Exit, Voice and International Jurisdictional
Competition: A Case Study of the Evolution of
Taiwan’s Regulatory Regime for Outward
Investment in Mainland China, 1997-2008

Chang-hsien Tsai

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EXIT, VOICE AND INTERNATIONAL JURISDICTIONAL COMPETITION: A CASE STUDY OF THE EVOLUTION OF TAIWAN’S REGULATORY REGIME FOR OUTWARD INVESTMENT IN MAINLAND CHINA, 1997-2008

Chang-hsien Tsai*

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International jurisdictional competition can restrict governments’ ability to implement their preferred policies through the “law market.” This is the competitive mechanism through which “governing laws can be chosen by people and firms rather than mandated by states. This choice is created by the mobility of at least some people, firms, and assets and the incentives of at least some states to compete for people, firms, and their assets by creating desired laws.”1 As a result of this competition, as Professors Erin O’Hara and Larry Ribstein have explained, the market for law provides a significant check on governments.2 Taiwan’s experience with investment restrictions in the late 1990s and 2000s provides the first opportunity to test the O’Hara-

2. Id. at 13-15.
Ribstein law market theory internationally. By using Taiwan’s experience as a case study, this Article allows an examination of the extent to which capital mobility or exit, combined with jurisdictional competition, can produce local legal changes. As discussed in detail below, jurisdictional competition fueled by the physical mobility of Taiwanese firms had the effect of nudging the Taiwanese government in the direction of gradually relaxing its restrictions on outward investment in China (hereinafter also referred to as the “PRC,” “mainland China” or the “mainland”).

This demonstration of the impact of the law market has significant implications. On the one hand, this article shows the effect of jurisdictional competition in a time of increased globalization by illustrating how the interplay of the exit and voice rights imposed an effective constraint on Taiwan’s regulation of a subject of great concern to the Taiwanese government. On the other hand, by describing how law market dynamics under jurisdictional competition in an age of globalization are already working, this article reminds those in a position similar to Taiwan’s that the disaster of economic regulation with extra-territorial reach will come again if they fail adequately to recognize and deal with these competitive pressures exerted by Offshore Financial Centers (“OFC”s).

This article is organized as follows: Section I extends the O’Hara-Ribstein framework to include international jurisdictional competition. After analyzing the dynamics of international jurisdictional competition in a global economy, this section explains how cross-Strait trade and investments are entangled in politics between Taiwan and China while providing the background of the restrictions (including the capital controls and constraints). Section II introduces Taiwan’s politics in various ways pointing toward the capital controls. Section III answers the puzzle of why, despite Taiwanese politics’ initial support for the capital controls, the flight of capital (i.e. exit) and its effects through

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3. The People’s Republic of China is commonly known as China.
4. China did not recognize Taiwan as an independent sovereign political entity and has been intimidating it with political and military forces. This political antagonism accentuated between 1995 and 1996 and contributed to the imposition of the capital controls (as explained below) in 1997, especially as a response to Chinese military intimidation.
5. Geographically, Taiwan and China are divided by the Taiwan Strait in the same manner the UK and European continent are divided by the English Channel. Customarily, people refer to any relationship between Taiwan and China as a cross-Strait relationship.
6. The capital controls indicate the upper limits on outward investment in mainland China that are imposed by Taiwan’s government from 1997. The constraints point to related constraints (in order to help enforce the capital controls) on use of capital raised in Taiwanese stock markets towards investment in China by both domestic and foreign issuers.
jurisdictional competition on Taiwan (i.e. the voice of anti-regulatory and exit-affected interest groups strengthened by exit) eventually provided an effective counterforce. Section IV then compares the law market explanation to the major alternative theories. Section V concludes by asserting that through the positive argument developed here, regulatory jurisdictions in a position similar to Taiwan’s could, to an extent, understand the true costs and benefits of regulation in the international dimension among others, and regulate in light of that understanding.

THE INTERNATIONAL LAW MARKET

Although most of the discussion of the law market has been within the context of the United States and European Union, law market forces are active in international jurisdictional competition. As globalization lowers exit costs across borders and enhances firm and capital mobility, it increases international jurisdictional competition for worldwide mobile factors of production through jurisdictions’ offer of laws and institutions of which the accompanying benefits are worth the additional expense. We in turn come to the interaction between the economic process in the international environment and the political process within a jurisdiction when it engages in competition through changes in laws and institutions. Suppose that the jurisdiction proposes a law favored by pro-regulatory interest groups, which is costly for firms, and so creates a demand for legal flexibility and an incentive for firms to leave. In the international economy, firms as “economic agents” have a degree of jurisdictional choice. This mobility feeds the demand side of the law market which firms’ exit rights underlie, and sparks competition for the supply of law by other jurisdictions. Exit and entry by firms seeking to avoid regulation creates costs and benefits for other interest groups in the jurisdiction. For example, corporate lawyers and accountants benefit when firms stay and suffer when firms exit. This mobility can thus activate domestic interest group competition on the supply side. In particular, mobility may provide “an indirect voice to outsiders and a stronger voice to insiders who will be burdened by the proposed law.”

In the domestic political process, these “exit-affected” interest groups join with the groups that are directly burdened by the regulation

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7. See, e.g., O’HARA & RIBSTEIN, supra note 1, at 107-22; Chang-hsien Tsai, Demand and Supply Forces in the Market for Law Interplaying through Jurisdictional Competition: Basic Theories and Cases, 1 E. ASIAN L.J. 1, 9-15 (2010).
8. O’HARA & RIBSTEIN, supra note 1, at 29.
Taiwan’s Regulatory Regime

to promote legal changes even if the directly affected groups could not
defeat the regulation proposed by the pro-regulatory interest groups alone. This, in turn, pressures politicians and lawmakers within the regulating jurisdiction, as “political agents,” to appreciate the significance of the economic exit signals, to discover that they need to supply laws and institutions “which constitute an attractive locational factor,” and to enable the relaxation of the costly law. Hence, where a regulation might be costly, the jurisdictional competition could push the regulating jurisdiction to improve the substantive content of local laws. What’s more, “[l]egal changes [would be] provoked by firms’ increasing need for legal flexibility.” In other words, as Professor Ribstein argues, “the mobility of firms, people and money across borders, transmitted through interest groups to political decision-makers, can produce long-run legal changes.” That is, the feedback mechanisms, options of exit (choice of location) and voice (political action), can be translated into the regulatory evolution, or the liberalization of costly regulation.

Let us return to the dynamics of international jurisdictional competition under globalization. Globalization promotes mobility of capital, talent, and firms, and reduces their costs of exit from a country. This in turn helps materialize the rise of international jurisdictional competition, or international law market. In the long run, even for large countries with local captive markets, jurisdictions are affected by the law market forces underlying international jurisdictional competition. Accordingly, we can understand that if a country’s regulation of firms is over-burdensome, it would be disciplined by the international law market and then pressured to moderate the regulation to some degree. Exactly as Professors Butler and Ribstein emphasized in their analysis of the impact of the US “Sarbanes-Oxley” regulations, this understanding “would involve regulators appreciating the significant limitations on government’s ability... to anticipate the full

10. See O’HARA & RIBSTEIN, supra note 1, at 191, 199.
11. Id. at 110.
13. See Mihir A. Desai, The Decentering of the Global Firm, 32 WORLD ECON. 1271, 1282 (2009) (arguing that the U.S. limits on firms’ ability to change their legal domicile “will surely fail in the long run as the global market for corporate control can circumvent local efforts to retain ownership”).
In the Taiwan case, as prices in stock markets in China and Hong Kong performed well in recent years, Taiwan became attractive because it was the last place to seek relatively cheap shares in companies with business extensively based in China. Until 2007, Taiwan’s “weighting in the widely used MSCI Emerging index was second only to South Korea’s.” Nevertheless, preoccupied with difficult questions of national identity, including the extent of political independence from the PRC and national security threats from the mainland, Taiwan’s government obstructed economic integration of the private sector with China by imposing and rigidly enforcing the restrictions. Not until President Ma of the KMT won the presidential election in March 2008 did Taiwan begin to turn to large-scale deregulation. Therefore, although many Taiwanese companies were believed to be earning hefty profits on their mainland operations even before May 2008, they kept their successes a secret to avoid the Taiwanese government’s stringent restrictions on China-investment.

Despite the restrictions, Taiwanese investment in the mainland was significant long before May 2008. After the 1979 change in the mainland’s policy on Taiwan, from insisting on the possible forcible “liberation” to calling for peaceful unification, the door to cross-Strait investment opened. When China opened up to outside investors during the 1980s, Taiwan-based firms were among the first companies to invest on the mainland. Once Taiwan allowed its citizens to visit their relatives on the mainland in October 1987, economic relations across the Taiwan Strait (the “Strait”) developed further. More importantly, economic ties grew after representatives of China’s Association for Relations Across the Taiwan Strait and Taiwan’s Straits Exchange Foundation in April 1993 had a historic meeting in Singapore. In this meeting, “[a]lthough characterized as unofficial, both delegations were headed by former high level officials tied to the top leadership in each capital.” As

16. The KMT, abbreviated from “Kuomintang” and denoting the “Nationalists,” is the opposition party before the 2008 presidential election and the current ruling party in Taiwan, whereas the Democratic Progressive Party (the “DPP”) is the former ruling and current opposition party.
17. Ping Deng, Taiwan’s Restriction of Investment in China in the 1990s: A Relative Gains Approach, 40 ASIAN SURV. 958, 962 (2000).
Taiwan's Regulatory Regime

Brasher reported in 2007, "[e]stimates of total Taiwan holdings on the mainland run as high as $280 billion."\(^{18}\)

Taiwanese investment into the mainland grew rapidly for several reasons. First, the financial liberalization followed substantial appreciation of the New Taiwan ("NT") dollar resulting from the Plaza Accord.\(^{19}\) The NT dollar's value increase made manufacturing in Taiwan less competitive and reduced Taiwanese exporters' profits. Taiwanese firms, to remain internationally competitive, started to make large investments on the mainland where costs of production were lower, as the price attracted much of the manufacturing and exporting activities originally based in Taiwan. In addition, the justification for Taiwanese investment mainly rests on comparative advantages as well as economic complementarities. Taiwan's plentiful funds and technology match China's abundant natural resources and low production cost almost perfectly. These comparative advantages, combined with cultural and linguistic similarities as well as geographic closeness, contribute to capital flows from Taiwan to China. Last but not least, Taiwanese firms feared they would lose markets to low-cost rivals like South Korean firms, unless they could lower their own costs by relocating their factories to China.\(^{20}\)

As cross-Strait economic interactions intensified, Taiwanese officials struggled to slow the development of business connections. In September 1996, President Teng-Hui Lee stressed the restrictive investment policy of "jie ji yong ren" ("No Haste, Be Patient," the "NHBP" policy) while requiring Taiwanese firms to reduce their rapid expansion of mainland operations. He emphasized that Taiwan would become susceptible to Chinese political pressure with greater cross-Strait economic interdependence. The Council for Economic Planning and Development, the official think tank of Taiwan's government, at the same time withdrew a suggestion to lighten restrictions on China-investment.\(^{21}\) The following July, the Ministry of Economic Affairs ("MOEA") revised Principles Governing the Review of Investment or

\(^{18}\) Bradsher, supra note 15.

\(^{19}\) The Plaza Accord indicates: [The] agreement in August of 1985 in which the finance ministers of the Group of 5—the United States, Great Britain, France, Germany, and Japan—met to reduce the value of the U.S. dollar against other major currencies. Though the dollar had already begun its decline months earlier, the Plaza Accord accelerated the move. The action was necessary because the dollar had become so strong that it was difficult for U.S. exporters to sell their products abroad, weakening the American economy. JOHN DOWNES & JORDAN ELLIOT GOODMAN, DICTIONARY OF FINANCE AND INVESTMENT TERMS 537 (8th ed. 2010).

\(^{20}\) Deng, supra note 17 at 962-64.

\(^{21}\) Id. at 965-66.
Technical Cooperation in mainland China (the “Principles”). Crucially, these included a cap on investment in Article 3 of the Principles, enacted under the authorization by Paragraph 1 of Article 35 of the Act Governing Relations between Peoples of the Taiwan Area and the mainland Area (the “Act”). The intention of the Principles was to protect Taiwan’s economic growth and national security. The Principles broadened the scope of prohibited investments, prohibited major infrastructure projects, confined single-project investments in China to fifty million dollars, and imposed a general system to limit Taiwanese firms’ investments in the PRC according to their overall financial exposure and ownership structure (collectively, I refer to these as the “capital controls”).

Today, the capital controls are much more flexible. The gradual relaxation of the capital controls demonstrates how international jurisdictional competition shapes the regulatory evolution of a democratically constrained onshore jurisdiction such as Taiwan. A crucial role was played by international jurisdictional competition led by OFCs, especially Hong Kong and the British Caribbean territories (e.g. the Cayman Islands). I argue that according to Taiwan’s regulatory transitions law, market forces underlying international jurisdictional competition spurred by capital flight nudge Taiwan’s government to relieve the costly regulation on outward investment in mainland China and create a more flexible regime.

THE POLITICS OF THE CAPITAL CONTROLS

Officially sanctioned direct investment by Taiwanese firms and individuals (Taiwanese Direct Investment, “TDI”) into mainland China has soared since the early 1990s, rising from insignificant levels to nearly $10 billion. Key drivers of TDI are Taiwanese firms’ searching for lower production costs and the linguistic and cultural affinity

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23. Andrew P. Morriss, The Role of Offshore Financial Centers in Regulatory Competition, in OFFSHORE FINANCIAL CENTERS AND REGULATORY COMPETITION 102, 104 (Andrew P. Morriss ed., 2010) (explaining that “[d]emocratically-constrained governments are those that are subject to significant degrees of constraint as a result of their need to win relatively open and fair elections, although the degree of constraint will obviously vary with the competitiveness and fairness of the political system.”).

Taiwan’s Regulatory Regime

between the mainland and Taiwan. China’s entry into the World Trade Organization (“WTO”) in 2002 further spurred Taiwanese firms’ desire to invest there and led to a shift in the nature of TDI industries from labor-intensive small firms to capital-technology-intensive large conglomerates. The Taiwanese government, however, attempted to control and limit the growth in TDI through a variety of restrictions on investment into the mainland. This section begins by explaining why the amount of outward investment in mainland China has been increasing substantially over time, and analyzes how and why the transitions of Taiwan’s capital controls are a general trend towards liberalization: from the restrictive investment policy (i.e. the NHBP policy) in 1997, to the tentative liberalization policy of “ji ji kai fang you xiao guan li” (“Proactive Liberalization with Effective Management,” the “PLEM” policy) in 2001, to the re-tightening policy of “ji ji guan li you xiao kai fang” (“Proactive Management and Effective Liberalization,” the “PMEL” policy) in 2006, and to the full-fledged liberalization policy after May 2008. It then describes the paradox of the relaxation of the capital controls following the surge of investment in China as Taiwan’s government struggled to regulate outward investment in China. This not only highlights the regulation’s ineffectiveness in controlling capital flight, but also suggests the relaxation of the capital controls in stages can be connected to exit, as discussed in Section III. In other words, these regulatory efforts ultimately proved unsuccessful, providing an important demonstration of the law market in action as explicated in Section III.

The Transition to Capital Mobility

Beginning in the late 1980s, Taiwan’s government has gradually lightened the regulation of foreign exchange and foreign direct investment (“FDI”) outflows and increased the mobility of Taiwanese capital and firms. In part, this reflected the post-Bretton Woods acceptance of capital mobility and de-emphasis on restrictions on capital movements. Thus, beginning with Taiwan’s adoption of a

25. See Jack W. Hou & Kevin H. Zhang, Taiwan’s Outward Investment in mainland China, in Financial Markets and Foreign Direct Investment in Greater China 182, 200-01 (Hung-gay Fung & Kevin H. Zhang eds., 2002) (“The TDI boom in China is a typical story of conventional comparative advantages plus cultural and linguistic affinity across the Taiwan Strait.”). Id. See also Julian Chang & Steven M. Goldstein, Introduction: The WTO and Cross-Strait Economic Relations, in Economic Reform and Cross-Strait Relations: Taiwan and China in the WTO 1, 21-22 (Julian Chang & Steven M. Goldstein eds., 2007).


27. Alan Dignam and Michael Galanis confirm this conclusion. See Alan J. Dignam &
floating exchange rate system on July 10, 1978. Taiwan has progressively relaxed controls on foreign exchange. Further liberalization of the laws on outward investment contributed to a considerable upsurge of investment in foreign areas (including mainland China) that began in the 1990s. Investment into the mainland as China’s low production costs and potential markets held a special attraction for Taiwanese firms.

In theory, “[s]uch economic complementarities are conducive to large unilateral capital flows from Taiwan to China, as long as both governments do not impose too many restrictions that might hamper such movement.” In fact, prior to the imposition of the capital controls in 1997, “[f]or most Taiwanese investors, it is rational... to move their sunset industries to mainland China where they can rejuvenate their declining competitiveness. But Taiwan government’s idea is somewhat different.” National security concerns over the dramatic rise in TDI in...
the PRC during the China investment boom of the mid-1990s, coupled with increased cross-Strait tensions in 1995 and 1996 (discussed below), prompted former President Ten-Hui Lee in August 1996 to announce the NHBP policy that sought to slow the flow of TDI into the mainland.34

The Restrictive Policy (1997-2001)

In July 1997 Taiwan introduced heavier restrictions on investment in mainland China. The restrictive policy significantly hampered business activities.35 Under the NHBP policy (in effect until 2001), the restrictions prohibited individual investments in the PRC of more than $50 million and required a case-by-case review of investments in sensitive sectors such as IT, chemicals, real estate, and infrastructure, by using a rating system to assess a variety of factors. This policy was driven by two main ideas: “Rapid outflows of FDI from Taiwan to mainland China might ‘hollow out’ Taiwan’s industries;” and “businessmen putting too many eggs in one basket in mainland China might render Taiwan vulnerable to future antagonistic moves by China.”36

MOEA classified potential investments in China as permitted, prohibited, and “special case.” Permitted projects were of industries where Taiwan was no longer internationally competitive, those that were not a critical part of a production chain or labor intensive, or projects for which the PRC could supply key raw materials for production. Prohibited investments included projects that involved critical technologies and products related to national defense, strategic industries, and infrastructure. Special-case investments were generally supposed to be under $50 million. As shown below in Table 1, Taiwan also imposed a general system to limit Taiwanese firms’ investments in

34. Karen M. Sutter, Business Dynamism across the Taiwan Strait: The Implications for Cross-Strait Relations, 42 Asian Surv. 522, 525 (2002). See also Zhen-Yin Jiang, Yin Ying Jing Ji Quan Qu Hua Zhi Liang An Jing Mao Guan Xi [Handling Cross-Strait Economic Relations under Globalization], 26 Taiwan Jing Ji Yan Ji Yue Kan [Taiwan Economic Research Monthly] (Issue 1) 50, 51 (2003) (Taiwan).


36. Chen & Chu, supra note 33, at 220. See also Chyan Yang & Shiu-Wan Hung, Taiwan’s Dilemma across the Strait: Lifting the Ban on Semiconductor Investment in China, 43 Asian Surv. 681, 682 (2003) (“There is a fear that the Taiwanese manufacturing sector could be swallowed up by China.”).
the PRC according to their overall financial exposure and ownership structure.

Table 1 The Capital Controls on Investment in mainland China under the NHBP Policy

<table>
<thead>
<tr>
<th>Type</th>
<th>Net worth or capital (whichever is higher)</th>
<th>Cap on accumulated amount of investments in China or on the percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Individuals and small- and medium-sized firms</td>
<td></td>
<td>The limit is NT$60 million.</td>
</tr>
<tr>
<td>2. Private firms</td>
<td></td>
<td>Private firms’ investment may not exceed 40% of net worth or capital (whichever is higher), or NT$60 million, whichever is higher.</td>
</tr>
<tr>
<td>3. Listed firms</td>
<td>Firms with under NT$5 billion</td>
<td>Their investments may not exceed 40% of their capital or net worth, whichever is higher.</td>
</tr>
<tr>
<td></td>
<td>Firms with between NT$5 billion and NT$10 billion</td>
<td>Their investments may not exceed 40% of NT$5 billion plus 30% of the portion of their net worth or capital (whichever is higher) over NT$5 billion.</td>
</tr>
<tr>
<td></td>
<td>Firms with over NT$10 billion</td>
<td>Their investments may not exceed 40% of NT$5 billion plus 30% of the part over NT$5 billion plus 20% of their net worth or capital (whichever is higher) over NT$10 billion.</td>
</tr>
</tbody>
</table>

Source: Investment Commission, MOEA

The Tentative Liberalization Policy (2001-2005)

In 2001 the Taiwanese government significantly liberalized the regulations, announcing the PLEM policy (i.e. the tentative liberalization policy). The change to this policy came about because of a sagging economy and Taiwan’s January 1, 2002 entry into the [WTO]. With the economic problems over the last three years, especially in 2001, industry executives are hoping that the opportunity for Taiwan’s manufacturers to expand and flourish more in China will result in a stronger local economy. The WTO entry for both China and
Taiwan is pressuring Taiwanese officials to dismantle trade barriers.\textsuperscript{37} Taiwan’s entry into the WTO on January 1, 2002, not long after the regulatory transition from NHBPP to PLEM was carried through, shows the relevance of this transition to Taiwan’s efforts for accession to the WTO.\textsuperscript{38} Moreover, subsequent to the WTO accession of both the PRC and Taiwan, Taiwanese firms confronted more intense international competition from other industrial countries, which forced Taiwanese firms to invest even more in China so as to further lower production costs and to expand market share on the mainland.\textsuperscript{39} Also, given how the East Asian international division of labor has developed since the 1990s and flourished further since China’s WTO entry in 2002,\textsuperscript{40} Taiwanese firms kept voicing their desire for the liberalization of the NHBPP policy in order to maintain their value in the global production chain.\textsuperscript{41}

The liberalization of investment regulations did not signal an end to the national security concerns that had driven the adoption of the policies. There remained “a concern in some quarters in Taiwan that from a national security perspective Taiwan is becoming overly dependent on the PRC market. Policy makers in Taiwan are also worried about the speed and direction of economic integration with further liberalization following WTO accession [of both Taiwan and China].”\textsuperscript{42} Despite this, “as the PRC liberalizes investment opportunities in the very sectors that remain regulated by Taipei, many firms are skirting domestic ceilings.”\textsuperscript{43} In order not to lose control over cross-

\begin{itemize}
\item \textsuperscript{37} Yang & Hung, supra note 36, at 682. See also Tain-Jy Chen, The Impact of China’s Accession into the WTO and Taiwan-China Trade and Investment Relations, in CHINA ENTERS WTO: PURSUING SYMBIOSIS WITH THE GLOBAL ECONOMY 153, 168-69 (Ippei Yamazawa & Kenichi Imai eds., 2001).
\item \textsuperscript{38} Qiao-Xuan Li, Wo Guo Dui Da Lu Jing Mao Zheng Ce Yu Gui Fan Zhi Guo Jia An Quan Fen Xi [Analysis of National Security regarding Taiwan’s Economic and Trade Policy and Regulation] 85 (June XX, 2006) (unpublished master thesis, National Taiwan University) (Taiwan).
\item \textsuperscript{39} See Zhong-Cong Xie, Tai Shang Dui Da Lu Tou Zi Zhi Jin Kuang Fen Xi [Recent Analysis of Taiwanese Businesses' Investment in mainland China], DIAN GONG XI XUN YUE KAN [TEEMADATA], July 2003, 54, 54 (Taiwan).
\item \textsuperscript{40} Sutter, supra note 35, at 30.
\item \textsuperscript{41} Shu-Cheng Weng, Wo Guo Da Lu Jing Mao Zheng Ce Bian Qian Zhi Yan Jiu—Cong “Ji Ji Kai Fang You Xiao Guan Li” Dao “Ji Ji Guan Li You Xiao Kai Fang” [Study on the Change of Taiwan’s Economic and Trade Policy towards mainland China—from “Proactive Liberalization with Effective Management” to “Proactive Management with Effective Liberalization”] 93 (Jan., 2007) (unpublished master thesis, National Taiwan University) (on file with author) (Taiwan).
\item \textsuperscript{42} Sutter, supra note 34, at 534.
\item \textsuperscript{43} Id. at 535.
\end{itemize}
Strait trade and investment, Taiwan’s government was forced to adapt. President Shui-Bian Chen of DPP, who was sworn in in 2000 and deeply anxious about maintaining cross-Strait trade and investment in the early period of his presidency, “regained some momentum with the formation and meeting of the Economic Development Advisory Council in [August] 2001.” The Economic Development Advisory Council (“EDAC”) not only “included representatives from Taiwan’s business community and major political parties,” but “agreed on a range of economic recommendations, including the liberalization of direct trade and investment, the creation of more flexible cross-Strait capital flow mechanisms, and the opening of travel and tourism.” The EDAC statements “offer an important source of support and legitimacy that allow Chen’s administration to pursue liberalization.”

In sum, shortly before Taiwan’s accession to the WTO in 2001, the Shui-Bian Chen administration “tried to seize the initiative in managing economic relations with the [M]ainland. It abandoned the [NHBP] policy and replaced it with a policy of [PLEM], which was both the recognition of the failure of earlier attempts to regulate and a political concession to the business community” just prior to the then legislative elections. According to the Principles amended on Nov. 20, 2001, Taiwan’s government eased the NHBP policy towards the PLEM policy. Under the new investment policy of PLEM, Taiwan’s state department simplified the classification into a general category that would require case-by-case approval and a prohibited category. This new policy also included the much-discussed lifting of the $50 million ceiling on individual investments and a simplification of approvals for investment projects under $20 million. The general system to limit Taiwanese firms’ investments in the PRC according to their overall investment exposure and ownership structure was also relaxed as exhibited in Table 2.

| Table 2 The Capital Controls on Investment in mainland China under the PLEM Policy |
|---------------------------------|---------------------------------|---------------------------------|
| Type                           | Net worth                       | Cap on accumulated amount of investments in China or on the percentage |
|                                 |                                 |                                 |

44. Sutter, supra note 35, at 32.
45. Id.
46. Sutter, supra note 34, at 532.
47. CHANG & GOLDSTEIN, supra note 25, at 35 (alteration in original) (emphasis added).
### Taiwan's Regulatory Regime

<table>
<thead>
<tr>
<th>1. Individuals and small- and medium-sized firms</th>
<th>The limit is NT$80 million.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Firms with over NT$80 million in their paid-in capital</td>
<td>Firms with under NT$5 billion</td>
</tr>
<tr>
<td></td>
<td>Firms with between NT$5 billion and NT$10 billion</td>
</tr>
<tr>
<td></td>
<td>Firms with over NT$10 billion</td>
</tr>
</tbody>
</table>

**Source:** Investment Commission, MOEA


In President Shui-Bian Chen's 2006 New Year message, he advocated a "new idea and method" concerning cross-Strait economic and trade policies in a reaction against the earlier liberalization. He asserted that the consensus of the PLEM policy reached by EDAC in August 2001 would be replaced by the PMEL policy (i.e. the re-tightening policy). According to the Mainland Affairs Council (“MAC”), the primary aim of this re-tightening policy is to advance “disciplined” liberalization of cross-Strait economic and trade policies, to alleviate the negative impact incidental to liberalization, to assure the individuality of Taiwan’s economy, and to carry out the macro-economic developmental strategy of “Richly Cultivating Taiwan while Reaching Out to the World.” Put simply, this new policy is an attempt to decrease Taiwan’s dependence on China’s economy.\(^4\)

Three factors play key roles in this regulatory transition from PLEM to PMEL. First, as Wang notes, Beijing’s new leader, Chairman Hu Jintao... clearly defined the policy toward Taiwan as well as set up a “Red Line,” using military force to backup [the] Anti-Secession Law [enacted Mar. 14, 2005]. This was the first time that Beijing transferred the political issue of

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using military force toward Chinese unification to a legal perspective.\textsuperscript{49}

Second, Taiwan’s economy had become increasingly and substantially dependent on China’s market. Encountering China’s military hostility especially after the enactment of the Anti-Secession Law, Taiwan’s policymakers sought to enhance national security via the PMEL policy. Third, Taiwan’s government reckoned that the liberalization dimension of the PLEM policy was over-emphasized whereas the “security coefficient of the economy” (“Effective Management”) is not implemented effectively. Therefore, the transition from PLEM to PMEL is to strengthen the regulatory or “management” dimension of the former policy.\textsuperscript{50}

In particular, the most noticeable policy tool to help enforce the PMEL policy lies in the “Policy Review” on significant investments in China. According to the Principles as amended on December 25, 2006, on top of the pre-existing case-by-case approval by MOEA, under specific circumstances a Policy Review would be conducted of applications for prior approval of investments in China. Under the Policy Review, Taiwanese firms’ CEOs would be interviewed by a panel consisting of the personnel from all authorities concerned. Furthermore these firms would have to commit themselves to assenting to on-site investigation on factories located in China by professionals delegated by MOEA.

\textit{The Full-Fledged Liberalization Policy since May 2008}

The efforts to control TDI into mainland China failed to stop the torrential outflows of Taiwanese capital and firms. More importantly, business interests continued to pressure Taiwan’s government to adopt a more laissez-faire position on TDI into the mainland. Both candidates in Taiwan’s March 2008 presidential election advocated liberalization,\textsuperscript{51} largely in reaction to Taiwan’s sluggish economy.\textsuperscript{52} The current KMT

\textsuperscript{49} Chen-Yu Wang, The Impact of Regional Economic Integration under the GATT/WTO Regime toward the Peace Process: The Case of Conflict Resolution between Taiwan and mainland China 82 (Dec. 2006) (unpublished S.J.D. dissertation, American University) (on file with author) (citation omitted).

\textsuperscript{50} Weng, \textit{supra} note 41, at 93-94.

\textsuperscript{51} “Mr. Chen is prevented by the Constitution from running for a third four-year term when voters go to the polls on March 22, 2008 to choose the next president. And both candidates want closer economic relations with the mainland, including the front-runner, Ma Ying-Jeou of the opposition Nationalist Party, as well as Frank Hsieh, from President Chen’s own Democratic Progressive Party.” Bradsher, \textit{supra} note 15.

\textsuperscript{52} Mr. Ma, the candidate from the KMT and the new president-elect, supported the relaxation of the capital controls by a wide margin. \textit{See A Breakout Bull Market for
government has been, step by step, introducing a series of deregulation measures since President Ma, who advocated anti-regulatory and pro-China policies, was inaugurated in May 2008.

According to the Principles amended on Aug. 29, 2008, Taiwan’s government significantly eased the PMEL policy. Under this new investment policy, the following measures are taken in order to simplify the review process for investment in China: First, the Policy Review on significant investments in China was canceled. Second, investments in China of less than $1 million may now be reported ex post within six months of the carrying out of these investments. Third, only when the accumulated amount of an individual investment exceeds $50 million will a special-case review be conducted. Fourth, a review system of key technology, that substantially affects Taiwan’s domestic economy and is required for domestic industrial development, is established to ensure that the key technology will not flow out and thus to maintain the competitiveness of Taiwanese industries. Moreover, the general system to limit Taiwanese firms’ investments in the PRC according to their overall investment exposure and ownership structure is appreciably liberalized as shown in Table 3:

Table 3 The Capital Controls on Investment in mainland China since May 2008

<table>
<thead>
<tr>
<th>Type</th>
<th>Cap on accumulated amount of investments in China or on the percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Individuals</td>
<td>The limit is relaxed to $5 million for investments per year.</td>
</tr>
<tr>
<td>2. Small- and medium-sized firms</td>
<td>The limit is NT$80 million, or 60% of their net worth or the consolidated net worth of the affiliated enterprises involved, whichever is higher.</td>
</tr>
</tbody>
</table>

3. Firms that are not classified into small- and medium-sized firms

The limit is all relaxed to 60% of their net worth or the consolidated net worth of the affiliated enterprises involved, whichever is higher. But if a firm is qualified by MOEA to be a subsidiary of a Multi-National Enterprise or to establish its headquarters in Taiwan, there will be no upper limit for such a firm.

Source: Investment Commission, MOEA

The Regulation's Ineffectiveness in Controlling Capital Flight

TDI in China grew significantly from $1.61454 billion in 1997 to $9.97055 billion in 2007 despite the capital controls designed to stem the tide of TDI in China. If we use the caps on Taiwanese individuals’ accumulated amount of investments in China from the NHBP policy in 1997 (NTS60 million), to the PLEM policy in 2001 (NTS80 million), to the PMEL in 2006 (NTS80 million), and to large-scale liberalization in 2008 ($5 million or around NT$168 million) as a proxy for Investment Allowance, we see that the capital controls were generally relaxed in stages: the capital controls are relaxed in 2001 and again in 2008 after President Ma took power. The wide range of relaxation is especially evident in the cases involving the investment upper limit of a Taiwanese corporation establishing its headquarters in Taiwan or of a multinational enterprise’s Taiwanese subsidiary is wholly lifted.

Figure 1 Comparison between the Surge of TDI in China and the Increase of Investment Allowance

Source: This Author
The evolution of the capital controls raises several questions. First, why did both TDI in China and Investment Allowance rise as shown in Figure 1? As a matter of fact, this not only highlights the regulation’s ineffectiveness in controlling capital flight, but also suggests the relaxation of the capital controls in stages can be connected to exit or capital flight, as further discussed in Section III. As summarized in Figure 2, the regulatory transition of the capital controls from 1997 to 2008 appropriately illustrates how international jurisdictional competition provoked by business demands of Taiwanese firms and their firm or capital mobility under globalization shaped the easing trend of China-investment regulation by Taiwan’s government. To be concrete, business demands, via exit and voice rights (the law market forces underlying international jurisdictional competition), spurred stage-by-stage relaxation of Taiwan’s capital controls. Furthermore, the international jurisdictional competition, which was stimulated by business demands and fuelled by firm or capital mobility, pushed a democratically constrained onshore jurisdiction such as Taiwan to relieve its regulation to a more flexible regime, even though Taiwan’s government struggled to regulate investment in mainland China as effectively as possible but failed after all due to the impacts of globalization in general and the “denationalization of financial capital” in particular. In other words, both the notable increase of TDI in China under economic globalization and the fact that the international jurisdictional competition (primarily provoked by the denationalization of financial capital) turns the capital controls almost ineffective, as explained below, might drive the stage-by-stage liberalization.

53. A comprehensive discussion may be found in Section III.B.3.
54. See Dignam & Galanis, supra note 27, at 217 (discussing that “with the denationalization of financial capital, significant constraints have been imposed on national authorities’ discretion to formulate macroeconomic policies,” and that “global financial integration has led to a loss of national autonomy, at least in the sphere of macroeconomic policy making”).

Exit and Voice in Taiwan’s Capital Controls, 1997-2008

This section explains the evolution in the capital controls as described above, arguing that while the Taiwanese politics initially supported the capital controls, the flight of capital (i.e. the exit) and its effects through jurisdictional competition on Taiwan (i.e. the voice of anti-regulatory and exit-affected interest groups strengthened by exit) eventually provided an effective counterforce. Section III.A first illustrates the problems in enforcing the capital controls: how an onshore jurisdiction’s regulatory capacity is impaired by unfettered capital mobility under globalization even though it has strong intention for such enforcement. Section III.B then elaborates on how jurisdictional competition intensified by capital flight drove Taiwan’s policy changes. Specifically, despite the Taiwanese government’s strong interest in controlling investment in China, the law market demand and supply forces (or the underlying exit and voice rights) under international jurisdictional competition forced Taiwan’s government into a quest for more legal flexibility and the liberalization of the capital controls. Thus, the stage-by-stage liberalization at issue has much to do with not just the surge of Taiwanese outward investment in China as a result of economic globalization, but also the fact that the international jurisdictional competition (chiefly spurred by the
Taiwan’s Regulatory Regime

Denationalization of financial capital rendered the capital controls almost ineffective.

Problems of Enforcement: Strong Intention but Weak Capability

The capital controls promulgated by Taiwan’s government became so costly that Taiwanese firms investing in China turned to other jurisdictions to satisfy their demands for access to the Chinese market. The international jurisdictional competition led by OFCs for corporate charters, listings, and other local economic activity emerges under the influence of globalization and firm or capital mobility bettered by technological and transportation advances. Since there are a variety of suppliers, ranging from the Cayman Islands (for corporate charters and relevant financial services) to Hong Kong (for listings), of alternative regulatory products which were not subject to the capital controls, these Taiwanese multi-national corporations (“MNC”s) could attempt regulatory arbitrage. At this time although Taiwan’s government agencies, knowing futility of acting unilaterally, attempt to look for regulatory cooperation to enforce the capital controls, those competing jurisdictions have no reason to help Taiwan to enforce the capital controls, given their own markets for those prosperous China-based Taiwanese firms and that Taiwan has no bargaining chips with which to purchase coordination. In consequence, economic globalization resulting from technological change, market processes, and other exogenous variables deprives Taiwan’s government of the power to act alone. Discovering these firms’ continuous “exit” from local markets, Taiwan experiences a radical change of political power in 2008 particularly as President Ma of KMT, advocating anti-regulatory and pro-China policies, won the presidential election. Large-scale relaxation of the capital controls follows.

Ignoring Business Demands under Globalization

The phenomenon of economic globalization—the removal of barriers to free trade and the closer integration of national economies—plays a central role in why Taiwanese firms have massive business demands for increasingly investing in mainland China. Crucially, in Taiwan, cross-Strait economic relations are primarily treated as a political issue, rather than an economic issue. In short, “the main reasons behind Taiwan’s tough economic regulations are concerns over national security—that is, worries that China could use its economic power to make Taiwanese businessmen in China further the [PRC’s]
This political view of the capital control issue is important, since it enables us to see how the preferences of Taiwanese political actors diverged from the interests of economic actors. From the economic point of view, however, the gradual growth of investment by Taiwanese companies on the mainland is a natural result of economic globalization. As Sutter argues, “Taiwan’s growing commercial ties to China’s economy are part of a larger globalization trend that ultimately puts cross-Strait relations into a much larger scheme of regional and global economic interdependence.” Thus, TDI in China “is a part of the global division of labor.”

Ultimately, Taiwan’s regulation of TDI in China was incapable of wholly thwarting the operation of market incentives—economic globalization and cross-Strait specialization. At best, the restrictions delayed or forced underground TDI in China. Due to the restrictions, Taiwan was incapable of being fully integrated into the system of international specialization and prevented from exploiting its competitive advantages. Taiwan might thus be trapped in a bottleneck in economic development. As a result, as elaborated below, “the political foundation [and legitimacy] for a coherent and feasible policy [of the restrictions] is eroding, and commercial interests are digressing from the Taiwan government’s policy goals” by exit to evade the restrictions. By forcing Taiwanese political actors to relax the capital controls despite their preference for maintaining them, the law market forces constrained the supply of law.

**Pervasive Evasion**

Many Taiwan-invested firms have funneled funds to China through their affiliates or subsidiaries incorporated in jurisdictions like the Cayman Islands, British Virgin Islands (“BVI”) and Hong Kong in order to skirt the investment restrictions. We can observe from the

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55. Chen & Chu, *supra* note 33, at 221 (alteration in original).
57. Sutter, *supra* note 34, at 534.
illustrations below how underground outward investment in mainland China occurred. Table 4 shows two sets of statistics as TDI in China: one recorded by Taiwan’s government and the other by Chinese government, both on a prior approval basis. Although some of the approved projects have never materialized, the investment figures recorded by the Chinese government are believed to be closer to the reality. Why do the two statistical sources (the official data both from Taiwan and China) differ that substantially? As Hou and Zhang argue, the dominant reason for the discrepancy is that the capital controls placed by Taiwan’s government “forced many Taiwanese investors to avoid documenting their cases to their government.”

Table 4 TDI in China (Comparison between the Statistics of Taiwan and China)

<table>
<thead>
<tr>
<th>Year</th>
<th>Taiwan’s Statistics</th>
<th>China’s Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cases</td>
<td>Amount ($ million)</td>
</tr>
<tr>
<td>1991 and before</td>
<td>237</td>
<td>174</td>
</tr>
<tr>
<td>1992</td>
<td>264</td>
<td>247</td>
</tr>
<tr>
<td>1993</td>
<td>1,262 (8,067)</td>
<td>1,140 (2,028)</td>
</tr>
<tr>
<td>1994</td>
<td>934</td>
<td>962</td>
</tr>
<tr>
<td>1995</td>
<td>490</td>
<td>1,093</td>
</tr>
<tr>
<td>1996</td>
<td>383</td>
<td>1,229</td>
</tr>
<tr>
<td>1997</td>
<td>728 (7,997)</td>
<td>1,615 (2,720)</td>
</tr>
<tr>
<td>1998</td>
<td>641 (643)</td>
<td>1,519 (515)</td>
</tr>
<tr>
<td>1999</td>
<td>488</td>
<td>1,253</td>
</tr>
<tr>
<td>2000</td>
<td>341</td>
<td>1,102</td>
</tr>
<tr>
<td>Total</td>
<td>22,475</td>
<td>15,598</td>
</tr>
</tbody>
</table>

Source: Chen & Chu, supra note 33, at 219.
Note: Statistics are up to June 2000 only.

We could thus conclude that “most Taiwanese investments projects on mainland China are not screened by the Taiwan government,” and that “[g]overnmental interventions from Taiwan play only a marginal role in regulating this unique economic relationship.” Overall, the

63. See Chen & Chu, supra note 33, at 218.
64. Hou & Zhang, supra note 25, at 186.
65. Numbers in parentheses are investment projects recorded through make-up registration; they were not approved by MOEA in advance. See infra Part III.A.2.2.
67. Ho & Leng, supra note 61, at 738.
rampant evasion might demonstrate high enforcement costs of the restrictions and their regulatory failure.

**Regulatory Failure**

To enforce the capital controls, Paragraph 1 of Article 35 of the Act states: “Any individual, juristic person, organization, or other institution of the Taiwan Area permitted by the Ministry of Economic Affairs may make any investment or have any technology cooperation in the mainland Area...” (emphasis added).” According to Article 86 of the Act, any person who makes an investment or has technology cooperation in violation of the provisions of Paragraph 1 of Article 35 (i.e. without MOEA’s ex-ante approval) shall be punished with an administrative fine of not less than NT$50,000 but not more than NT$25 million. To clarify and identify what would be “investment in the mainland Area” in the above provisions, MOEA reenacted the Regulations Governing the Approval of Investment or Technical Cooperation in mainland China (the “Regulations”) on July 31, 2002. Article 4 of the Regulations stated:

For the purposes of these Regulations, the term “investment in the mainland Area” shall denote any of the following activities by any nationals, legal entity, organization or other institution in Taiwan Area: 1. Establishing a company or business entity; 2. Increasing the capital of an existing local company or business entity; 3. Acquiring the equity of, and operating, an existing local company or business entity, but excluding the purchase of stock of a listed company; or 4. Establishing or expanding the business of a branch company or business entity. (Paragraph 1) These Regulations shall be applicable to those investments mentioned above made by any company in a third area in which any national, legal entity, organization or other institution in Taiwan Area invested while owning a controlling interest of that company. (Paragraph 2)

Given that Taiwanese parent companies are not permitted to freely shift funds located in Taiwan to satisfy their branches’ and subsidiaries’ demand in mainland China, many Taiwanese companies or individuals organized a company in a third area like the Cayman Islands while owning a controlling interest in that company, or channelled investment on the mainland to a company in a third area. Then those companies in a third area would directly set up a company in mainland China and transfer capital to that company or have that company list shares in

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68. Taiwan’s Supreme Administrative Court held that the above two routes were in violation of Article 4 of the Regulations. See discussion *infra* Part IV.A.
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Shenzhen or Shanghai stock market on the mainland, or would indirectly head for stock exchanges in the neighboring areas in the Greater Chinese Economy (sometimes also encompassing Singapore\textsuperscript{69}), the Hong Kong Stock Exchange ("HKSE") primarily, so as to raise capital there which the parent company in Taiwan could freely invest in mainland China.\textsuperscript{70} A number of cases\textsuperscript{71} illustrate how Taiwanese companies found these investment avenues into mainland China.

MOEA struggled to enforce the capital controls,\textsuperscript{72} often unable to submit documentation with sufficient evidentiary weight, like stock ledgers or records of companies incorporated in a third area, to the courts, but forced to fall back on reports bought from private detective agencies expert in acquiring internal corporate information. The courts thus held against MOEA on the ground of their failure to meet the burden of proof. In other words, the failure of MOEA’s enforcement conspicuously reveals that the enforcement cost might be too high in that MOEA does not have the necessary skills and resources to collect required evidence. This fact also implies that it was not difficult for Taiwanese companies, especially the closely-held corporations usually used by Taiwan’s small- and medium-sized enterprises, to circumvent the capital controls if those companies so doing are not required to report all material activities within their enterprise group under Taiwan’s securities and company laws.\textsuperscript{73}

Taiwan’s government to an extent could not help but acknowledge China-investment projects that were already underway via underground


\textsuperscript{70.} Until 2008, more than fifty-three Taiwanese companies used these tactics to become listed on the HKSE and twenty-three on Singapore Stock Exchange. Chin-Ho Hsieh, \textit{Wan Dian Zai Wang Tai Wan Xin Cai Fu Zao Shan Yun Dong [Approaching 10,000 Points of Taiwan’s Bourse: Taiwan’s New Orogeny of Wealth]}, \textit{JIN ZHOU KAN [BUS. TODAY]} (Taiwan), July 16, 2007, at 138. Additionally, some Taiwanese companies also directly incorporated in mainland China, and in turn listed on the Shenzhen Stock Exchange or the Shanghai Stock Exchange. Chong Chen [Sean Chen], \textit{Tai Min Jin Rong He Zuo Hu Meng Qi Li [The Financial Cooperation between Taiwan and Fujian Province, PRC Benefits Each Other]}, \textit{MIN ZHONG RI BAO [THE COMMONS DAILY]} (Taiwan), Nov. 4, 2006.


\textsuperscript{72.} Especially Paragraph 2 of Article 4 of the [regulation name].

channels. As shown in Table 5, numbers in parentheses are investment projects recorded through make-up registration rather than prior approval. Any jump in official Taiwan investment figures should thus be considered against unofficial estimates of what has been moving into the PRC market via offshore structures. For example, in 2002 MOEA issued a six-month grace period for firms that had illegally invested or entered into technology cooperation in the PRC, during which they can register with MOEA with no or merely a trifling fine. 74 In March 2008 before the Presidential election, MOEA announced a new round of make-up registrations, which was successful because the MOEA lowered administrative fines. 75 As these outliers in 1993, 1997, 1998, 2002, 2003, and 2008 demonstrate, on the one hand, Taiwan’s government through these “amnesties” intended to make Taiwanese firms’ exit to the PRC emerge from underground; on the other hand, Taiwan’s government recognized the failure of its efforts to regulate Taiwanese firms’ outward investment in mainland China.

Table 5 TDI in China (Taiwan’s Statistics)

<table>
<thead>
<tr>
<th>Year</th>
<th>Taiwan’s Statistics Cases</th>
<th>Amount ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>237</td>
<td>174</td>
</tr>
<tr>
<td>1992</td>
<td>264</td>
<td>247</td>
</tr>
<tr>
<td>1993</td>
<td>1,262 (8,067) 76</td>
<td>1,140 (2,028,046)</td>
</tr>
<tr>
<td>1994</td>
<td>934</td>
<td>962</td>
</tr>
<tr>
<td>1995</td>
<td>490</td>
<td>1,092</td>
</tr>
<tr>
<td>1996</td>
<td>383</td>
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</tr>
<tr>
<td>1998</td>
<td>641 (643)</td>
<td>1,519 (515)</td>
</tr>
<tr>
<td>1999</td>
<td>488</td>
<td>1,253</td>
</tr>
<tr>
<td>2000</td>
<td>840</td>
<td>2,607</td>
</tr>
<tr>
<td>2001</td>
<td>1,186</td>
<td>2,784</td>
</tr>
<tr>
<td>2002</td>
<td>1490 (1,626)</td>
<td>3,859 (2,864)</td>
</tr>
<tr>
<td>2003</td>
<td>1,837 (2,038)</td>
<td>4,595 (3,104)</td>
</tr>
<tr>
<td>2004</td>
<td>2,004</td>
<td>6,941</td>
</tr>
<tr>
<td>2005</td>
<td>1,297</td>
<td>6007</td>
</tr>
</tbody>
</table>

74. Yi-Fu Lin, Bu Zhang Zhi Tai Shang Gong Kai Xin [Public Letter from Minister of MOEA to China-Based Taiwanese Firms] (June 26, 2002) (on file with author) (calling on Taiwanese firms to conduct make-up registration).

75. Deng Lu Tou Zi Shang Xian Ke Wang Tan Xing Song Bang Zheng Yuan Da She Tai Shang [The Investment Caps Are Expected to be Relaxed: Taiwan’s State Department Will Pardon China-Based Taiwanese Firms]. FA YUAN FA LÜ XIN WEN [LAWBANK] (Taiwan).

76. Numbers in parentheses are investment projects recorded through make-up registration rather than prior approval.
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<table>
<thead>
<tr>
<th>Year</th>
<th>Registered</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>1,090</td>
<td>7,642</td>
</tr>
<tr>
<td>2007</td>
<td>996</td>
<td>9,971</td>
</tr>
<tr>
<td>2008</td>
<td>482 (161)</td>
<td>9,843 (848)</td>
</tr>
<tr>
<td>From 1991 to Dec. 2008</td>
<td>37,181</td>
<td>75,560</td>
</tr>
</tbody>
</table>


Note: Statistics are up to December 2008.

Moreover, primarily via OFCs in the British Carribean Taiwanese firms indirectly made large investments in mainland China largely in order to evade the capital controls imposed from 1997. By the time President Chen replaced the NHBP with his own PLEM policy in September 2001, “many had already invested in the Chinese market, disregarding government regulations. To many in the business community [the PLEM policy] is nothing more than a rationalization of fait accompli, as it is an open secret that many investors could simply route their money to a third country, then transfer the fund to China.”

According to several reports, from 1992 to 2001 many famous Taiwanese conglomerates, including Taiwan Ting Hsing Group (the largest food and drinks manufacturer in the Greater Chinese Economy), invested in China through holding companies incorporated in the Cayman Islands, Bermuda and BVI. This illuminates that Taiwan’s

77. The number of cases and amount in this row include those of previously unregistered investments which are recorded through make-up registration.

78. See Koong-Lian Kao, Liang An Jing Mao Zheng He De Qi Dian—Zi You Mao Yi Qu [The Starting Point of Cross-Strait Economic Integration—Free Trade Area], 2 GUO JIA ZHENG CE LUN TAN [NAT’L POL’Y F.], no. 7, 2002, at 26, 31 (Taiwan) (arguing that Taiwan’s government possesses poor knowledge regarding Taiwanese firms’ real investment in mainland China).

79. Ho & Leng, supra note 61, at 737-38 (alteration in original). See also Jia-Ke Hung & Chen-Yuan Tung, Tai Shang Dui Zhong Guo Jing Ji Fa Zhan Ji Fa Zhan De Gong Xian: 1999-2008 Nian [Contributions of Taiwan Businesspeople Towards the Economic Development of China: 1988-2008], Address at Symposium of the Center for China Studies, National Chengchi University, Taipei, Taiwan, in Tai Shang Da Lu Tou Zi Er Shi Nian: Jing Yan Fa Zhan Yu Qian Zhan [Taiwan Businesspeople Invested in China for Two Decades: Experience, Development, and Foresight] 6 (Oct. 3-4, 2009) (on file with author). See also Sutter, supra note 34, at 528-30 (reporting that Dan-Yang Shen, a senior research fellow and official in PRC’s Ministry of Commerce, also estimated that about two-thirds of funds invested in China from OFCs in the British Caribbean like BVI were originally derived from Taiwanese businesspeople).

80. CHEN-YUAN TUNG, QUAN QIU HUA XIA DE LIANG AN JING JI GUAN XI [CROSS-STRAIT ECONOMIC RELATIONS IN THE ERA OF GLOBALIZATION] 26 (2003) (Taiwan). See also
economic regulation hardly could completely stem the outflows of Taiwanese capital and firms.

In a nutshell, the huge gap between Taiwan’s official estimates and Taiwanese firms’ real investment in China reveals that costs of enforcing the capital controls are so high that ineffective enforcement results. This emphasizes that Taiwan’s regulatory failure is a consequence of Taiwanese firms’ internationalization also created by globalization, that is, the progressive change into MNCs with the ability of international planning and management.81

Onshore Jurisdictions’ Regulatory Capacity Impaired by Globalization

This section describes how after Taiwanese firms’ transformation into MNCs, Taiwan’s government often failed to effectively control MNCs due to the enhancement of their exit right to evade the capital controls. In other words, the impacts of globalization in general and the denationalization of financial capital in particular profoundly undermined the territorial basis of the capital controls. As globalization intensifies the international jurisdictional competition for mobile factors, out-flowing capital and firms as well as emigrating labor would thus compel regulatory jurisdictions to improve on the quality of their regulations.

The Role of Offshore Financial Centers in International Jurisdictional Competition

As discussed above, Taiwanese firms have tackled the capital controls by structuring abroad in OFCs such as the BVI.82 One of the significant reasons for bypassing the capital controls through OFCs is that the confidentiality policies are a specific feature of most OFCs,83 particularly in relation to both the beneficial ownership of companies and to bank accounts.84 For instance, the ownership of BVI International Business Companies is confidential. Information regarding shareholders and directors in these companies is not made public. The beneficial
ownership of these companies cannot be disclosed either. Only owners of registered shares and persons designated by BVI courts are allowed to review stock ledgers. Therefore, in general, the public and the Taiwanese government could not know which companies have something to do with investment in mainland China.  

When it comes to how Taiwanese firms have their offshore subsidiaries or affiliates list shares overseas to evade the restrictions, “four jurisdictions of incorporation are prescribed [by HKSE] for the purpose of eligibility for listing by the Listing Rules, namely Hong Kong, the [PRC], Bermuda and the Cayman Islands. The Listing Committee of HKSE in October 2006 also approved Australia and Canada (British Columbia) as “acceptable jurisdictions.” According to HKSE’s statistics, by March 2, 2006, among forty-eight Taiwan-invested firms once or then listing shares on HKSE, fourteen of them are incorporated in Bermuda, one in Hong Kong, and thirty-five in the Cayman Islands. Now that HKSE also permits firms incorporated in the PRC for listing, why are most of the listed Taiwan-invested firms, which make large investment in China, incorporated in OFCs, rather than mainland China? We can clearly find that, given the confidentiality for companies incorporated in OFCs, not only most of the Taiwanese conglomerates would by incorporating holding companies in OFCs break through the blockade of the capital controls, but also those which need to raise funds on HKSE would also first incorporate a company in the Cayman Islands or Bermuda and then have that offshore company list shares on HKSE, so as to successfully circumvent the restrictions. Since Hong Kong neither imposes any restraint on listed firms’ operation areas or uses of funds raised, nor assists Taiwan’s government in enforcing the restrictions, the HKSE, as a supplier for a listing product of legal flexibility in dealing with the capital controls and constraints, progressively becomes a favorite fund-

85. Shao-Yun Fang, Hang Wai Ren Shi Dui Jing Wai Gong Si De Wu Jie Yu Zheng Jie [Layperson’s Misunderstanding over Offshore Companies and the Clearing Up], SHI YONG YUE KAN [TAXES & BUS. MONTHLY SERVICES], Oct. 2003, at 54-55 (Taiwan).
raising venue for Taiwanese firms investing in China.

Apart from Hong Kong, in the jurisdictional competition for Taiwanese firms led by OFCs, jurisdictions in the British Carribean are also crucial suppliers for regulatory products of legal flexibility in dealing with the capital controls. Taiwan’s capital controls sought to change Taiwanese firms’ behavior by altering incentives (through imposing an exit tax on China-based Taiwanese firms or on capital flows from Taiwan to China). However, Taiwanese firms, after turning into MNCs with multinational production and distribution networks, could avoid the restrictions, minimizing the more costly operation of headquarters and listing activities in Taiwan, and favoring transactions conducted in Hong Kong and other OFCs. These OFCs not only operate company registries and similar activities, but also “secure high value added transactional work creating and managing business entities.”9 Since many of them “today have evolved... to a mix of financial center activities that include legal, accounting, and other services in an attempt to expand the portion of the economic activity occurring within their borders,” they can yield greater benefits to the local economy.90 Likewise, by attracting more and more prosperous China-based Taiwanese firms to list shares, Hong Kong secures more financial center activities to its local economy as well.

Therefore, these OFCs are incentivized to compete on these margins by supplying not simply the confidentiality for investment into mainland China but also the flexibility of capital movement, which increases “the cost-effectiveness of the regulatory package.”91 Competition on this margin should tend to force Taiwan to produce less costly forms of the capital controls, as the stage-by-stage relaxation from 1997 to 2008 demonstrates. Specifically, these OFCs are able to undercut the price charged by Taiwan’s government through exit taxes as well as to facilitate TDI in China, which the Taiwanese government dislikes. Hence these OFCs enable avoidance of exit taxes if operations of headquarters and listing activities can be moved to the offshore jurisdiction and so limit the ability of Taiwan’s government to impose exit taxes on TDI in China. International jurisdictional competition thus both limits the Taiwanese government’s “freedom of action in specific areas” and “changes the mix of government policies by changing the relative costs of various policies in terms of economic activity forgone”

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90. Id at 107, 133.
91. Id. at 114.
such as IPOs which could have stayed in Taiwan.\textsuperscript{92} Over and above limiting regulatory efforts, international jurisdictional competition can lead to positive changes in onshore law by creating an incentive for onshore jurisdictions like Taiwan to respond to the legal flexibility supplied by these OFCs.

Moreover, these OFCs must be concerned with their commitment to supply the secrecy and legal flexibility of TDI in China. Indeed, compared with other large onshore economies like the United States, these OFCs have much more reason to be concerned with their credibility, as New Jersey did until it “suffered an important blow to its once-dominant position in corporate charters within the United States to Delaware when New Jersey damaged its reputation for consistency and reliability [of respecting business demands] by passing the ‘seven sisters’ corporate law changes in 1913...”\textsuperscript{93} Nowadays, both Delaware and these OFCs rely upon their regulatory competitive position to “sell” their laws to consumers across borders. They are small jurisdictions to which the benefits derived from international jurisdictional competition make a big difference if compared with other bigger and more powerful jurisdictions.\textsuperscript{94} This fact acts as a bond to their respective customers that they will not change their policies towards them and that they will continue to be receptive to new convenient regulations.

More important, these OFCs play a significant positive role in the international legal system that is rarely recognized by providing a different type of competitor in the market for law. Democratically-constrained onshore governments learn that more vigorous international jurisdictional competition will raise the cost of over-burdensome regulations, which leads them to engage in less of it.\textsuperscript{95}

In the Taiwan case, international jurisdictional competition is likely to have a significant impact on Taiwan’s capital controls. Because of these OFCs’ focus on maximizing their revenue from the sum total of transactions occurring within their jurisdictions, they are unlikely to help Taiwan’s government enforce the restrictions which seek to change regulated entities’ behavior in ways unrelated to that goal, not to mention that Taiwan has few bargaining chips for regulatory cooperation. Competition from these OFCs is thus likely to exert greater pressure on regulatory efforts of the capital controls, thus

\begin{itemize}
\item \textsuperscript{92} See Morriss, \textit{supra} note 23, at 121-22.
\item \textsuperscript{93} \textit{Id.} at 115 (alteration in original).
\item \textsuperscript{94} See \textit{Id.} at 139-40.
\item \textsuperscript{95} \textit{Id.} at 144-46.
\end{itemize}
forcing Taiwan’s government to gradually reduce them.

In sum, these OFCs’ non-cooperation with Taiwan’s government exercises an important discipline on Taiwan’s government by allowing Taiwanese firms and capital to route around the restrictions to lower transaction costs of TDI in China. Meanwhile, the above discussion to an extent demonstrates why Taiwan’s capital controls were relaxed stage by stage over time, as more and more capital were invested in China and evasion via OFCs grew.

Home Regulation Invalidated by Internationally Oriented Firms with Unfettered Capital Mobility

Changing into “autonomous business communities that have integrated their operations into a global division of labor,” Taiwanese “[i]nternationally oriented firms have presented a major challenge to Taiwanese government’s constraining economic policies toward mainland China, as such regulations do not have substantial binding effects on these firms.” As Leng further explains, “[i]t is the international market that has created the gap between governmental policies and investment behavior.”

Given increasingly intense international competition, the key for a firm to survive, develop and improve competitiveness is to be integrated into the global system of specialization. MNCs, by bargaining in a global setting, can obtain the lowest tax rate and the most advantageous infrastructure and other public goods. In this regard, traditional state boundaries will gradually disappear. The global capital mobility and the development of international markets push laws within the territory of the state to be adjusted. Thanks to the advancement of IT and telecommunication technology, MNCs no longer largely retain their national identities while their headquarters activities no longer remained bundled primarily in their home countries. Meanwhile, MNCs will invest in a jurisdiction with the most advantageous mix of tax rates, laws, labor resources, basic infrastructure and so forth. By the commitment of FDI and the threat of exit from markets, MNCs limit regulatory jurisdictions’ rent-seeking.

97. Tse-Kang Leng, supra note 66, at 508.
98. Id.
100. Chung-Yuang Jan, Quan Qiu Hua Zhi Guo Jia Zhu Quan Yu Jing Ji—Liang An Jia Ru WTO Zhi Fen Xi [A Nation State’s Sovereignty and Economy—Analysis of China’s
Taiwan's Regulatory Regime

businesspersons have escaped governmental restrictions and launched new investment projects on mainland China based on their own calculations of economic profits. The real parties with whom they must bargain are the local authorities in host countries. Taiwan's regulative policies have not proven to be so successful. The above analysis of how the Taiwanese business community has dealt with its home country's restrictive policies when it invests in mainland China thus leads to a re-examination of the effectiveness of Taiwan's economic statecraft in the era of market internationalization and the changing role of the state. In a word, it is internationalized markets, rather than laws, that "regulate" economic activity.

In particular, another factor that may cause difficulties for Taiwan's government in controlling Taiwanese MNCs' activities is that channels through which capital can be acquired develop further. Moreover, as Taiwanese enterprises have turned into internationalized MNCs, "it has become harder for the government to control capital flows to mainland China. The most recent trend is for Taiwanese enterprises to obtain capital in the international capital market to support their mainland projects. The favorite places for Taiwanese business communities are Singapore and Hong Kong." In addition, "[o]ther [Taiwanese MNCs] such as Formosa Plastics undertake their projects in mainland China through branch companies or subsidiaries in a third country." Put differently, they raise the capital overseas—"a process long underway through finance companies established in the Cayman Islands and the British Virgin Islands." As Leng adds, "[this] is a typical example of how [MNCs] can evade a home country's control. In other words, major financial support has come from international, rather than domestic, sources."

In sum, after Taiwanese firms develop the ability to use international planning and management, Taiwan's government could not effectively control every MNC everywhere. The enhanced exit ability allows them to evade the capital controls. In other words, "the increasing globalization of business would be rendering local

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and Taiwan's Accession to WTO], 1 GOU JIA ZHENG CE LUN, [NAT'L POL'Y F.] (ISSUE 9) 157, 162 (2001) (Taiwan).
101. Tse-Kang Leng, supra note 66, at 495.
102. See Leng, supra note 81, at 35.
103. See Tse-Kang Leng, supra note 66, at 502.
104. Id. at 501.
105. Id. (alteration in original).
106. Sutter, supra note 34, at 536.
107. Tse-Kang Leng, supra note 66, at 503 (alteration in original).
The impacts of globalization in general and the denationalization of financial capital in particular have profoundly undermined the territorial basis of the capital controls.

**Economic Sovereignty Eroded by International Jurisdictional Competition**

The economic and political entanglement between Taiwan and China provides rich materials for examining the interaction between the state and business in the era of globalization. Leng argues: “Cross-Taiwan Straits economic interaction is a political as well as an economic issue. General trends of economic interdependence and globalization that are weakening the role of the nation state should promote a focus of shared ‘civilian governance’ between Taiwan and mainland China.”

To tentatively summarize, economic globalization, involving the removal of trade and investment barriers for Taiwan’s and China’s joining the WTO (“the institutionalized force of globalization”) as well as the capital mobility enhanced by the denationalization of financial capital, indirectly exerts transformative pressures on Taiwan’s government to seek progressive deregulation of the capital controls to meet business demands, which were also created under the power of economic globalization.

Let us return to the conundrum confronted by MOEA. Why does MOEA run into such high difficulties in enforcing the capital controls? We might find the answer from international jurisdictional competition prompted by globalization. In theory, as regards underlying factors spurring jurisdictional competition in a global setting, as Macey argues, increased competition, specifically increased global competition among private sector actors, makes it difficult or impossible for administrative agencies [in regulatory jurisdictions] unilaterally to regulate national firms. . . . This increased competition is caused by a number of factors. Technological change and greater efficiencies in transportation networks have increased global competition by making it easier for distant companies to compete with local businesses. Similar market advances have made it easier for local manufacturers and service providers to engage in regulatory arbitrage [especially via OFCs] by moving their operations overseas. These developments [regarding the evolvement for firms to become MNCs] have had a direct effect on regulators, because they have made it easier for firms

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108. O’HARA & RIBSTEIN, supra note 1, at 222.
110. Id. at 262.
Taiwan’s Regulatory Regime

[with the capability of international planning and management] to mitigate the effects of unwanted regulation or to avoid such regulation altogether by moving their activities beyond the jurisdiction of the regulator that has promulgated the unwanted regulation.111

In short, under globalization, the increase in international production factor mobility and technological improvement lowers firms’ exit cost, arms firms with the ability of international operation, and then intensifies the international jurisdictional competition for mobile factors. Out-flowing capital and firms as well as emigrating labor would thus compel regulatory jurisdictions to improve on the quality of their regulations.

The Relationship between Capital Flight and Changes in Political Policy

This section makes the positive argument that in the Taiwan case jurisdictional competition fuelled by capital flight may drive changes in political policy. In other words, Taiwanese firms’ business demands, via exit and voice rights, have been nudging the capital controls in the direction of relaxation stage by stage from 1997 to 2008 as the power of Taiwan’s government was so constrained by international jurisdictional competition prompted by economic globalization that the capital controls were rendered all but ineffective.

The Relaxation from the Restrictive Policy in 1997 to the Tentative Liberalization Policy in 2001

How did business demands push for the relaxation from NHBP in 1997 to PLEM in 2001? First, President Lee in 1996 persuaded the business community to diminish its investments on the mainland and tightened administrative regulations. What followed was that the government threatened to enforce the capital controls more diligently while inflicting severe punishment for violations. Nevertheless, the influential business community kept resisting the government policy by “voicing” demands for a less restrictive trade and investment regime as well as by “exiting” via OFCs to simply circumvent the capital controls.112 Based on interviews carried out by Tse-Kang Leng in Shenzhen and Guangzhou, Guangdong, PRC in 1997, the [NHBP] “policy has not had significant impact on small- and medium-size businesses from Taiwan; they are many steps ahead of government

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112. See Chang & Goldstein, supra note 25, at 34-35.
policies and will continue to be so in the foreseeable future." This fact points out that official policies lagged behind those of business entrepreneurs. Moreover, given that the business community argued that the enlargement of their investments in China would contribute to a better local economy in Taiwan, and that Taiwan's government was in urgent need of these Taiwanese firms to help resolve the conundrum of sagging economy not least in 2001, Taiwan's government had no other option but to appropriately respond to business demands for the liberalization of the NHBP policy. As the pressure was building up in Taiwan for the government to abandon the NHBP regulation, feedbacks of voice and exit from the Taiwanese business community influenced the regulatory evolution from the NHBP to the PLEM.

Second, the WTO, after Taiwan and China entered, also matters in bringing about the transition from NHBP to PLEM. From the viewpoint of the law market forces, the WTO increased business demands of Taiwanese firms to more actively invest in China and to meanwhile seek more legal flexibility of the capital controls—otherwise they would just leave with their exit rights reinforced by outside globalizing forces. As this demand force sparked the supply force, it was their voice rights in Taiwan’s political market strengthened by their physical exit and threats of exit that put enormous pressures on Taiwan’s government to substitute the more liberal PLEM policy for the more restrictive NHBP policy.

Third, the international division of labor drives Taiwanese firms to invest in mainland China to lower production costs and capture Chinese domestic markets. The business community thus continues voicing their desire for liberalization of the NHBP policy, which culminated in EDAC held in August 2001, determining the regulatory transition from the NHBP policy to the PLEM policy. In this arena for interest group competition, the KMT, turning to embrace an anti-regulatory and pro-China position after its defeat in the presidential election in 2000, actively voiced its support for relaxation of the capital controls that Taiwan’s government should help firms operate globally with the

113. Tse-Kang Leng, supra note 66, at 502 (alteration in original).
114. Id. at 502-03.
115. See also Weng, supra note 41, at 46.
116. See Leng, supra note 109, at 267-68.
117. See Xiao-Jia Qiu, Song Bang Liang An Jing Mao Yi Li Taiwan Chan Ye Quan Qiu Bu Ju [Liberalizing Cross-Strait Economic Relations to Facilitate Taiwanese Enterprises' Global Operation], 1 GUO JIA ZHENG CE LUN TAN [NAT’L POL’Y F.] (ISSUE 8) 143, 143 (2001) (Taiwan).
118. See Jiang, supra note 34, at 51-52.
strategy of international planning and management in order to follow the trends of economic globalization. Moreover, during the period of EDAC, six major local chambers of commerce, as anti-regulatory interest groups, pushed for this transition as well: the Chinese National Federation of Industries ("CNFI")\textsuperscript{121}, the General Chamber of Commerce of the R.O.C. ("ROCCOC")\textsuperscript{122}, the Chinese National Association of Industry and Commerce, Taiwan ("CNAIC")\textsuperscript{123}, National Association of Small and Medium Enterprises Republic Of China ("NASME R.O.C.")\textsuperscript{124}, Taiwan Federation of Industry ("TFI")\textsuperscript{125}, and Taiwan Electrical and Electronic Manufacturers’ Association ("TEEMA").\textsuperscript{126} Therefore, EDAC, on the one hand, acts as a sort of feedback mechanism to turn small- and medium-sized Taiwanese firms’ exit from Taiwan into voice, filling gaps in the political or “voice” mechanism for these less influential enterprises which lack effective choice in the political process. On the other hand, it provides those ruling anti-regulatory groups with an efficient arena where they together with big business groups could exercise voice rights, or exert pressure on the government to moderate the NHBP regulation.\textsuperscript{127}

In sum, in the face of the business community’s increasing demands for more legal flexibility of the capital controls, “[President Chen] released his strategic design to balance economic globalization
and national security during the Presidential election campaign [in 2000]. Chen argued that instead of maintaining the [NHBP] policy, national security and economic benefit are not necessarily mutually exclusive.”\textsuperscript{128} Put it another way, “Chen’s policy design represented his attempt to accommodate business interests and attract more support on the domestic front from the business community. In his 2001 New Year’s Remarks, Chen emphasized on the new perspective of [PLEM] on cross-Straits economic relations.”\textsuperscript{129} Through this first stage of the regulatory transitions of the capital controls from 1997 to 2008, business demands, via exit and voice, push for the relaxation from NHBP to PLEM.

\textit{The Relaxation from the Re-tightening Policy in 2006 to the Full-fledged Liberalization Policy in 2008}

The Lee administrations in the 1990s remained highly suspicious of cross-Strait economic relations and eventually embraced the pro-security policy of NHBP. This policy, however, was replaced by the PLEM policy during the first term of Chen’s presidency. In fact, Leng notes that whereas “[d]irect investment in China with a value of less than $50 million is allowed . . . the Taiwanese state still attempts to impose hurdles in the high tech sectors, out of security concerns.”\textsuperscript{130} The re-tightening of regulation can be observed from the transition from the PLEM policy to the pro-security policy of PMEL in 2006. Nonetheless, business demands, once again, pushed the government to liberalize the capital controls, as demonstrated in the relaxation from the PMEL policy in 2006 to large-scale liberalization in 2008. In effect, the re-tightening of the capital controls in 2006 was unilaterally decided by the Chen administration, not as the liberalization towards PLEM in 2001 was determined in EDAC, an arena for collective policy making, or formal interest group competition. Therefore, the stricter PMEL policy not only ignored business demands for aggressive investment in mainland China\textsuperscript{131} and for concomitant legal flexibility, but also undermined the Chen administration’s reputation to cater to market demand, which had been established during EDAC in 2001. As discussed above, in response to this transition towards more regulation in 2006, Taiwanese firms, on the one hand, continued voicing their

\begin{footnotesize}
\begin{enumerate}
\item See Leng, \textit{supra} note 109, at 264.
\item Id. at 265.
\item Leng, \textit{supra} note 96, at 75.
\item See also Weng, \textit{supra} note 41, at 95.
\end{enumerate}
\end{footnotesize}
petition to liberalize the capital controls in a variety of ways. On the other hand, they exited from Taiwan’s stock markets to list shares overseas or further substantially transfer their funds abroad for investments in China through underground channels, so as to avoid more severe regulation.

Although there might be other reasons for Taiwanese companies to list shares overseas, the primary cause is that the re-tightened capital controls in 2006 compel Taiwanese companies to do so. This argument can be illustrated by the dramatic plan of an attempted delisting from TWSE by Advanced Semiconductor Engineering Inc. ("ASE"), so as to circumvent the re-tightened capital controls (the "ASE case"). Its threat of exit not only triggered a formal interest group competition, but also strengthened the business community’s voice for legal flexibility, which might eventually galvanize liberalization of the capital controls and constraints in 2008.

ASE, founded in 1984 in Taiwan and later listed on TWSE, is one of the world’s leading providers of semiconductor manufacturing services and the world’s largest supplier of advanced IC packaging with a market value of up to NT$150 billion. Frustrated with the application to MOEA for prior approval of its investment on the mainland, ASE allegedly considered collaborating with the Carlyle Group ("Carlyle"), an American private equity firm, to be bought out and turned into an actual foreign corporation. Through this management buy-out ("MBO") it planned to be delisted from TWSE and then list shares overseas. This deal was disclosed by the press in November 24, 2006. In April 17, 2007, this MBO finally failed in part because both parties could not agree on the purchase price. As commentators emphasized, however,

132. See, e.g., Editorial, Zi Xun Jie Lu Ying Zhong Zhi Bu Zhong Liang [Quality Is More Important than Quantity in Terms of Information Disclosure], JING JI RI BAO [ECONOMICS DAILY] (Taiwan), Dec. 3, 2007, at A2 (reporting that TWSE held 13 forums with executives from nearly 700 TWSE-listed corporations and these executives from the perspective of business practice made clear their heartfelt wishes that the capital controls could be loosened).


135. Wen-Chieh Wang, Kai-Lin Faung & Jerry G. Fong, Taiwan Guan Li Ceng Shou Gou Zhi Fa Li Wen Ti [Legal Issues of Management Buyouts in Taiwan: The Cases of ASE
if this deal had been successfully closed, Taiwan would have lost the control over more than NT$100 billion of output value in the global semiconductor industries. In fact, since this deal was an MBO, even if Carlyle had acquired ASE in form, this company’s original owners and management could indirectly still hold a majority of ASE’s shares. More importantly, even though the acquired ASE would still be based in Taiwan in the short term, the Taiwanese government would have less say over how the new ASE would invest in mainland China. If ASE became a foreign company, delisted from TWSE, and re-listed shares overseas—changing its legal nationality—ASE could maximize its ability to raise funds without being subject to the capital controls and constraints.

The Taiwanese business community was then in an uproar over ASE’s voting with its feet. It was said that many China-based Taiwanese companies restrained by the regulation would follow its lead. The European Chamber of Commerce Taipei (“ECCT”), American Chamber of Commerce in Taipei (“AmCHam”), and many local chambers of commerce started eagerly requesting the government to loosen the restrictions, and made this request through the legislature.

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Hence economic signals of physical exit (e.g., Taiwanese firms’ listing shares overseas) or threats of exit (e.g., ASE’s attempt to avoid the capital controls by a delisting in the first place and reincorporating overseas) were then sent to the political marketplace within Taiwan where the voice rights of the anti-regulatory business community, reinforced by exit, were exercised to exert important pressures for the relaxation of the capital controls via the legislature among other things.\textsuperscript{139} The ASE case obviously sparked the formal interest group competition in the legislature over the relaxation of the capital controls,\textsuperscript{140} which might arguably lead to the regulatory transition from the PMEL policy to large-scale liberalization in 2008. This interest group competition occurred in November 2006. I-Ru Liu, as a then-legislator in Taiwan, acted as an agent mainly for anti-regulatory interest groups combined with exit-affected interest groups,\textsuperscript{141} and made two proposals to modify the Act and relax capital controls in order to solve the predicament of Taiwanese companies with investments in China. Even though more than 100 legislators\textsuperscript{142} lent their support for these two proposals, the legislature was not able to pass the proposals in the face of the then-ruling party, DPP, and its allies, which had a majority and took an anti-China and pro-regulatory stance.\textsuperscript{143}

During the regulatory transition of the capital controls for this time, the debate over whether to further liberalize the capital controls after the attempted ASE’s MBO is but one case, albeit a highly critical one presaging large-scale easing of the capital controls in 2008, of the interest group competition where voice rights boosted by exit rights are exerted to push for the relaxation of the capital controls. Although the relaxation initiative provoked by the ASE case failed, it was a dry run for the later successful exertion of voice rights in the first half of 2008. As discussed above, the restrictions forced Taiwanese companies with

\textsuperscript{139} See Editorial, Zai Lun Fu Da Lu Tou Zi She Ding Shang Xian De Bu Shi Dang Xing [The Illegitimacy of the Imposition of Upper Limits on Investment in mainland China Revisited], GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), Dec. 3, 2006, at A2 (reporting that under the impacts or pressures of the ASE case, it was said these days that Taiwan’s state department tended to ease the capital controls while the then-legislator I-Ru Liu formally proposed amendments to the Act with a view to forcing the executive branch to loosen the capital controls).

\textsuperscript{140} Weng, supra note 41, at 115.

\textsuperscript{141} Erin A. O’Hara & Larry E. Ribstein, Rules and Institutions in Developing a Law Market: Views from the U.S. and Europe, 82 TUL. L. REV. 2147, 2152 (2008) (“Politicians can be viewed as acting as brokers among interest groups, where politicians provide these groups with political favors and the interest groups return those favors with enhanced reelection prospects, in the form of campaign contributions and votes”).

\textsuperscript{142} There were, in total, 225 seats in Taiwan’s legislature at that time.

\textsuperscript{143} Internationalization, supra note 134, at 87.
substantial investment in China to list their shares overseas to raise capital that could be used for investments in China. The mobility, or rather the physical exit and threats of exit as exemplified by the ASE case, fed the demand side of the international law market led by OFCs. This subsequently sparked the supply side within Taiwan to voice the demands for legal flexibility which had already been made available by jurisdictions such as Hong Kong and OFCs in the British Caribbean. The pressure for relaxation has greatly been building up on the Taiwanese government. For instance, in November 2007, encountering continuous voice for the liberalization of the restrictions, MAC, the brains of Taiwan’s government concerning cross-Strait affairs, was forced to concede that the investment caps according to the unitary proportional design fit neither economic principles nor the initial intent of the security element of the capital controls (Effective Management).  

The DPP government’s re-tightening of restrictions in 2006 and the flocking of Taiwan-invested firms to list shares overseas to avoid capital controls and constraints arguably drove exit-affected interest groups—mainly—represented by local retail investors—to join anti-regulatory interest groups. They dominated the political arena not least in the presidential election in March 2008. This domination in the political marketplace can be substantiated by the almost identical promises from both candidates in the election to embrace the future liberalization of capital controls. In other words, given the torrential exodus of Taiwanese firms, both presidential candidates were in favor of prospective relaxation of the capital controls, differing only on the scope of liberalization. Where the regulation might be costly, the resulting competition of interest groups moderated the substantive content of Taiwan’s regulation by forcing the Taiwanese government to take account of the costs imposed. Then President Ma, advocating anti-regulatory and pro-China policies, won the presidential election. As discussed above, the Ma administration swiftly liberalized the capital


145. Tsai, supra note 133, at 105-09 (discussing that Taiwanese firms’ mobility via listing shares overseas might motivate a strong exit-affected interest group, local retail investors, to join anti-regulatory interest groups, especially in the March presidential election in 2008).
Taiwan’s Regulatory Regime controls and constraints on a large scale. Once again, business demands, through the exercise of Taiwanese firms’ exit and voice rights, advance the transition of release from PMEL in 2006 to large-scale liberalization in 2008.

International Jurisdictional Competition Fuelled by Capital Flight Drives Changes in Political Policy

Why did both TDI in China and Investment Allowance rise as shown in Figure 1 in Section II.B? In face of the surge of TDI in China, why were the regulatory transitions of capital controls from 1997 to 2008 nudged in the direction of liberalization? We might give this paradox the following interpretation: under economic globalization, business demands of Taiwanese firms, for which TDI in China acts as a proxy, may have the effect of galvanizing the relaxation of capital controls, for which the increase of Investment Allowance is used as a proxy. Just as Sutter predicted in 2002 subsequent to the transition from NHBP to PLEM, “to remain globally competitive and to capitalize on commercial opportunities in the PRC, Taiwanese firms will likely continue to pull government policy along while testing and skirting the existing restrictions.”

This argument explains how the feedback mechanisms of voice and exit could once more push the transition to a more flexible policy of the capital controls, which took place in 2008.

Sutter discusses how the feedback mechanisms of voice and exit might bring about a change in the capital controls:

Burgeoning people-to-people and commercial ties across the Strait have been challenging policies [of Taiwan’s government] to keep pace since the opening of the PRC to foreign goods, capital, and people in the early 1980s. But it is important to consider not only policy changes but also the commercial fundamentals that pushed for these shifts. While the lifting of restrictions has significantly boosted cross-Strait interactions, fundamentally it has been a combination of the pressure to ease restrictions with the successful circumvention of regulations that has led [Taiwan’s government] to seek ways to manage growing contacts across the Strait. Business pressure and government policy have together formed a mutually reinforcing dynamic. The Taiwanese business community has effectively lobbied for liberalization of government restrictions both directly by expressing its concerns [(i.e., “voice”)] and, perhaps more important, indirectly by bypassing regulations to satisfy commercial demand in the PRC [(i.e.,

146. Sutter, supra note 35, at 28-29.
This argument offers support for the descriptive or positive mechanism that Taiwanese firms' business demands, via exit and voice rights, have been nudging the capital controls in the direction of relaxation stage by stage as the power of Taiwan’s government was so constrained by international jurisdictional competition prompted by economic globalization that the capital controls were rendered all but ineffectual.

In summary, we could account for this stage-by-stage relaxation of the capital controls from an integral perspective of law market forces underlying international jurisdictional competition led by OFCs. Since globalization lowers exit costs across borders and enhances firm or capital mobility, the intensification of globalization is gradually giving rise to a particularly active international jurisdictional competition for mobile production factors by providing cost-justified and flexible legal regimes. Furthermore, under economic globalization, changes in global business practices force Taiwanese firms to inevitably invest more and more in mainland China to the advantage of changes in the global division of labor. Nevertheless, Taiwan’s capital controls, the costly regulation favored by local pro-regulatory interest groups, ignores business demands not simply for increasing investments in mainland China but also for accompanying legal flexibility. As a result, when technologies and economic globalization increased the effectiveness and benefits of Taiwanese firms’ evasive tactics through international operation and created incentives for these firms to avoid regulatory impediments, Taiwanese firms have a choice either to engage in costly lobbying to remove the capital controls (by way of voice rights) or to move to other OFCs not in the shadow of the capital controls in order to transit funds for investment in mainland China (by way of exit rights). Although Taiwan’s government struggles to stem the outflows of firms and capital, in the age of globalization it is limited in its ability to control the flow of capital, goods, and know-how across the Strait, and therefore can merely slow but not constrain these firms’ physical exit.

In the international economic process, the demand side of the law market, through the exercise of exit rights of Taiwanese firms avoiding capital controls (as economic agents), first brings about OFCs’ participation in the competition for these fugitive firms (by supplying regulatory products of legal flexibility) on the supply side in the international context, thereby giving Taiwanese firms an exit route. Then the international supply force of the law market activated interest

147. Sutter, supra note 34, at 523 (alteration in original) (emphasis added).
group competition on the domestic supply side within Taiwan. Such economic exits sent out signals to those in Taiwan’s political marketplace. As a result, in the domestic political process, anti-regulatory groups in Taiwan (which are directly burdened by the capital controls) exercised their voice rights strengthened by physical exit and threats of exit to promote legal flexibility together with exit-affected interest groups. These economic signals in turn pressured politicians and policymakers in Taiwan (as political agents) to acknowledge the significance of the exit signals, and to enable more legal flexibility of the capital controls. In other words, the feedback mechanisms of exit and voice are translated into the regulatory evolution, or the stage-by-stage liberalization, of the capital controls from 1997 to 2008. The structure discussed above is summarized in Figure 2.

COMPETING EXPLANATIONS FOR THE TAIWAN CASE

There are alternative theories which might account for this evolution. Any effort to employ the jurisdictional competition theory to elaborate the Taiwan case thus needs to address the following major competing explanations. To be sure, this Article cannot rule out all competing explanations, but, as shown below, the regulatory evolution of Taiwan’s capital controls on China-investment from 1997 to 2008 correlates more closely with the jurisdictional competition story than any of the alternative theories.

What Are Politicians’ Incentives?

Some theorists might argue that it is possible that the Taiwanese government, by pushing through capital controls which are very strict at face value, actually allowed most firms most of the time to avoid this regulation (e.g., by creating loopholes). For example, Prof. Aviram’s bias arbitrage theory asserts:

Bias arbitrage is the extraction of private benefits through actions that identify and mitigate discrepancies between actual risks and the public’s perception of the same risks. Politicians arbitrage these discrepancies by enacting laws that address the misperceived risk and contain a “placebo effect”—a counter-bias that attempts to offset the pre-existing misperception. If successful, politicians are able to take credit for the change in perceived risk, while social welfare is enhanced by the elimination of deadweight loss caused by risk misperception.148

Accordingly, it was possible that Taiwan’s government might have complex incentives to regulate outward investment in mainland China. Taiwanese politicians might try to maximize their positions by manipulating the enforcement of capital controls while reaping a private profit that mitigated the discrepancy between the actual and the perceived risk of outward investment in China. In other words, even though capital controls were imposed, Taiwan’s government might not strive to implement this regulation effectively.

However, we can reject this explanation because there is substantial evidence that Taiwan’s government sought to enforce the laws thoroughly. First, according to a criminal case decided by a district court, the three defendants who were the executive management of United Microelectronics Corporation (“UMC”) were indicted for acts involving investment in mainland China without prior approval of MOEA, even though they were afterwards held not guilty by the district court in 2007. This decision was later confirmed by the court of appeals in 2008. These UMC executives actually maintained good political relations with the then-ruling DPP. For instance, when UMC was suddenly searched by prosecutors and agents from Taiwan’s Investigation Bureau in mid-February 2005, Chien-Min Ker (DPP’s former acting chairman and a heavyweight party leader) came out in favor for UMC while angrily accusing these prosecutors and agents of their acts as destroying UMC. More importantly, as Ker noted, as soon as President Shui-Bian Chen won the presidential election in 2000, the first company President Chen visited was UMC. Robert H. C. Tsao (UMC’s former chairman of the board) had been President Chen’s Presidential National Policy Adviser. This prosecution, followed by

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149. Taiwan HsinChu Difang Fayuan [Taiwan HsinChu Dist. Ct.], 95 Zhu Su Zi No. 1 (2006) (Taiwan).


MOEA’s NT$5 million administrative fine, was a leading case from the time Taiwan’s government announced its intention to re-tighten capital controls in 2006. It illustrated the government’s continuous efforts to thoroughly enforce the capital controls by all available administrative or judicial means.\footnote{153}

Second, Taiwan’s Supreme Administrative Court, the highest judicial authority in administrative cases in Taiwan, held that one should define the term “investment in the mainland Area” from a perspective of substance. That is, that Taiwanese government’s broadening of the scope of the violation of the capital controls, or its intention to expand its local regulation extra-territorially against corporations incorporated in a foreign area, was confirmed by the judiciary. Specifically, according to the two judgments\footnote{154} made by the Supreme Administrative Court, the term “investment in the mainland Area” should be interpreted from a perspective of substance, not form. In other words, even though Taiwanese parent companies establish corporations in a third area such as an OFC or channel investment in mainland China, those offshore companies are not only still regarded as the alter ego of parent companies and as of Taiwanese nationality, but also deemed to have their main center of activity in Taiwan and therefore to be subject to restrictions on investment imposed by Taiwan’s statutes as well as regulations promulgated by MOEA. In a word, these administrative regulations combined with the judicial interpretation of capital controls further demonstrated the Taiwanese government’s efforts to enforce the laws thoroughly.\footnote{155}

\footnote{153} Mian Chong Ji [Robert Tsao Reveals that UMC Was Searched Because A Stool Pigeon from SMIC Snitched; DPP Leaders Say that They Did Not Know in Advance that Prosecutors and Agents Would Take Action; Rumor Has It in Political Circles that There Is Machinations Such that DPP Leaders Urgently Discuss How to Cushion Negative Impacts], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Feb. 18, 2005, at A1.

\footnote{154} See Li, supra note 38, at 129; Editorial, He Jian An Zui Da Shu Jia Shi Zheng Fu [The Biggest Loser in the UMC Case is Taiwan’s Government], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Oct. 28, 2007, at A2.

\footnote{155} As discussed in Section II.A.4, after the capital controls and constraints were substantially lightened in 2008, China-based Taiwan-invested firms can first incorporate an overseas holding company in, say, the Cayman Islands, and list this overseas company’s shares in Taiwan stock markets. That way, the funds raised by this “foreign” issuer can all be used for investments in mainland China. Hence, we can find that the Ma administration to an extent invalidated the “perspective of substance” judicial interpretation by modifying the relevant administrative regulations. In this case, “investment in the mainland Area” would be identified from a perspective of form, thus suggesting the scope of the violation of the capital controls has been narrowed.
In summary, efforts made by Taiwan’s executive and judicial branches, as discussed above, showed that Taiwan’s government sought to enforce the law. Therefore we can reject the bias arbitrage explanation that Taiwan’s government would not try its best to implement the regulation effectively.

Does Mere Exercise of Political and Military Power Cause the Relaxation?

An alternative explanation could also be that mere exercise of mainland Chinese political and military power caused the relaxation of capital controls. So why is the Taiwan case closer to a jurisdictional competition explanation?

To refute this alternative theory, we must review the cross-Strait tensions between 1995 and 2000. Tung reports:

The 1995-1996 tensions were triggered by a combination of President Lee Teng-hui’s visit [in June 1995] to his alma mater, Cornell University, and the speech he made at Cornell University during the trip. In addition, when interviewed by Deutsche Welle Radio on July 9, 1999, President Lee said that since 1991, when the Republic of China [(a.k.a. Taiwan)] Constitution was amended, cross-Strait relations became “state-to-state,” or at least “a special state-to-state relationship.” These two incidents were taken by Beijing as deliberate attempts to strengthen both domestic and international acceptance of Taiwan as a sovereign nation. . . . [Accordingly,] [t]he 1995-1996 and 1999-2000 Taiwan Strait incidents created significant strain between Taiwan and China. Beijing attempted both to coerce Taipei to return to the previous status quo by accepting the “one-China principle” and to deter Taipei from declaring (or marching toward) Taiwan independence. The [PRC] threatened the use of force against Taiwan through moderate military mobilization and an expansion in the scope of the intended military exercises near Taiwan from July 1995 to March 1996 and from July to September 1999. 156

In response to the 1995-1996 tensions, President Lee in the “Nationwide Business Owner Assembly” held in September 1996 announced the NHBP policy, which unveiled the prospective imposition of capital controls in a year. President Lee was quoted as saying:

[Mainland China intentionally adopts] the statecraft of “yi shang wei zheng” and “yi min bi guan” to press our government by intensifying anxiety in our society. Regarding this situation, we must follow the

156. Chen-Yuan Tung, Cross-Strait Economic Relations: China’s Leverage and Taiwan’s Vulnerability, 39 ISSUES & STUD. (NO. 3) 137, 140-41 & n.4 (2003) (Taiwan) (alteration in original).
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major principle of “jie ji yong ren” [no haste, be patient] to tackle current cross-Strait relations.\textsuperscript{157}

Specifically, “China’s political strategies toward Taiwan, yi min bi guan (utilizing the public to urge the official) and yi shang wei zheng (exploiting business to press politics),” are based on the expectations that some particular groups in Taiwan hurt by Chinese sanctions would petition Taiwan’s government to comply with China’s demands; that the greater the sanction hurt Taiwan’s government directly, the greater the chance to influence its policy; that core support groups of the Taiwanese regime affected by sanctions would put pressure on Taiwan’s government; and that Taiwan’s government, facing domestic political and economic instability, would ultimately concede to China’s demands.\textsuperscript{158}

However, according to Chen-Yuan Tung’s study on Taiwanese public and political reactions to Chinese intimidation during the 1995-1996 and 1999-2000 Taiwan Strait tensions, these tensions did not effectively push the parties to influence Taiwanese policy or press the Taiwanese government to concede to Chinese political goals.\textsuperscript{159} In particular, there is little evidence that China’s political strategy of yi shang wei zheng (exploiting business to press politics) was working in these two incidents. In general, most China-based Taiwan-invested firms asked the government for caution and to refrain from further provoked. Furthermore, the majority of these firms strongly opposed Chinese military threats.\textsuperscript{160} Also, “Beijing has actually proven reluctant and generally ineffective... in exploiting its economic leverage through economic sanctions [as well as political leverage through cross-Strait economic relations] against Taiwan, even during the 1995-1996 and 1999-2000 cross-Strait tensions.”\textsuperscript{161} Since the relaxation of the capital controls is less likely attributable to mere exercise of Chinese political and military power, jurisdictional competition is a better model to use to think about the Taiwan case than other competing theories.

\textit{Are the Capital Controls Loosened Due to the Popular Support for Less National Security Concern and for More Economic Integration?}

\textsuperscript{158} \textit{Id.} at 191-92.
\textsuperscript{159} TUNG, \textit{supra} note 80, at 387-420.
\textsuperscript{160} \textit{Id.} at 418-19.
\textsuperscript{161} Tung, \textit{supra} note 156, at 141 (alteration in original).
One might argue that capital controls were loosened because the popular support on national security grounds faded while the support for more economic integration with China grew. However, the political polling data largely rules out this explanation.

After the pro-China KMT was at the helm in 2008 and capital controls were relaxed on a large scale, Taiwanese government agencies and the press respectively conducted several public opinion polls in April and May 2009. First, the results of these polls generally showed that the support for Taiwanese national identity and independence did not decline whereas that for Chinese national identity and unification with China fell, which, as Chen-Yuan Tung argued, indicated the failure of China’s two political strategies, *fan dui tai du* (opposing Taiwanese independence) and *yi tong cu tong* (exploiting cross-Strait exchange to promote unification). Second, they also reveal that a majority of Taiwanese people, unwilling to concede to China in terms of politics and sovereignty in exchange for economic benefits, required the Ma administration to fulfill its duty to protect Taiwanese sovereignty and individuality. Further, the poll results demonstrated that more than 60% of Taiwanese stood for the open-door policy concerning cross-Strait economic integration through institutionalized negotiation. In other words, popular support for national security measures continued even though further economic integration was also widely supported. This suggests that the jurisdictional competition, not just underlying politics, had more to do with the shift of capital controls. Capital controls were thus loosened not because the popular support on national security grounds decreased, but because of jurisdictional competition.

162. Chen-Yuan Tung, Op-Ed., *Liang An Zheng Ce Yao Zhu Ti Yao Kai Fang [Both Taiwanese Sovereignty and Open Exchange between Taiwan and China Matter in Cross-Strait Policies]*, *ZHONG GUO SHI BAO [CHINA TIMES]* (Taiwan), June 3, 2009, available at http://news.chinatimes.com/2007Chi/2007Chi-News/2007Chi-News-Content/0,4521,11051401+112009060300350,00.html (last visited Jan. 27, 2012); see also Yin-Ji Xu, *Yu Liu Cheng Min Zhong Zan Cheng Liang An Xie Shang Ru Qi Ju Xing [More than 60% of People Uphold that the Negotiation between Taiwan and China Should Be Held as Scheduled]*, *GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES]* (Taiwan), Oct. 1, 2009, available at http://news.chinatimes.com/CMoney/News/News-Page-content/0,4993,11050701+122009100100463,00.html (describing that the result of a MAC’s poll announced on September 30, 2009 also demonstrated that as high as 87% of Taiwanese supported the maintenance of the separate status quo of Taiwan from China in a broad sense; among others, the support for the permanent maintenance of this de facto political independence showed an inclination to go up) (last visited Jan. 27, 2012; see also Editorial, *Fen Lan De Qi Shi [Implications from Finland]* GONG SHANG SHI BAO [INDUSTRY & BUS. TIMES] (Taiwan), May 22, 2009, at A2 (reporting that a poll in April 2009 sponsored by Council for Industrial and Commercial Development R.O.C., a.k.a. CICD, showed that 56% of Taiwanese were “very worried” or “worried” about the high dependence on China of Taiwan’s economy).
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Why Does the Jurisdictional Competition Story Not Apply to Hong Kong?

Some might suppose that since Hong Kong is also located in the Greater Chinese Economy, why did Taiwan and Hong Kong (as a competitor of Taiwan in the jurisdictional competition) take different paths when faced with mainland China? What relevant differences could account for why Hong Kong did not impose restrictions on outward investment in mainland China similar to capital controls?

First of all, as Clough puts it in terms of the cross-Strait political antagonism, “[a] trip made by President Lee Teng-hui to the United States [in June 1995], in an effort to enhance [Taiwan]’s international image, triggered the PRC’s [1995-1996] military reaction—a serious warning to the United States and Taiwan that it would not tolerate an independent state of Taiwan.” The 1995-1996 Taiwan Strait tensions illustrate that the PRC did not recognize Taiwan as an independent country and had been intimidating it with military forces. This political antagonism between 1995 and 1996 contributed to Taiwan’s imposition of capital controls in 1997 in response to Chinese military intimidation. On the contrary, Hong Kong became subordinate to Chinese authority after re-integration with China in 1997. It is impossible that Hong Kong would impose restrictions similar to capital controls (which are surely not allowed by China). In addition, China elected to preserve Hong Kong law by promoting a “one country, two systems” policy, and opened its door wide open to Hong Kong corporations through the Closer Economic Partnership Agreement (CEPA, essentially a free trade agreement). The signing of CEPA in 2003 was a catalyst for the recent economic upspring in Hong Kong. Through CEPA, Hong Kong wholly embraced mainland China’s market without any national

163. Macau is also located in the Greater Chinese Economy; it is labelled as “Las Vegas in Asia” with its economy mainly based on the gambling industry. Bo Yi Fa Zhan Ao Men Zheng Fu Cai Sha Che [Macau Government Brakes the Development of the Gambling Industry], JIN RI XIN WEN [NOWNEWS] (Taiwan), Oct. 13, 2009, http://tw.news.yahoo.com/article/url/d/a/091013/17/1sw15.html (last visited Oct. 13, 2009). As Macau is not a comparable competitor to Hong Kong and other OFCs with the institutional and regulatory architecture which is indispensable in the international jurisdictional competition, the discussion here is focused on Hong Kong.

164. RALPH N. CLOUGH, COOPERATION OR CONFLICT IN THE TAIWAN STRAIT?, at ix-x (1999) (alteration in original).

security concern, not to mention the imposition of the investment restrictions like the capital controls on national security grounds.

**CONCLUSION**

Although definitively proving a causal relationship between international jurisdictional competition and the progressive relaxation of capital controls is impossible, I rule out the major alternative theories and find strong evidence to support the jurisdictional competition hypothesis. The regulatory evolution on China-investment from 1997 to 2008 correlates more closely with the jurisdictional competition story than with alternative theories.

The case study tests the process in which, although the Taiwan politics initially supported capital controls, the flight of capital (i.e. exit) and its effects through jurisdictional competition on Taiwan (i.e. the voice of anti-regulatory and exit-affected interest groups strengthened by exit) eventually provided an effective counterforce. In particular, the Taiwanese government has encountered a dilemma of relaxing capital controls while avoiding boosting the mainland economy at Taiwan’s expense. Whereas Taiwan’s past efforts to restrain investment were designed to prevent China from gaining an economic or technological advantage over Taiwan, “a review of cross-Strait developments shows dynamics of business interests pulling government policy along as policy makers struggle to keep apace with commercial reality.” As Sutter foretold in 2002, “enticed by an economic upswing in China, the opening of new markets in both the PRC and Taiwan as a consequence of WTO accession and Taiwan’s ongoing goal to become a regional operations center, business interests are likely to continue to nudge policy makers along a course of further liberalization and integration.”

While TDI in China is surging, why is the regulatory evolution of the capital controls from 1997 to 2008 directed generally towards liberalization stage by stage? We could give this paradox a positive interpretation.

To begin with, Rafael La Porta et al. also note:

Globalization leads to a much faster exchange of ideas, including ideas about laws and regulations, and therefore encourages the transfer of legal knowledge. Globalization also encourages competition among countries for foreign direct investment, for capital, and for business in general, which must as well put some pressure toward the adoption of

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166. Sutter, *supra* note 34, at 522.
167. *Id.* at 523.
Accordingly, globalization leads to international jurisdictional competition, or competition through changes in the provision of laws and institutions among regulatory jurisdictions. Amid this jurisdictional competition there is the interaction between economic and political processes to push local governments to improve their regulation. In the international economic process firms can exercise exit rights in response to a jurisdiction’s costly regulation and voice rights in the domestic political process. In the Taiwan case, under economic globalization business interests, via economic and political agents, responded to the costliness of Taiwan’s capital controls; or rather these alert feedbacks of exit and voice are delivered into the evolution of Taiwan’s regulations, or the relaxation of the capital controls. Put differently, the general demand and supply forces underlying international jurisdictional competition, stimulated by Taiwanese firms’ business demands as well as concomitant physical mobility, galvanize the gradual liberalization of capital controls as international jurisdictional competition underlying globalization impairs regulatory capacity of Taiwan’s government.

The transitional trajectories of Taiwan’s capital controls illustrate that international jurisdictional competition constrains a democratically-constrained onshore jurisdiction such as Taiwan from disregarding business demands and from imposing costly regulation. In this sense, it is globalized markets and not parochial laws that “regulate” economic activity across borders.169 By exploring an important development in Taiwan’s policy for Taiwan-China relations, we reveal the effect of jurisdictional competition in a time of increased globalization. Moreover, by describing that law market dynamics under jurisdictional competition are already working, we remind Taiwan’s government and those in a similar position that when regulating jurisdictions refuse to recognize business demands backed by globalization, businesses have incentives and ability to seek out more cost-justified and flexible laws worldwide.


169. TUNG, supra note 80, at 10 (arguing that it is the market forces sourcing from cross-Strait dynamics of business interests, rather than Beijing’s political strategies, that compelled Taipei to adopt a more open cross-Strait economic policy).