in which Panama is capable of independent volition and action amidst great power competition.

Of particular relevance to our agency perspective is the established research programme of neoclassical realism. This school seeks to explain why an individual state at different times pursues a particular foreign policy strategy (Elman 1996, 12). Instead of focusing solely on the external security environment, neoclassical realists contend that the complex domestic political processes should be included as ‘transmission belts that channel, mediate and (re)direct policy outputs in response to external forces’ (Schweller 2004, 164). Differing from Kenneth Waltz’s ‘sparse understanding of power,’ this school recognises the importance of ideas and nonmaterial political factors, such as nationalistic sentiments and ideological bias, in harnessing latent material power (Rathbun 2008, 296). When external constraints—regarded as a leading explanatory variable—cannot explain the behaviours of small states in foreign policy, neoclassical realists suggest that ideas and nonmaterial variables can provide clues, as these variables can distort domestic decision-making processes (Taliaferro 2000, 133).

Therefore, we ascribe the current insufficiencies of Panama’s Strait policies to the overemphasis on external security constraints at the expense of historically shaped domestic politics (Gvalia, Lebanidze, and Siroky 2019). We thus aim to yield a framework that combines external and internal factors to comprehensively understand Panama’s diplomatic choice over the Taiwan Strait. In accordance with our neoclassical realist starting point, we expect the external security environment to take precedence over state capacity. As the leading factor of diplomatic switches, external threat refers to potential or actual security risk and systemic pressure that Panama and its leaders face when making diplomatic decisions. Here we pay special attention to the interests of Panama’s nearby great power—the US (Browning 2006, 669). Being a small state located close to the US has been decisive for Panama’s diplomatic predicament. For example, the US abetted Panama’s independence in 1903 in exchange for the right to operate a ship canal and build military bases there (Conniff 2012, 63). The US dollar started circulating in Panama in 1849 and has officially served as Panama’s national currency since 1904 (Moreno-Villalaz

1998, 421). As the first American use of force since 1945 that was unrelated to the Cold War, the 1989 US invasion of Panama brought a direct end to the regime in place at the time (Gilboa 1995, 539). Despite the Canal handover in 1999, American legacies have remained through various channels, such as bilateral trade and investment treaties. Thus, Panama's choice over the Taiwan Strait has been inevitably influenced by the preferences of the US, particularly considering America's deep engagement in Taiwanese affairs.

To bring the state back into the analysis, we propose an intervening factor of state capacity to specify Panama's action space in the face of external security constraints. We define state capacity as the capacity and capabilities of the Panamanian government to implement its political goals (Sikkink 1991). Considering the state capacity as an important yet quality-inconspicuous concept (Hanson and Sigman 2021; Evans, Rueschemeyer, and Skocpol 1985; Tilly 1992), we adopt a minimalist approach and measure state capacity in three aspects: extractive capacity, coercive capacity, and administrative capacity. As perhaps nothing is more essential than raising revenue (Tilly 1992, 27), we use the indicator of tax revenues as a proportion of GDP to measure extractive capacity and retrieve data from the Relative Political Capacity Dataset (Hendrix 2010). The economic growth captured by the GDP is used as an alternative indicator. Second, coercive capacity is defined as the ability to preserve national borders, resist external threats, and maintain domestic order. In line with Singer, Bremer, and Stuckey (1972), we set our indicator pool by using three variables: military expenditure per capita, military personnel/total population, and military expenditure as a percentage of government spending.<sup>2</sup> In the particular case of Panama, we also trace changes in the government's capacity to control the canal. Third, we define bureaucratic capacity as the ability to produce and deliver public goods and services. We use two datasets as our main measurement indexes, including the International Country Risk Guide's (ICRG) bureaucratic quality rating and the Worldwide Governance Indicators (WGI) government effectiveness rating.

We adopt an inductive process-tracing approach to explore the causal path that has led Panama to shift in its policymaking. As stated by Vennesson (2008, 233), one of the strengths of process tracing is to 'help the researcher to flesh out causal mechanisms.' Through the use of histories and archival documents, this method allows us to formulate a sequential theory and explore how the combination of external and internal conditions has influenced Panama's diplomatic choices. It also allows us to examine the values of engaging the newly specified factor of state capacity to explain the long trajectory of foreign policies (George and Bennett 2005, 6). We do so in three steps. First, we sequentially filter through historical events related to Taiwanese issues and focus on critical events that have changed Panama's China policy. Second, we trace two explanatory factors and examine whether the causality we propose can be observed in sequence (Mahoney 2015). Third, we ultimately provide a narrative explanation of this causal path and suggest more general propositions for small states' foreign policy (Capoccia and Keleman 2007).

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<sup>2</sup> Data can be found in large-N datasets like World Development Indicators, the Stockholm International Peace Research Institute, the Correlates of War and World Bank Group.

*1949–1989: From bandwagoning to desperate status-seeking*

Since the ROC relocated to Taiwan in 1949, Panama followed the US stance and continued to recognise the ROC as the sole legitimate government of China. In addition to maintaining formal diplomatic relations with the ROC, the Panamanian authorities upgraded its consulate in Taipei to make it an embassy and started to dispatch ambassadors there in 1954 (MOFA 1998). To promote cultural exchanges, the Panamanian government initiated the Special Treaty on Cultural Fields in 1960. At the time, Omar Torrijos, *de facto* head of Panama, further increased cooperation with Taipei by signing a series of treaties, such as a trade agreement in 1964 and the Technology Cooperation Agreement in 1969.

However, subsequent relations between Panama and Taiwan were not frictionless. Since the late 1960s, the Panamanian government had started moving closer to the other side of the strait. This move was largely due to the ever-worsening relations between Panama and the US. Despite the US military's prerogatives concerning this isthmus since independence, Panamanians' ambitions for complete sovereignty never ceased. After several failures in bargaining efforts about the canal's profit-sharing schemes (Conniff 2012, 98), the Panamanian delegate to the United Nations, Aquilino Boyd, publicly condemned the US for using the workers' geographic origin to set the basic wage in the Canal Zone in 1956. Tensions continued to build as two important flag riots occurred in 1959 and 1964 (Langley 1970, 350). On 9 January, 1964, Panamanian students launched a significant assault and requested that the US display Panama's national flag in the Zone, which the US immediately refused to do. In response, the Panamanian government broke off diplomatic relations with its superpower neighbour, which sharply increased the external security threats coming from the US.

Amidst rising tensions between Panama and the great power, General Torrijos covertly started diplomatic engagement with communist China. In 1968, Foreign Minister Antonio Tack dispatched a secret message to Beijing that

General Torrijos has always expressed deep sympathy and support for the PRC's patriotic and just movements ... He believes that maintaining diplomatic relations with Taiwan rather than the People's Republic of China was a shame to Panama, and it must be resolved as soon as possible' (Wu 2014; Xu 2018).

However, Tack soon added that

Now the top priority for Panama is to reach an agreement about the canal [with the US]. To avoid extraneous complications, diplomatic relations with Beijing can only be considered later (Wu 2014).

As the negotiations between Panama and the US reached an impasse in the early 1970s, General Torrijos again sent a confidential message to Beijing in 1976, elaborating that 'it is hoped that the [diplomatic] relations with Beijing will be considered first, but the US continues to exert pressure and force us to maintain the status quo' (Xu 2018). Remarks such as these indicate that while Panama had a strong identity and an emotional connection with Beijing, it was



also an exceptionally weak and small state. Therefore, external threats from the US constituted dominant factors in the country's diplomatic choices, resulting in a lack of 'action space' in the cross-strait issues. Panama thus could only passively bandwagon with the US and maintain existing relations with Taiwan.

The second source of turmoil in Panama's cross-strait diplomacy began in 1985. Being a small state located close to a superpower was decisive for Panama's foreign policy. After the five successive microcrises between 1984 and 1989 (Conniff 2012, 154–164; Gilboa 1995, 540), tensions between the US and Panama peaked. Soon, the US cut off all economic aid and preferential loans to Panama (Weeks and Zimbalist 1989, 23). In the face of such external threats, Panama's state capacity reached its lowest point in the mid-1980s. Panama's extractive capacity, as measured by all taxes/GDP, was a mere 6.7% in 1989, which was much lower than the global average of 18.3% (Kugler and Arbetman 1997). Panama's GDP growth rate dropped to its lowest point of –13.4% in 1988. In terms of bureaucratic capacity, Panama received a grade of zero from the ICRG. Another indicator—public sector employment as a percentage of total employment—was only 10.6% on average, which was much lower than the global average. Regarding coercive capacity, despite military expenditures reaching US\$141 million and military personnel increasing to 14,000 by 1989, Panama's capacity was much weaker than the world's average of US\$2.74 billion and 187,000 persons. Notably, Panama had no control over the canal during this period. The US military had stationed troops in the Canal Zone since 1903 and established at least 134 anti-aircraft sites there during World War II. Because of the great power next door, Panama had almost no *de facto* self-defence capability.

The ever-rising threats from the US pushed Panama to seek status from Beijing (Neumann and de Carvalho 2014). Here, status-seeking refers to acts undertaken to maintain or better one's placement in the international system (Wohlforth et al. 2017, 528). This concept is intrinsically coupled with recognition. Since Panama found itself in an asymmetric power relationship, it sought status through recognition. In the spring of 1989, Jorge Eduardo Ritter, Panama's Foreign Minister, invited Wang Yusheng, then the Chinese ambassador to Colombia, to visit Panama as his personal guest.

Minister Ritter publicly said that 'Panama is facing great challenges and hopes to obtain Beijing's support to restrict US power' (Wang 1997, 35). In July, Noriega secretly sent emissaries to Beijing, despite the sanctions the US imposed on China after the Tiananmen protests. In early November, a team of delegates led by Ambassador Wang visited General Noriega. Soon after, the two parties reached a consensus to draft a joint communiqué on the establishment of diplomatic relations and an agreement on economic and technological cooperation. At a private dinner party, Minister Ritter expressed that

We attach great importance to the friendship with the PRC, share a good aspiration for new China, and recognise the PRC's important role in the international community ... We have always hoped to normalise relations with the PRC. However, due to various reasons, as our Chinese friends know, we have failed to achieve our wishes ... We are facing severe external threats and economic pressures and need material and diplomatic support from Beijing (Wang 1997, 36).



The Foreign Minister of the PRC, Qian Qichen, responded that Beijing fully understood Panama's difficulties and was willing to recognise Panama and provide all possible assistance. However, on 20 December, 1989, just when Panama and Beijing were preparing to establish diplomatic relations, the Pentagon commanded Operation Just Cause. This operation moved 24,000 troops and Stealth fighters, such as F-117s, and put down the Panamanian Defence Forces and Noriega, making all these diplomatic preparations be in vain (Yates 2007; Conniff 2012, 154). Quickly after, the new Panamanian government led by Guillermo Endara was recognised by Taipei on 5 January, 1990, allowing the continuation of existing relations (Conniff 2012, 164).

Based on the analysis of archival documents and memoirs, we examined the sequence and values of two explanatory factors. Over this period, Panama faced a rising external security threat from the US, which further weakened Panama's state capacity internally. Wedged in a configuration dominated by a superpower, the weak Panamanian government no longer chose to bandwagon with the US. Instead, it hoped to protect its national sovereignty and enhance its status in the international system by seeking recognition from Beijing. While our starting point remains a realist reading of power, nonmaterial considerations such as anti-colonialism and nationalism certainly exerted weight on Panama's foreign policy during this phase (Foulon 2015; Chong and Maass 2010). The PRC and Panama shared a similar experience of patriotic movements and could 'read their own history and international condition in a similar light' (Long and Urdinez 2021, 2). From the perspective of agency, this status-seeking indicates that Panama, as a small state, did not always comply with great powers nor accepted an imposed role. Instead, Panama invoked its moral authority through patriotic and justice movements and its territorial integrity as it sought to enhance its status (Wohlforth et al. 2017). In doing so, Panama enjoyed a certain 'freedom of subjectivity' to modify and violate the expectations implied in its relations with the US (Gigleux 2016, 35; Berg and Vits 2020).

However, this historical narrative reveals that the external threats that came from the US have a primary role in Panama's foreign diplomacy. Although Panama planned to build its relationship with Beijing, its freedom to manoeuvre across the Taiwan Strait was restrained mainly by the US. This hindrance has been effective in each of Panama's administrations. General Torrijos directly expressed that the US forced Panama to maintain diplomatic relations with Taiwan. The Noriega administration was overthrown after the tension with the US peaked. Being close to the US was decisive for Panama's action space. As a weak agent in an asymmetric relationship, Panama was unable to preserve autonomy and act towards its own diplomatic preferences (Wivel, Bailes, and Archer 2014, 9). In the face of overwhelming threats from the US—the primary factor in our framework—Panama, as a weak state, was eventually forced to maintain the *status quo* and abandon its strategic shift.

#### *1990–1999: A smart Panama and issue-linkage strategy*

After the traumatic invasion of 1989, the 1990s witnessed a gradual decline in the external threats directed towards Panama. This decline can be attributed to two reasons. First, relations between Panama and the US gradually recovered

and stabilised. After Operation Just Cause, US authorities scaled back the amount of aid they defrayed. To prevent the return of Noriega's influence, the US military assigned advisors to monitor Panama's domestic affairs (Conniff 2012, 171). Second, the US objectives in Panama changed after the end of the Cold War. The two parties started to negotiate an agreement to prepare the canal's post-turnover situation (Shultz 1993, 8–10). Once the Panamanian government was no longer viewed as a rival by the American superpower, Panama could gain more space for action in the Taiwan Strait. During this period, maintaining diplomatic relations with Taipei, rather than with Beijing, was far more attractive to Panama.

First, the previous lesson suggested that stabilising relations between Panama and Taiwan could prevent a provocation from the US, especially as Beijing faced an international embargo after 1989 (CEIC 2020; Xu 2008, 53). Second, as one of Asia's 'Four Tigers,' Taiwan had experienced an economic miracle with double-digit growth, which brought Panama numerous opportunities. Taiwan's export-oriented model, together with a large volume of foreign reserves and the sharp appreciation of the new Taiwan dollar, fit well with the re-exporting function of the Colón Free Zone—a commercial showcase for the whole continent. Third, after Lee Teng-hui took over as the leader of Taiwan in the late 1980s, Taipei started to promote 'pragmatic diplomacy' globally. This strategy aimed at increasing Taiwan's international exposure through trade and international organisation engagements. Such pursuits brought Panama closer to supporting Taiwan's membership in the UN and other international organisations. Since then, the two parties entered a new phase of reciprocal demands (Winkler 2012).

During this phase, Panama provided Taiwan with diplomatic support in the international system in return for Taiwan's material help in improving its state capacity (McGinnis 1996, 141). This was partially because the diminishing external threat from the US did not directly lead to prosperity in Panama. Instead, Panama's state capacity deteriorated further during the 1990s. The taxes/GDP decreased to a mere annual average of 8.6% in Panama, which was lower than half of the global average of 18.3% (Fisunoglu et al. 2011). Panama's bureaucratic capacity received an average of only 0.29 points from the WGI government effectiveness rating when compared with the highest 2.5 points in the scoring system. Meanwhile, Panama received an average of 1.01 points from the ICRG bureaucratic quality rating, which, again, was lower by half than the global average of 2.2 points (the highest score is 4). In terms of coercive capacity, Panama still had no control over the canal. Its military expenditure accounted for only 4.7% of government expenditure, whereas the world's benchmark was 9.86% on average (SIPRI 2020). Other indicators further reflected a debilitating state capacity: official unpaid debt rose significantly from US\$338 million in 1992 to US\$736 million in 1999; the unemployment rate was double digits in 1989, and this withering level of underemployment persisted in the 1990s (USAID 2020). In all, Panama's state capacity remained weak after the invasion.

Under the combination of low external threats and weak state capacity, Panama shifted its attention back to domestic affairs and acted as a smart state in foreign policies (Grøn and Wivel 2011). It did so by adopting an issue-linkage strategy with Taipei. Such strategy manifested in two aspects. First,

frequent high-level bilateral visits took place in order for Panama to attract investments and development funds from Taipei. Two months after the invasion, the Panamanian government named Carlos Yap Chong, of Chinese descent and son-in-law of President Endara, ambassador to Taipei. In May 1990, President Endara paid a special visit to attend Lee Teng-hui's inauguration ceremony. Soon after, Vice President Ford paid another visit for the National Day celebration in Taipei (Li 1991). In 1991, in return, Taipei agreed to establish a special export processing zone (EPZ) in Panama.<sup>3</sup> In 1992, President Endara visited Taipei again and expressed his gratitude to Taiwan for sending technical assistance teams to help with crop cultivation, aquaculture, and fishing operations. He also expressed a willingness to invite Lee to pay a visit to Panama (Office of Taiwan Government 1992). The two parties quickly signed another investment treaty to promote capital and technology transfer, mainly focusing on investment flows from Taiwan to Panama. In 1994, Lee Yuan-tsu, then Vice President of Taiwan, attended the inauguration of new Panamanian President Ernesto Pérez. After the ceremony, the two countries signed the Bilateral Aviation Pact to open the first direct flights to Panama from Taiwan, which became the first direct route between Taipei and Central American countries. In September 1995, President Pérez paid a return visit to Taipei. During that visit, Taipei-affiliated companies took over Fort Davis near Colón to create a manufacturing facility. The Taiwanese shipping giant, Evergreen, won a concession to operate the former naval base at Coco Solo as a container port (Conniff 2012, 177–178). In August 1997, Lee Teng-hui brought an investment package of US\$7 million to Panama to set up refrigeration installations and expand aquaculture in Gatun Lake (Pérez 2002, 423). The two parties further signed the new Tourism Arrangement to enhance cultural exchanges. By the end of the 1990s, Taiwan ranked among the top three countries with registered vessels in Panama (Zhang 2005). Among all of the countries that recognised Taiwan in Central America at the time, Panama's diplomacy with Taiwan had the highest profile. In return, Panama also received the highest levels of investment and aid from Taiwan, which improved its extractive and bureaucratic capacities.

Second, Panama endeavoured to support Taiwan's national identity within international society. Panama had seconded Taiwan's motions in almost every UN General Assembly since 1993, the year Taiwan renewed its UN campaign. After Taipei deposited US\$150 million into the Central American Bank for Economic Integration (CABEI), Panama—as one of Taiwan's sponsoring countries—consecutively submitted a proposal to the General Assembly requesting the establishment of a special committee to consider 'the parallel representation of divided countries at the UN' in 1993 and 1995 and 'the participation of Taiwan, the Republic of China, in the activities of the UN' in 1996 and 1998 (Chen 1996, 201). These draft resolutions shifted significantly away from the 'one China policy' upon which Beijing has insisted. In addition, in 1996, the Panamanian government proposed the establishment of the Universal Canal Congress, which was to be a high-profile gathering of world leaders to discuss the vital waterway's future. Despite Beijing's strong opposition to these

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<sup>3</sup> All bilateral treaties can be found in Taiwan's Law and Regulation Database (<https://law.moj.gov.tw/Law/LawSearchAgree.aspx>).

attempts and calls for a boycott of Taiwan in the UN (Yu 1999, 46), Panama was determined to invite Lee Teng-hui after Taiwan promised to defray US\$800,000 of event expenses, which in turn provided a rare chance for Lee to be visible on the world's stage (Rohter 1997).

Notably, Panama only maintained minimal interactions with Beijing during that period, limiting those to a few unavoidable trade activities like the establishment of a branch of the Bank of China in 1994 and, the Panamanian Trade Office in 1996, and the opening up of two canal ports—Balboa and Cristobal—in 1997 (Conniff 2012, 177).

At this stage, Panama took part in the Taiwan Strait debate without provoking the great power next door. Once assured that its status was no longer threatened by the US, Panama's diplomatic action space and room to manoeuvre expanded. The Panamanian government could turn its focus to domestic development and 'afford the luxury of focusing on the long term' (Wivel and Oest 2010). Hence, the intervening factor of state capacity started playing a more important role in Panama's diplomatic considerations. With careful calculations about material and security benefits, Panama maintained formal relations with Taiwan rather than with Mainland China. It did so by adopting an issue-linkage strategy, using its diplomatic power to support Taiwan's desire to be recognised as a state in exchange for foreign aid and trade opportunities. From the perspective of agency, Panama, as a small state, 'punched above its weight' and increased its state capacity by levelling the playing field across the Taiwan Strait (Baldacchino and Wivel 2020).

#### *2000–2017: From two-sided bargaining to strategic shifting*

On the last day of the twentieth century, the US turned the control of the canal over to Panama and closed all US military bases on the isthmus. After almost a century of US dominance, Panama finally had control of its greatest assets—the Panama Canal and its own sovereignty. Since then, the Panamanian government has coped with residual external threats from its superpower neighbour. With regard to the US, the severe casualties caused by the wars in Afghanistan and Iraq had aroused an anti-war sentiment nationwide (Heaney and Rojas 2007, 432). It became clearly difficult for the US to openly intervene in Panamanian affairs through threats of force or military invasion as it had done during the Cold War. Thus, the US started to moderate its strategy, and the two countries together shifted their common attention to issues such as drug trafficking, money laundering, migrant smugglers, and other civil emergencies (Bureau of Western Hemisphere Affairs 2019). In the context of this new bilateral relationship, our primary factor—external threats from the US—became exceptionally low compared with the previous phases, when Panama had not assumed full jurisdiction over its territory. This situation directly gave Panama more action space to benefit from the Taiwanese question.

At that stage, Taiwan, after its international visibility had shrunk, counted more on Panama's diplomatic support; however, Panama has become less dependent on trade and investments from Taiwan because Panama's state capacity had improved all-around. According to our measurement of state capacity, the first indicator, all taxes/GDP, kept rising from 7.6% in 2000 to 10.3% in 2006 and 14.9% in 2017, increasing two-fold and reaching a level even

higher than the global average. Panama's GDP increased from US\$21 to US\$42 billion between 2001 and 2009—an astonishing growth rate of over 9% (World Bank 2020). Such stronger extractive capacity was partially attributed to the increased revenues from the canal and Panama's new positioning as a new global enterprise hub after the Colón Free Zone and Manzanillo port were combined (Conniff 2012, 177). Regarding coercive capacity, Panama has enjoyed full control over the canal. The military expenditure of Panamanian Public Forces quickly reached US\$551 million in 2012 (NMC 2020). In terms of bureaucratic capacity, Panama doubled its ICRG bureaucratic quality rating (with a mean of 2.08 points) (ICRG 2020).

The combination of lower external threats and greater capacity brought Panama more diplomatic autonomy in its actions and volition (Berg and Vits 2020). In the first half of the period between 2000 and 2007, Panama stood in a dominant position, able to impose its conditions on Taiwan. In contrast, Taiwan gradually assumed a passive position and lost bargaining power as Mainland China rose. For example, when then-Vice President Lu Hsiu-lien visited Panama in August 2003, President Mireya Moscoso directly claimed that Panama had faced heavy pressure to support Taiwan in the UN. Panama expressed its willingness to grant Taiwan a voice in the 58th UN General Assembly in September only after Lu agreed to assist in establishing a maternal and child health hospital (Panama Statement 2003). Three months later, when President Chen Shui-bian visited Panama, President Moscoso clearly stated that Panama's trade relations with Beijing had been developing well, whereas cooperation with Taipei had slowed down (Peralta 2006, 175). Chen responded on the spot that he was willing to promote Taiwan's first Free Trade Agreement with Panama to enhance bilateral trade cooperation. In 2004, Martín Torrijos, son of Omar Torrijos, was elected President of Panama. Torrijos remarked in the general election that he 'hope[d] to establish diplomatic ties with China [PRC];' therefore, Chen immediately proposed another initiative—the 'coprosperity project.' That project entailed an investment of US\$250 million and assistance for local businesses in Panama and other states in Central America (NDC 2020). Notably, Taipei occasionally resorted to irregular practices to maintain bilateral relations. For instance, former President Moscoso was accused of receiving US\$1 million from Chen Shui-

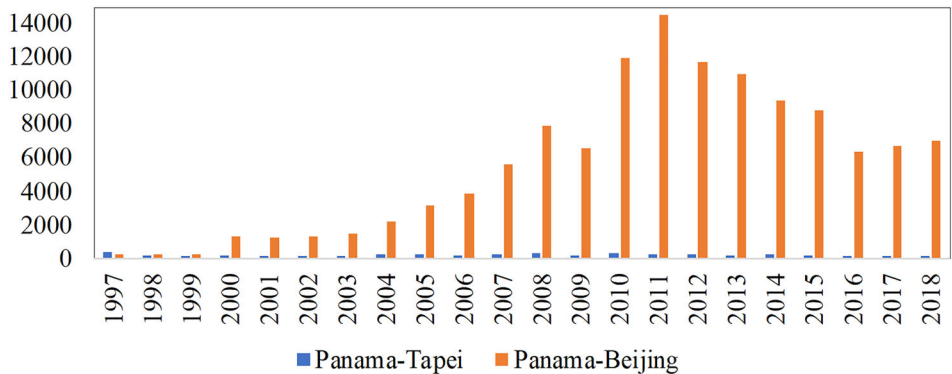


FIGURE 1. Comparative trade value between 1997 and 2018 (million USD).

bian as a birthday present and of embezzling US\$45 million, which had been donated by Taipei, from the Mar del Sur Foundation (Esteban 2008, 18).

In contrast to its aloofness towards Taipei, Panama set out an engagement policy that proactively promoted trade ties with Beijing. As shown in Figure 1, the total value of imports and exports between Panama and Mainland China boomed in the 2000s, increasing from US\$1.29 billion in 2000 to US\$7.94 billion in 2008. In 2006, Mainland China first surpassed the US in becoming the largest exporter to Panama, capturing 19.51% of all exports with a total of US\$2.1 billion in value (WITS 2020). In 2011, the total value of exports reached a historic high of US\$14.6 billion (World Bank 2020). In contrast, the trade value between Panama and Taiwan remained relatively unchanged from what it had been in the previous 20 years, at approximately US\$0.2 billion.

As trade boomed, companies in Mainland China asserted themselves. For example, as early as 2003, the chairman of the China Ocean Shipping Company (COSCO) sat on the board of directors of the Panama Canal Authority, replacing the chairman of the Taiwan Evergreen Group (Wang 2004). In addition to engaging in economic cooperation, the two parties initiated a political engagement process. In 2000, invited by the National People's Congress (NPC), the Panamanian National Assembly delegates visited Beijing and spoke face-to-face talk with Li Peng, then NPC Chairman. Two years later, the Foreign Affairs Committee of the Chinese People's Political Consultative Conference (CPPCC) organised the first semi-official visit to Panama and initiated a regular visit mechanism with some research institutes in Panama. In the same year, the guided-missile destroyer CNS Qingdao and supply ship CNS Taicang of the People's Liberation Army Navy embarked on a first round-the-world voyage and passed through the Panama Canal for the first time as a goodwill gesture (Zhang 2019).

By sequentially unfolding Panama's policies about Taiwan and Mainland China, we observed that Panama had some considerable leverage in Taiwanese affairs. Without interventions and security threats emanating from its super-power neighbour, Panama significantly increased its room for manoeuvre and autonomy in foreign policy. In this context, Panama acted as a pragmatic agent and strengthened its state capacity by overcharging Taiwan and engaging with Mainland China. By introducing the intervening variable of state capacity, our framework provides a more nuanced understanding of Panama's diplomatic strategies during that period.

During the second half of this phase, from 2008 to 2017, the primary factor of external threats further weakened. In late 2007, the US experienced one of the worst economic disasters, which brought severe economic losses and further decreased the influence of the US on Central America. Under these circumstances, small states in Central America started to foster regional competitiveness to reduce dependence on the US market and foreign aid. As an economic engine in Central America, a stronger Panama acted firmly to push the country into becoming an international business hub (Conniff 2012, 193). To achieve this goal, Panama further strengthened economic and diplomatic interactions with Beijing, which had enjoyed a rapidly expanding economy. In comparison, Panama maintained almost no relations with Taipei.

The thinning diplomatic relations between Panama and Taiwan are evidenced by mutual political interactions. Since Panamanian President Ricardo



Martinelli visited Taipei in October 2010, the records show that there were no additional visits from high-level Panamanian officials there. In 2014, when Ma Ying-jeou, then President of Taiwan, attended the inauguration ceremony of President Juan Carlos Varela, he was the only foreign head of state who was not welcomed by a military honour guard in Panama City. In fact, Ma was greeted on arrival by Foreign Minister Francisco Alvarez, and this diplomatic treatment was different from that reserved for the other foreign heads of state (CNA 2014). In June 2016, after Tsai Ing-wen's visit for the inauguration ceremony of the Panama Canal expansion, President Varela immediately sent a post on Facebook, explicitly calling 'Taiwan' 'Taiwan (China).'

In stark contrast, Panama showed an extremely welcoming attitude towards Beijing. In addition to the ever-growing bilateral commercial communications mentioned above, Panama initiated a series of flexible visa policies to promote business and cultural exchanges, for example through a visa exemption for diplomatic and official passport holders coming from in China. In fact, as early as 2009, the newly elected President Martinelli had expressed to Barbara Stephenson, then US ambassador to Panama, that he would like to recognise Beijing because 'Panama's business community would benefit as a result' (Keating 2012). In 2010, then Foreign Minister Juan Carlos Varela met with the Chinese Foreign Minister Yang Jiechi during his visit to Asia, demonstrating again to Beijing the willingness of Panama to establish diplomatic relations with Mainland China (Shi and Wong 2017).

Low external threats, combined with an ever-rising state capacity, led Panama to shift its strategy and sever ties with Taiwan in favour of Mainland China. In June 2017, Panamanian President Varela stated that Panama decided to establish full diplomatic links with the PRC and upgrade its commercial ties with the canal's second most important customer (Wang 2017). Notably, the US was not informed of this shift in advance. After encountering strong opposition from the US, President Varela responded that

We just called the US ambassador to Panama...one hour before the announcement. This is our decision, the Panamanian government, the President of Panama ... did the right thing for our people (Wang 2017).

As an explicit counterattack in the struggle over Taiwanese, the US recalled its top diplomats from Panama (Brunnstrom 2018). However, this threat did not work as expected. Within only one month, the US silently sent diplomats back to attend a high-level conference on Latin America's security and economic prosperity (Harris 2018).

Compared to the first phase, Panama could exercise its independent diplomatic will and, more importantly, had the capabilities and capacity to do so during this period (Berg and Vits 2020). Clearly, the US threats were not perceived credible nor did they prompt changes in Panama's Taiwan policy. Differing from conventional wisdom, small states such as Panama did not 'tend to accept the conditions of an order created by the stronger actors' or 'avoid provoking the great power next door' (Morrow 1991; Dinesen and Wivel 2014). Instead, Panama's diplomatic choice became less constrained by external threats when Panama's state capacity was enhanced. As a smart and agile agent, Panama seized the initiative over the Taiwan Strait and sought to instrumentalise strategic competition between Taipei and Beijing for its own

benefit. Specifically, when the external threats were still relatively credible at the beginning of this phase, Panama chose to maintain the status quo while adopting a more aggressive bargaining strategy with Taipei. In the second half of this phase, when US threats decreased while state capacity was further enhanced, Panama no longer needed to consider the US stance when it decided to shift diplomatic allies; Panama did not need to seek US consent in advance. When choosing between Taipei and Beijing, the Panamanian government considered long-term payoffs as a top priority.

## **Conclusion**

It has long been understood that small states cannot act for their own sake in the face of superpowers (Wivel, Bailes, and Archer 2014). We challenged this traditionalist view by introducing the perspective of agency and stressing 'the agent side of the agent-structure debate' (Gigleux 2016). Some agent-level factors, such as state capacity and nonmaterial consideration, were incorporated into our hierarchical framework to understand when and how small states commit, obtain, and shift between great powers to maximise their own national interests. Instead of bandwagoning with the US, Panama has adopted a series of flexible strategies, such as status-seeking, issue linkages, strategic shifting, and two-sided bargaining on the question of Taiwan over the past seventy years. Smallness should not automatically equate to helplessness. Although Panama is a small state that has been deeply influenced by the US, it has not been a passive pawn for its superpower neighbour over the Taiwan issues. Instead, Panama has pursued its own domestic and international ambition in an asymmetric power relationship and has acquired the freedom to act smartly within the constraints of a given situation (Baldacchino and Wivel 2020; Gigleux 2016).

Arguably, Panama constitutes a representative case. In the five years following Panama's switch, the Dominican Republic, Burkina Faso, El Salvador, the Solomon Islands, Kiribati, and Nicaragua had successively severed diplomatic relations with Taipei in favour of Beijing. Mirroring Panama's shifts, one manifestation has been the ever-growing state capacity and autonomy of these small powers despite certain external pressures. Panama's patterns of behaviour have not been exceptional either. Other states in Central America, such as Guatemala and Belize, adopted a similar issue-linkage strategy between 1971 and 1996 and between 1987 and 1989, respectively. At the time, they both were weak states and faced relatively mild external threats. Since 1997, as external threats have decreased and its state capacity has greatly increased, Guatemala has asked for more from Taiwan administration.

Undoubtedly, many factors have explained Taiwan's international visibility. Possible explanations comprise systemic factors such as international norms (for example, self-determination and sovereign equality), the structure of the global system (such as hierarchical balance of power), the characteristics of states (for example, geographical location and resource abundance), domestic politics (such as party politics and elites' preference), and even some emergent effects (Jervis 1998). This article does not challenge either of those influences. Rather, our aim is to draw attention to the importance of studying the agency of small states. More specifically, we want to demonstrate the strategic flexibility of small states amidst great power competition. When considered from this

point of view, the IR literature on Taiwan's international space has fallen short, not only because it often focuses on variations along just one variable only—such as material power—but also because it has heavily focused on the 'giants' such as the US and Mainland China.

### Notes on contributors

**Chen Xiang** is an Assistant Professor in the School of International and Public Affairs at Shanghai Jiao Tong University, and she is also a Fulbright Fellow at the Harvard-China Project on Energy, Economy and Environment at Harvard University. Her research explores the antinomies that emerge through economic and political modernization, such as development and environmentalism, nationalism and populism, and China's foreign policies. Her recent works have been published in *Environmental Science & Policy*, *Energy for Sustainable Development*, and *International Affairs*. Email: [chen.xiang@sjtu.edu.cn](mailto:chen.xiang@sjtu.edu.cn)

**Qiang Xin** is a Professor and Deputy Director of the Centre for American Studies at Fudan University. His research is mainly focusing on China-US relations, US politics, and Taiwan issues. His recent research appeared in several journals, including *Journal of Contemporary China* and *The Pacific Review*. His new book, *Mainland China's Taiwan Policy: From Peaceful Development to Selective Engagement*, was published by Routledge in April 2022. Email: [xinqiang@fudan.edu.cn](mailto:xinqiang@fudan.edu.cn)

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