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# INTERNATIONAL TRADE AND INVESTMENT REGULATION: DEVELOPING JURISPRUDENCE IN TAIWAN

*Paul S.P. Hsu\**

## I. INTRODUCTION

Past and present economic development in the Republic of China has provided a model for a successful experiment whereby a society under a workable economic and social system with very limited natural resources makes the most of what it has. Yet, the momentum of the development will not permit the R.O.C. to rest at its present stage or to reminisce about past achievements. Clearly, many more stages of economic development lie ahead. Other industrially advanced nations that operate under similar limitations, such as the Netherlands, Sweden, and Switzerland, have higher per capita income, better quality of life, and a more comprehensive infrastructure. The experience of those countries suggests that, despite its limited resources, there is no limit to the economic development that Taiwan can achieve.

The key for the R.O.C. at this stage is to thoroughly reassess its available resources. Such a reassessment will allow the R.O.C. to identify what resources will be necessary to meet its needs in the years to come and what measures need to be adopted to attract and acquire such resources. In the course of this examination and assessment, new business opportunities should be identified and explored.

Legislation will be equally important in preparing the R.O.C. to meet the challenge of continued development. Several key areas which require new legislation or amendment of existing legislation will be examined in this paper.

This task has become increasingly important, even urgent, in view of the new economic environment that has developed during the past years; specifically, dropping exports due to the drastic appreciation of the New Taiwan dollar, narrowing trade surplus, declining foreign investment in the R.O.C., and increased investment abroad. The continuing liberalization of the political environment and increasing social consciousness should lead to demands for better environmental protection and for better social welfare.

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## II. LAND REFORM AND BEYOND

### A. *The Value of Land Reform*

The spearhead of economic reform in the R.O.C. is its successful land reform program. A society must be politically and economically stable in order to become more highly developed and prosperous. In the initial stage of such development, many nations have experienced difficulty in maintaining a proper balance between land distribution and population. A government seeking to achieve political and economic stability should launch a land reform program at the earliest stage of its economic development for the following reasons:

1. Only through land reform can capital investment in land and a misutilized labor force be shifted for the purpose of developing industries and trade.

2. Land reform serves as one of the vehicles through which disproportionate distribution of wealth can be adjusted.

3. Since the productivity of the land is one of the major sources of national revenue, a sound system of taxation can be more effectively established if the tenant farmers or tillers receive sufficient incentive to increase production.

4. Through the redistribution of land, cadastral problems can be avoided and through land reform the gap between the privileged classes and the masses can be more effectively narrowed.

5. A land reform program can improve the utilization and increase the productivity of land.

The legislative foundation for the R.O.C.'s land reform program is set forth in articles 142 and 143 of the R.O.C. Constitution.

### B. *The Land Reform Association*

The Chinese Land Reform Association, which was formed in April, 1947 in Mainland China, set forth the following objectives:

1. All natural resources and benefits derived from land as a result of the progress of the society should belong to the nation, should be enjoyed by all the people of the nation, and may not be possessed or monopolized by any private individual or private organization.

2. Farmland, unless it is run by the national government or by a local government organization, should belong to the individual farmers so that the feudal landlord-and-tenant system can be eliminated.

3. In principle, all land within cities and major economic centers should belong to the nation.

The Land Reform Association subsequently moved to Taipei due

to the civil war on Mainland China and continued to encourage the development of the land reform program.

### C. *Land Reform in Taiwan*

The Provincial Government of Taiwan's promulgation in 1948 of the "Measures Governing the Leasing of Privately Owned Cultivated Land in Taiwan" and its "Enforcement Rules" marked the beginning of the land reform program in Taiwan. This program has been the most important social and economic policy measure since departure from Mainland China in December, 1949. The program in Taiwan was divided into three stages. In the first stage, the rent on farmland was reduced to 37.5 percent of the original rent. The second stage involved the selling of government-owned land; and in the third stage, the "land-to-the-tiller" program was implemented. In implementing this last and most important stage of the land reform program, the government set forth the following guidelines:

1. The land reform program must be carried out by peaceful means, the landlord being permitted to retain a good portion of his rented land with the remaining amount of land to be sold at fair and fixed prices to the government for resale to the previous tenant farmers with financial help provided.

2. Both the compulsory purchase of land and its resale will be effected through the government without direct contact between landlord and tenant so as to prevent abuses and disputes.

3. The Government will ensure that the buyer is the original tiller, the one who tilled the same lot of land previously.

4. Farmlands owned by educational, social, or economic undertakings and industrial and commercial plants will be exempted from compulsory purchase.

5. Protection will be given to owner-cultivators by preventing the transfer or lease of farmland purchased under the land-to-the-tiller program before the price has been paid in full.

By offering good prices to the landlord for land bought and fair prices in selling it to the newly independent farmers, the government was able to stimulate all sectors of the pre-industrial society. The new farmers needed no more encouragement than to know that any increase in productivity and resulting profit belonged to them. The displaced landlord had a source of capital with which he could become a new-age entrepreneur, initiating the first steps of industrialization by setting up small-scale light industries.

One of the most important lessons that we have learned is that the

land reform program should not be treated as an isolated program to be used to cope with a specific situation. Rather, the success of a land reform program is determined by its integration into a thorough economic development plan formulated subsequently to bring prosperity to the general public, not just to a wealthy few.

The land reform program is almost history now as many of the farmers/tillers have become the wealthiest group of people in Taiwan. They have become owners of factories, tourist hotels, office buildings, and apartment buildings, and their sons and daughters, if they so choose, are able to receive the best education, domestically and abroad. However, it is ironic to note that Taiwan is facing a very different set of problems now. In view of the scarcity of land and the higher productivity of industrial land compared with farmland due to rapid industrialization, the pressure to convert farmland into industrial land is mounting. It would not be surprising if legislation was introduced to convert more farmland into industrial land. However, in any attempt at future land reform, consideration also shall be given to equal distribution of land through an equitable tax system and other measures. I believe the success of the R.O.C. land reform program will be remembered for a long time as an outstanding example of land reform and economic development.

### III. THE PROMULGATION OF THE INVESTMENT INCENTIVE PROGRAM AND ITS LEGISLATIVE EVOLUTION

As early as 1954, the Government of the Republic of China realized that the economic development of Taiwan was not progressing at a satisfactory rate. Growth potential, including natural and manpower resources, was not being fully explored or utilized. In addition, the Government realized that the island's economy could not rely on foreign economic aid indefinitely and that a major self-sufficiency campaign was necessary to ensure the island's future. As a result, efforts to improve the domestic investment climate were intensified.

The R.O.C. government began to encourage savings, institution of a foreign exchange reform, expansion of the infrastructure, promotion of export industries, activation of a task force for the promotion of investment, and, importantly, initiation of an incentive program geared to stimulate both domestic investment and the inflow of foreign capital and foreign loans.

The main objectives of the investment incentive program are to promote industries that: 1) are needed in the Republic of China, 2) have export markets, 3) can foster the development and improvement of important industrial, mining, and communications enterprises in

Taiwan, 4) are conducive to economic and social development in Taiwan, and 5) may introduce advanced technology needed in Taiwan. This incentive program, the details of which will be discussed later, is represented by the promulgation of three statutes: A) The Statute for Encouragement of Investment, B) The Statute for Investment by Foreign Nationals, and C) The Statute for Technical Cooperation.

#### A. *The Statute for Encouragement of Investment (SEI)*

The SEI provides various incentives to investors, foreigners, and nationals alike. To qualify for these incentives, the enterprise must be a company limited by shares incorporated under the R.O.C. Company Law and must engage in one of certain specified businesses. The January, 1987 amendment to the SEI also provides that a branch of a foreign company engaging in manufacturing activities in Taiwan may also qualify for some of the incentives under the statute.

The SEI offers the following key incentives to productive enterprises or their investors:

1. A productive enterprise engaging in the industries listed in the "Categories and Criteria of Productive Enterprises Eligible for Encouragement" may enjoy:

a) Upon its establishment:

i) a five-year business income tax exemption for some industries, commencement of which can be deferred for up to four years; or  
ii) an accelerated depreciation of machinery and equipment.

b) In an expansion project:

i) a five-year business income tax exemption, commencement of which, for some industries, can be deferred for four years.

ii) an accelerated depreciation of machinery/equipment.

c) The increased output due to an expansion in a productive enterprise's machinery and equipment during the income tax exemption period may be included in the tax exemption, provided that the increase in machinery and equipment received prior approval from the relevant government agency.

2. The business income tax, including surcharge, of a productive enterprise qualifying under the SEI shall not exceed twenty-five percent of its annual taxable income. If the enterprise is engaged in one of the industries listed in the "Categories and Criteria for Special Encouragement of Important Productive Enterprise," the maximum tax rate is twenty-two percent.

3. When a productive enterprise invests its retained earnings in an expansion project for the purchase of production machinery and

equipment, the stock dividends issued to shareholders as a result of this capital increase are deferred from consolidation into the shareholders' personal or business income tax until they are transferred.

4. Customs, duties, and dues on machinery and equipment that exceed a certain amount may be paid in installments or be totally exempted if they meet certain criteria.

5. When a productive enterprise sets aside as reserve the capital gains realized from the issuance of shares above par value, the amount of such gains shall be excluded from its taxable income.

6. A profit-seeking enterprise engaged in certain specified export business activities may have its gross business receipts exempted from the business tax.

7. A profit-seeking enterprise organized as a company may retain and not distribute earnings of up to one-half of its paid-in capital. Productive enterprises may retain earnings equal to their total paid-in capital. Enterprises engaged in a business listed in the "Applicable Scope of the Strategic Industry" may retain earnings equal to twice their total paid-in capital. In addition, any enterprise may retain an unlimited amount of earnings without distribution, provided it is willing to pay an additional ten percent income tax on that portion of retained earnings exceeding the above-mentioned limit.

8. The appreciated value of a profit-seeking enterprise's assets which results from revaluation shall not be taxable income.

9. The research and development expenses incurred in improving productive technology or in developing new products or productive enterprises may be deducted from the taxable income of the current year. If the research and development expenses for the current year exceed the highest annual amount expended on research and development over the previous five years, twenty percent of the excess amount may be credited against the corporate income tax of the current year. This credit may not exceed fifty percent of the income tax payable for the current year. Any excess credit may be carried forward to the ensuing five years; however, the same fifty percent limit will apply.

10. Other incentives such as providing conveniences in obtaining industrial land, etc.

Those who seek to streamline the incentive program and the relevant legislative framework have suggested that the SEI, as a separate piece of legislation, is no longer needed and the incentive measures should be incorporated in the other relevant legislation. Of course, the timing of such a move, if any, will be of critical importance if investment in Taiwan is to continue to be attractive.

### B. *The Statute for Investment by Foreign Nationals (SIFN)*

The SIFN provides certain incentives for investment by foreign nationals, both natural and juristic persons, as well as protection for these investments. However, these incentives and protections are only given to those foreign investments that are approved under the statute by the government.

Any investment project which falls into one of the following categories may apply for the privileges granted under the SIFN by filing a Foreign Investment Application with the Investment Commission (IC) of the Ministry of Economic Affairs:

1. Investments in productive or manufacturing enterprises which are needed domestically;
2. Investments in enterprises which have an export market;
3. Investments which are conducive to important industrial, mining, or communications enterprises;
4. Investments in enterprises which are engaged in scientific and technical research and development; and
5. Investments in other enterprises which are conducive to the economic and social development of the R.O.C.

If a foreign investor's Foreign Investment Application is approved by the IC, the investor (or the local company so established) is entitled to the following incentives under the SIFN:

1. Repatriation in foreign exchange of the yearly income of net profits or interest accrued from the investment;
2. Repatriation in foreign exchange in one lump sum of the total amount of invested capital, two years after the commencement of the business operation of the investment;
3. Exemption from requisition or expropriation for twenty years after the commencement of business, so long as the foreign investor holds forty-five percent or more of the total capital of the investment;
4. Exemption from the listing of stocks of the invested enterprise on the stock exchange, provided the foreign investor holds forty-five percent or more of the total capital of the investment;
5. Exemption from the requirements regarding domicile in the R.O.C., R.O.C. nationality, and amount of investment contained in the Company Law. This makes it possible for a foreign-invested company to consist of only foreign shareholders, and to have foreign nationals as directors, managing directors, supervisors, and chairmen; and

6. The right to apply to the Executive Yuan for a special exemption from the following restrictions:



a) Restrictions against the acquisition of mining rights and the operation of mines, as provided in the Mining Law;

b) Restrictions against the acquisition of certain types of land, as provided in the Land Law;

c) Requirements as to the percentage of R.O.C. nationals who must be shareholders or directors in a company, in order for its ships or aircraft to be regarded as R.O.C. ships or aircraft, as provided in the Law Governing Vessels and the Law Governing Civil Aviation, respectively.

Unless otherwise provided in the SIFN, a foreign-invested enterprise shall be accorded the same treatment as that accorded to a similar enterprise operated by R.O.C. nationals.

Even though the Foreign Exchange Control laws and regulations are likely to continue to be liberalized and repatriation of earnings in foreign exchange will not be a problem, it is still advisable for foreign investments in the R.O.C. to be covered by SIFN in view of the above-mentioned incentives.

### *C. Statute for Technical Cooperation (STC)*

The STC was promulgated to further the goals of the SIFN. Technical cooperation, as defined by the STC, refers to the furnishing of patents and know-how by a foreign licensor to a party in the R.O.C., not as capital stock but for fixed running royalties. To qualify under the provisions of the STC, the patent or know-how involved must be able to:

1. Facilitate production of new products;
2. Increase the volume of production, and improve the quality or reduce the production cost of products; or
3. Improve management, design, or operation efficiency.

If a technical cooperation project involves patent rights, in order to qualify under the STC, such patent must have been granted by the R.O.C. government, pursuant to the R.O.C. Patent Law. It is important to note that trademark and copyright are not covered by the prevailing STC, though they may be given due consideration in the forthcoming revision.

The STC stipulates that technical cooperation agreements shall not restrict the territory of sales of the products involved in the cooperation to the Republic of China. However, other contractual arrangements among and between the parties concerned may always provide sufficient flexibility to attain the business objectives.

In addition to the promulgation of these statutes, the R.O.C. gov-

ernment also has worked to improve the general investment climate in the R.O.C. This was done by working to improve the equality of costs and discipline for the labor force, adequacy of infrastructure facilities, price levels, social economic stability, the government's efficiency and commitment to development, the attitudes of the general public, and living conditions; and by supporting industries capable of providing low-cost parts and components needed by diversified manufacturing facilities.

At the beginning of the incentive program, emphasis was placed on the ability of an investor to bring in capital, the number of jobs a specific investment might create, its production capacity, and its export market. In recent years, however, the government has begun to favor investment proposals that will introduce technology to the R.O.C. over those that will simply introduce capital. This shift in focus is principally due to the inflationary effect of the continuous inflow of capital to Taiwan, the increased availability of local capital, and the government's desire to protect certain local industries. A foreign investment application is now evaluated by the government in terms of the type of job opportunities that it will create, components and supporting industries that will develop, the modern managerial skill that it will introduce, and the research and development capability of the investment. A new focus is to encourage foreign investments in selected service industries.

For the reasons stated above, the government is currently favoring investment proposals that will import advanced technology and management know-how or raise the standards of the service industries that are needed in any industrial nation, as well as proposals from firms that can market their Taiwan-made products abroad. In addition, however, the government hopes to encourage the overall development of the economy and foreign trade, as this will both foster economic stability and forge ties with the rest of the world. In this regard, approval recently has been given to foreign investments in both manufacturing and trading operations with the objective of selling foreign-brand products to the domestic market. There is reason to wonder whether the above-discussed incentive program will carry any meaning if total liberalization of the R.O.C.'s economy is attained.

#### IV. FUTURE LEGISLATIVE TRENDS

As mentioned earlier in this paper, legislation will play an important role in shaping the future of the R.O.C. as a nation and as a society. The following are several key areas where either new legislation or amendment of existing legislation is needed. However, this is by no

means an exhaustive survey. There are certainly many other legal areas to be explored.

#### A. *Environmental Protection Legislation*

Environmental protection legislation is an area which receives constant attention. There is much room for improvement in this area due to the rapidly changing technology applied by industry. Current legislation governing this area includes the Law Governing the Disposal of Waste, which deals with the disposal of waste in general but does not address the disposal of radioactive waste; the Water Pollution Control Act; the Air Pollution Control Act; and Enforcement Rules of the Law Governing the Prevention of Air Pollution.

Since Taiwan has limited resources, yet is still one of the most densely populated areas in the world, environmental protection laws and regulations are of vital importance. Legislation in this area must contemplate not only the best utilization of limited resources, but also continued economic development. An equally crucial problem is the enforcement of the legislation. Enforcement has become the biggest challenge to the relevant government agencies in charge of environmental protection, especially in the wake of the ever-increasing and intensified environmental protection movements.

Tremendous opportunities exist for those U.S. companies which have expertise in providing hardware as well as software in the field of environmental protection. Attention to the legislative trends in this area will certainly enhance such opportunities.

#### B. *Antitrust and Unfair Competition Legislation*

At present, the R.O.C. has several statutes that might be considered antitrust legislation in the Western legal sense. For example, the Law Governing Agricultural, Mining, Commercial, and Industrial Enterprises provides for treble fines and imprisonment for monopolization, manipulation, and speculative practices. However, this law applies only to certain categories of enterprises and their goods, and enforcement has been rare.

After many years of deliberation, the Executive Yuan of Taiwan has adopted a draft Fair Trade Law. It incorporates two major legal regimes: antitrust law and unfair competition law. It would govern monopolies, oligopolies, monopolization, combinations and mergers, concerted actions affecting competition, vertical restraints, exclusionary practices, and pyramid sales programs. It would also prohibit certain forms of unfair competition such as trademark infringement,

passing off, intentional mislabeling and other acts that may confuse consumers, trade libel, misappropriation of trade secrets, and other deceptive and unfair practices. Violations would result in criminal and civil liabilities, including imprisonment and treble damages. The draft law is now awaiting the approval of the Legislative Yuan.

It has been suggested that while the unfair competition element of the draft law is urgently needed to regulate the new economic order in the R.O.C.'s fast-changing society, the antitrust element may be against the world trend. If enacted, the draft law will have a major effect on the business practices in the R.O.C. and on the national economy as a whole. This particular legislative trend is also encouraging to American companies because it is meant to provide a fairer and more open business environment for business competition.

### *C. Labor Law*

With the new Basic Labor Standards Law and related supplementary regulations, the R.O.C. has put into place its first comprehensive statutory law on labor-related matters. This legislation is intended to regulate labor conditions, to protect the rights and interests of workers, to promote the relations between employers and workers, and to enhance social and economic development.

The R.O.C. government has attempted to upgrade and transform Taiwan's labor-intensive industries to capital and technology-intensive industries in recent years. Promulgation of this legislation can be viewed as a landmark indicating the gradual shift of Taiwan's economic structure. The legislation could have an international impact as well. The protection offered by these laws, for example, is relevant to the general review of the eligibility of articles from beneficiary countries under the Generalized System of Preferences (GSP) mandated by the U.S. 1984 Trade and Tariff Act.

The government has recently undertaken to further refine the Basic Labor Standards Law and its related regulations. For example, the government has provided guidelines on the operation of retirement reserve funds and has proposed to expand the applicability of the Basic Labor Standards Law to cover more business entities and their employees. While it is imperative to provide laborers with better protections and benefits, the government must also endeavor to maintain incentives for business entrepreneurs so that the business sector will continue to grow. Thus, a fundamental question is whether the R.O.C. should adopt legislation requiring employers to directly provide protection and benefits, or whether it should adopt the concept of collecting income tax from the business sector to set up social welfare

and security systems under government auspices to provide labor with maximum benefits and protection. The former proposal is risky, because imposing too great a financial burden on the business sectors could diminish the incentive for private business concerns to invest and expand and could lead to the socialization of society. Under the latter proposal, the government's role in both revenue collection and the utilization of revenue for the benefit of laborers would greatly increase.

The controversial issues raised in the study of the proposed Basic Labor Standard Law range from whether the salary owed the laborer by an employer should enjoy priority over general creditors' rights against the employer to what the amount of annual leave and holidays given to laborers should be. In the course of legislative preparation of future amendments to the law, it is anticipated that more controversial issues will surface. These controversies, in a sense, are healthy signs because the continuing debate will attract public attention to the issues of the status of laborers in a developing economy and of basic labor legislation in general. Nevertheless, the overall objective remains the same: to create a "socially benevolent" state in which political and economic stability is maintained and where the right of all to pursue happiness is also guaranteed.

#### D. *Tax Legislation*

The R.O.C.'s tax law is also currently undergoing some important reforms. In 1986, the government implemented a new value-added-tax (VAT) system to replace the original gross-business-receipts tax system. The purpose of the change was to assure the neutrality of the tax system by minimizing the distorting effect that the business tax had on the production process. The VAT system has contributed greatly to the economic development of Taiwan and the administration of tax collection, with no significant adverse effect on prices and business operations in Taiwan.

The current tax structure, tax administration, and tax rate schedule are still in need of reform, however. To this end, the government has recently formed a tax reform committee which is charged with conducting research on major tax issues and making legislative proposals for the government's consideration. One of the most critical issues facing the committee is the elimination of double taxation. It is fair to say that the legislative trend in this regard is toward constant improvement in the tax laws in order to cope with a rapidly changing economy.

### E. *Consumer Protection Legislation*

Spurred by the Taiwanese population's desire for a higher living standard as well as an enhanced quality of life, a movement for consumer protection has received overwhelming support. In May, 1988 a Draft Consumer Protection Law was introduced to the legislature and is currently still pending. The legislative procedure for the draft law is, hopefully, to be completed in the near future. Importantly, the Consumer Foundation, a non-profit organization devoted to consumer protection, exerts considerable influence on the Draft Consumer Protection Law currently introduced to the legislators.

The Draft Consumer Protection Law sets forth provisions governing:

1. Commercial practices such as advertising, labeling, contract forms, consumer credit, mail order, and home solicitation;
2. Rights concerning inspection requests and agencies, and emergency publications;
3. The handling of disputes such as complaints, strict and contract liabilities, and mediation;
4. Legal aids provided for litigation; and
5. Penalties and remedies such as product recall, cessation of production, fines, and compensation.

As with the Fair Trade Law, the promulgation of the Consumer Protection Law is expected to have a tremendous impact on traditional business practices in the R.O.C. This impact will be viewed as a positive one because there is a strong feeling that the fundamental rights of the consumer must be upheld to maintain the economic order of a modern society. Consumers also increasingly feel that they are entitled to enjoy higher quality products at a reasonable cost. American companies producing high quality products at competitive prices should be able to take advantage of the legislative trend in consumer protection, which provides an excellent opportunity to enter the Taiwanese market.

### F. *Improvements in Intellectual Property Rights Legislation and Its Enforcement*

During the past four years, Taiwanese trademark, copyright, and patent law has undergone substantial revision to enhance the protection of intellectual and industrial property rights. In view of the fact that, in an industrialized country, disputes over intellectual and industrial property rights will be common, the continued improvement of these laws, as well as the regulation and strengthened enforcement of

them, will always be desired. Some areas that are still outstanding and require constant attention, introspection, and legislative action include:

1. the promulgation of the Fair Trade Law (as mentioned earlier);
2. the issues of the scope of protection of scientific-technical or engineering design drawing and the mask work of semiconductor chips under the Copyright Law;
3. the issues of whether the use of a trademark by a licensee is sufficient and satisfactory under the Trademark Law, as well as the liberalization of sub-license and of contract manufacturer for licensee of Trademark Law; and
4. the issues of reversal of burden-of-proof and patentability of software and micro-organisms under the Patent Law.

#### G. *Trust Law*

The modern concept of trust does not exist in the Taiwanese civil code. In the absence of a trust law, many issues pertaining to common business transactions are left open. Important issues such as the status of nominee shareholders in a company, the question of whether property in the trust of a deceased person can be accepted by the tax authority as exempt from inheritance tax, the legal responsibility of the trustee, and the legal issues pertaining to the management of a trust fund all ought to be covered by appropriate legislation. A comprehensive trust law is necessary to regulate contractual relationships between and among individuals and corporations, and it is important in terms of the business activities of financial institutions. Dependence on contractual arrangements to govern trust relationships is not sufficient from the legal standpoint.

The promulgation of a trust law has been under discussion for years. Although there is not yet a timetable for the promulgation of a trust law, the trust business has already caught the attention of international as well as domestic financial institutions. As there is normally an increasing demand for various types of trust services in an industrial society, the promulgation of a trust law probably will create tremendous opportunities for financial institutions from the United States to promote their products.

## H. *Current Amendments and Future Changes of the Foreign Exchange Control Laws and Regulations: The Effect on the Capital Market*

Foreign Exchange Control Legislation has a profound impact on the manner in which transnational business is conducted. The existence of an internationalized capital market depends on the freedom to move capital without foreign exchange control. It thus would be helpful to examine the impact of the R.O.C.'s foreign exchange deregulation of July, 1987 on the development of its capital market, and to consider the implications of such deregulation for foreign investment in Taiwan.

### 1. July, 1987 Liberalization

Due to changed economic conditions, the R.O.C. has had to adjust its foreign exchange policy. The R.O.C. government had exercised strict control over all foreign exchange by means of the Statute for the Administration of Foreign Exchange (SAFE), the purpose of which was to balance international payments and preserve financial stability. However, two major factors led to deregulation: a) trade surpluses with the R.O.C.'s main trading partners, particularly the United States, and b) the accumulation of foreign exchange assets and reserves.

In a reversal of former policy, by early 1987 regulatory efforts emphasized control of foreign funds entering the R.O.C. Excess liquidity and speculative short-term funds, which flowed into the country in anticipation of the appreciation of the New Taiwan (N.T.) dollar, had produced a huge amount of "hot monies." The government, therefore, adopted deregulatory administrative measures aimed at decreasing foreign exchange reserves. When such measures failed to have the desired effect, in July, 1987 it approved a further liberalization of foreign exchange control.

As part of the new regulatory framework, the government adopted eight new regulations and a major amendment to the SAFE. The June, 1987 amendment authorizes several provisions of the SAFE to be suspended by the Executive Yuan in certain circumstances. These circumstances include a long-term international trade surplus, accumulation of a substantial amount of foreign exchange reserves by the R.O.C., and major changes in the world economy. However, if the Executive Yuan wishes to reimpose these provisions, it must obtain the approval of the Legislative Yuan.

Among the eight new regulations, the most important are the Reg-



ulations for Nongovernmental Inward Remittance (Inward Remittance Regulations) and the Regulations for Nongovernmental Outward Remittance (Outward Remittance Regulations). Under the Inward Remittance Regulations, foreign exchange earnings resulting from goods or services can be converted into N.T. dollars without any limitations. The regulations also place a \$1 million (U.S.) annual limit on remittances by an R.O.C. resident recipient. Under the Outward Remittance Regulations, foreign exchange payments for the import of goods or services can also be made without any dollar limitations. In addition, R.O.C. enterprises, entities, associations, and adult residents are subject to a \$5 million (U.S.) annual limit on outward remittances. Such legislative changes certainly provide many additional avenues for business opportunities that previously were blocked as a result of strict foreign exchange controls.

## 2. Implications of July, 1987 Liberalization

The gradual liberalization of the R.O.C.'s foreign exchange policy has important consequences for its economic development. It has already had an impact on direct investment (that is, investment and active participation in the management of a business entity) between the R.O.C. and the United States and has created greater potential for two-way portfolio investment.

The deregulation of foreign exchange in the R.O.C. has affected various aspects of two-way direct investment. The regulation of foreign investment in the R.O.C. has been relaxed to permit more liberal granting of Foreign Investment Approval (FIA) status and a wider range of investment opportunities. With respect to direct investment abroad by R.O.C. individuals and firms, the Outward Remittance Regulations also should provide greater access to raw materials, technology, and other markets. However, an important legal issue that has yet to be resolved is the disparate treatment of R.O.C. individuals and companies wishing to invest abroad. While there are still regulations in effect that require companies to apply for approval for outward investment, individuals who formerly had been unable to invest abroad can now do so by means of the less stringent Outward Remittance Regulations. Furthermore, under the Company Law, the total amount of investment that a company is permitted to make in another company is restricted to forty percent of the investing company's own paid-in capital.

The most significant impact of foreign exchange deregulation on two-way direct investment is the potential it has created for transnational "mergers" and acquisitions and the public offering and/or list-

ing of the securities of R.O.C. and foreign companies. The term "merger" is used descriptively because the Company Law does not contemplate R.O.C. companies merging with foreign firms. A recent example is the acquisition by Multitech-Acer, a successful R.O.C. computer company, of Counterpoint, a Silicon Valley computer company. While the July, 1987 liberalization has opened up new investment opportunities, it has burdened the regulatory scheme for two-way direct investment by adding a new layer of regulations.

The loosening of foreign exchange control also has important implications for two-way portfolio investment. Although foreign investors are still confined to indirect investment by means of R.O.C. securities investment trust funds, there has been a growing movement favoring direct foreign participation in the R.O.C. securities market. Under the recent Security Exchange Law amendment, foreign securities firms are permitted under limited circumstances to set up joint-venture local subsidiaries or branches.

Since the foreign exchange liberalization measures allow for too much discretion on the part of the regulatory agencies, a proposal set forth by the R.O.C.'s Council for Economic Planning and Development deserves further consideration. This proposal would revamp the SAFE and establish a new principle of freedom from foreign exchange control as the norm rather than the exception, as was the case with the July, 1987 liberalization.

The R.O.C. government has shown flexibility by recognizing that the loosening of foreign exchange control is central to internationalizing its capital market. Accordingly, it has been less concerned than in the past with maintaining substantial foreign exchange reserves. Continuing flexibility will be instrumental in the R.O.C.'s efforts to play a more important role in the world of international finance.

### *I. Legislation Regarding the Opening of the Securities Exchange Market and the Regulation of the Capital Market*

The industrial policy of the R.O.C. government emphasizes rapid development and increasing internationalization of Taiwan's economy, and thus, there is an ever-increasing need for a modern and efficient capital market. To this end, the government has taken measures to encourage companies to go public to promote the over-the-counter market. Similarly, the role of financial intermediaries has been strengthened to promote the introduction of advanced methodology of securities analysis and financial services. For instance, the government has approved the establishment of securities investment advisory companies and foreign-invested financial consulting companies in Tai-

wan. In an effort to internationalize the R.O.C. securities market, the government has also permitted the establishment of international and domestic securities trust funds.

As enacted in January, 1988, the amendment to the Security Exchange Law (SEL) is a major overhaul of R.O.C. securities regulation aimed at internationalizing and modernizing the capital market. It also attempts to strengthen enforcement of the SEL. The original legislation was patterned after U.S. securities law, and the amendment reflects further American influence.

### 1. Disclosure and Reporting Requirements and Enforcement Provisions

The first change brought about by the amendment was the simplification of the review system for stock issues. In what is considered to be a shift from a merit review system to a disclosure system, only reporting will be necessary. The public must subscribe to ten percent of each new stock issue by publicly listed companies, and existing shareholders no longer possess an absolute preemptive subscription right without a dilution of their ownership.

For the purpose of preserving the integrity of the market, the 1988 amendment has strengthened the enforcement provisions of the SEL. For example, the new legislation has more stringent reporting and public disclosure requirements.

### 2. Deregulation of Securities Industry

As far as foreign investment is concerned, the most significant change wrought by the SEL amendment is the trend toward deregulation of the securities industry. The amendment gives foreign securities firms access to the R.O.C. securities market for the first time. It also allows for the establishment of "integrated securities houses" (ISH), which are firms licensed to engage in underwriting, dealing, and brokerage operations simultaneously. Finally, in May, 1988 the SEC began to grant underwriter, broker, and dealer licenses to local firms, which had previously been suspended.

Foreign participation in the R.O.C. securities market is available through one of the following means: 1) a branch operation set up by a foreign securities firm; 2) a securities operation established by a foreign bank's R.O.C. branch which qualifies as a financial institution; or 3) a joint venture securities operation set up by a foreign or overseas Chinese investor in conjunction with R.O.C. investors. The Establishment Criteria give the SEC the discretionary authority to restrict the number and business scope of foreign securities firms or foreign banks'

R.O.C. branches seeking to set up local operations. A foreign securities firm and a foreign bank's R.O.C. branch are subject to the same requirements, except that the latter must select from one of five specifically enumerated securities operations.

### 3. Further Internationalization of the Market

The July, 1987 foreign exchange deregulation has further opened the way for R.O.C. individuals and companies to invest in foreign securities. At present, such access is afforded either through the marketing activity of SICE (security investment consulting enterprise) companies or the foreign exchange investment trusts offered by the trust departments of the five government-owned banks. While the present scheme is limited to portfolio investment in a trust fund with a pool of underlying securities, new alternatives are being proposed to further internationalize the market.

As a preliminary step toward the ultimate internationalization of the R.O.C. securities market, local companies should consider beginning to float securities abroad. A possible first step would be the offering of bonds. Such a step could enhance the name recognition of major R.O.C. companies. The feasibility of such direct foreign investment in the R.O.C. market, which is still impossible except for foreign-owned SEC-licensed dealers, depends on the Central Bank of China's foreign exchange control policy.

Some form of internationalization is already occurring with the cross-border "mergers and acquisitions" of listed companies. A relatively recent example is the acquisition by Nissan Motors (Japan) of twenty-five percent of the shares of Yue Loong Motors, an R.O.C. automobile manufacturer. Foreign securities firms have recognized the potential in this developing area and have begun to set up financial consulting companies offering corporate financial and general investment advice. It has also become "fashionable" to invest in a fast-growing company before it becomes listed.

### 4. Proposals for Legislative Reform

In addition to the overregulation of the capital market in Taiwan, the present legal infrastructure lacks the flexibility to create an efficient market. Certain changes and initiatives need to be made if the R.O.C. is to further develop its securities market.

Although the SEL authorizes the establishment of securities investment trusts, the R.O.C. has thus far failed to draft a comprehensive trust law. With the liberalization of securities regulation brought

about by the SEL amendment, the government should begin to draft a trust law at the earliest possible date.

Restrictions under the Company Law provide a glaring example of overregulation by the government. One provision places an investment ceiling of forty percent of its own paid-in capital on a company investing in another company (investment companies excepted). This restriction effectively prevents a company from diversifying its risk, becoming a conglomerate, or forming joint ventures. Other examples of counterproductive Company Law provisions are the prohibition against a company repurchasing its own common shares and the one-year restriction on share transfers by promoters. In order to encourage legitimate corporate transactions, I believe that these unnecessarily restrictive laws should be revamped.

Further opening and liberalization of capital markets would provide tremendous opportunities for a wide range of financial services to channel the abundant funds in Taiwan toward a wide selection of investment opportunities. For this reason, investment bankers and financial institutions specializing in many different fields are now discovering that Taiwan provides tremendous opportunities for them now and in the future.

### *J. Banking Law and Regulations*

Over the years, the development of the R.O.C.'s financial sector has received less attention than the development of the manufacturing sector. The financial sector's disproportionate growth has generated a greater demand for a higher quality and greater quantity of financial services. As a result, the government has made certain revisions to the Banking Law. Key provisions include the contemplation of electronic banking transactions and strengthened supervision of banks and trust and investment companies. In order to maintain the stability of the financial sector and to protect the interests of depositors, the government has also introduced a deposit insurance system.

The restructuring of the financial services industry in such countries as the United States indicates that unnecessary separation of the commercial and investment aspects of banking has an adverse effect upon the creation of innovative financial services and products. The drastic improvement in the standard of living and the recent consumerism in Taiwan indicate that investors and depositors will eventually demand one-stop financial services. They may well desire to have a bank account which pays money market rates, which can be liquidated instantly and converted into securities investments. By the same token, private and public companies (and government-owned enter-

prises) may wish to have their bank advise them on their securities investments and corporate finance in general, for a fee. In addition, to further internationalize and liberalize the R.O.C. economy, the government should grant more banking powers to foreign banks so that they can introduce their respective expertise in such segments of the R.O.C. financial market. Revisions of the Banking Law and relevant regulations again will be necessary to achieve this goal.

The new legislation seeks to privatize financial institutions and expand the financial market to allow more players. Thus, the promulgation of the new law and regulations should present abundant opportunities to American institutions.

#### K. *Establishment of Multinational Corporations and Creation of Holding Companies*

The establishment of a multinational corporation has proven to be an effective mechanism for a company wishing to expand its business operations internationally. However, it is difficult for any R.O.C. firm to establish a multinational corporation under the existing legal framework. Apart from the lack of government encouragement, the R.O.C. Company Law does not allow an R.O.C. company to invest in another company in an amount exceeding forty percent of its own paid-in capital. In view of the need to establish consolidated management on a local basis, a legal framework which permits the creation of holding companies must be established. In this regard, in addition to the amendment of the relevant provisions in the Company Law, foreign exchange control legislation and tax legislation must be amended accordingly.

#### L. *Legislation Regarding Investment Abroad*

A good number of developing nations have expressed their willingness to accept investments and technical assistance from the R.O.C. Even several developed nations have expressed the same desire in recent years. Notable examples include several States of the United States of America (including Georgia and Texas) that, through trade delegations, have invited R.O.C. firms to invest in their respective States. A number of R.O.C. companies have already accepted such offers. Notable examples include Formosa Plastics Corporation, Tatung Company, and Sampo Corporation. Many R.O.C. companies have also invested in Southeast Asian countries and other areas of the world.

Although this fact is not well-publicized, many developing countries desire technical assistance and investment from the R.O.C. Dur-

ing the past two decades, the R.O.C. has demonstrated an ability to achieve rapid economic development, the paramount goal of many developing nations today. In the course of its own development, R.O.C. government-owned as well as privately-owned industries have accumulated valuable experience, have developed know-how and technological skills well-g geared to a developing economy, and have trained tens of thousands of engineers, middle-level managers, skilled workers, foremen, and professionals, all of whom have been deeply involved in the R.O.C.'s economic growth. Given Taiwan's limited resources, the time is now ripe for both the government and private sectors to explore business opportunities for R.O.C. industries abroad.

In the next decade, it is possible that much of the existing legislation limiting investment by R.O.C. industries abroad will be amended and new legislation will be promulgated. Recently, there has been some major liberalization in this regard. For example:

1. In July, 1987, a restriction governing the outward remittance of foreign currency by individuals and companies was raised from \$5000 (U.S.) to \$5 million (U.S.) annually.

2. As of March, 1989, government approval is not required for foreign investments by Taiwanese enterprises in amounts below \$1 million (U.S.). For investments in amounts between \$1 million and \$5 million (U.S.), approval is required, but is usually granted within thirty days. The approval process was formerly quite time-consuming. Also, the restrictions regarding the total amount of paid-in capital that a company must have in order to invest overseas and the debt-to-assets ratio ceiling were abolished.

Local industries need government approval of investment abroad in order to obtain government foreign exchange settlements. Such settlements are obtained by submitting N.T. Dollars to make the investment abroad and to include the overseas assets in the book of the parent company to enhance its financial strength and value of its stock.

Other issues in this area that deserve legislative attention include:

1. Provision of adequate incentives for local investors to register their foreign investments by filing an official application with the government for investment abroad.

2. Provision of a low-cost premium investment guaranty against non-commercial risks for investment abroad.

3. Provision of incentives for local industries to license their technology abroad.

4. Provision of incentives for the inward remittance of dividends accumulated from investment abroad.

5. Simplification of application procedures, thereby providing investing enterprises with maximum flexibility in conducting investment activities.

6. Relaxation of the restrictions for qualification as a foreign investment project and the eligibility requirements for invested-in industries.

7. Provision of further tax incentives and other related assistance.

Because it is inevitable that, during the next decade, R.O.C. industries will expand business operations by investing abroad, an entirely new mentality must be adopted by government officials as well as business executives. The same challenge was previously faced by the Japanese and is currently faced by the business communities in Singapore and Hong Kong.

Facilitating the establishment of multinational corporations and holding companies and encouraging investment abroad will encourage investment by Taiwanese companies on a worldwide basis. Increased foreign investment by Taiwanese companies will certainly provide tremendous opportunities for U.S. businesses who are seeking joint venture partners and buyers of companies and other assets.

### *M. Trade Law and Trade Policies*

With the growing protectionism in a number of the marketplaces for Taiwan exports, the substantial appreciation of the New Taiwan Dollar, the growing need for environmental protection in Taiwan, the somewhat common labor unrest, and the keen competition from the other newly-industrialized Southeast Asian countries, Taiwan is under domestic and foreign pressure to establish a trading system which is compatible with world trends. After at least four years of deliberation, the administrative branch of the government is now very close to completing a draft Trade Act for submission to the legislature during its next session. The latest working draft of the R.O.C. Trade Act sets forth free trade, fair trade, and principles of reciprocity as the three guidelines for Taiwan's trade policy in the years to come. Some of the key features of the latest draft are as follows:

1. The Executive Branch (Executive Yuan) will retain considerable power in enforcing the policy guidelines regarding prohibition or control of trade between Taiwan and certain specific countries or areas. However, the Ministry of Economic Affairs may impose temporary measures to prohibit or control trade with specific nations or



areas, or to prohibit the export or import of specific commodities on certain limited grounds. Based on the latest draft of the R.O.C. Trade Act, the grounds for prohibition or control are limited to (i) acts of God, civil disturbances, or war; (ii) a severe shortage in domestic and international markets of a specific commodity, or a violent fluctuation in the price of a specific commodity; (iii) obvious trade imbalances between Taiwan and particular trading partners; (iv) requirements of international treaties or agreements or for reasons of international cooperation; and (v) the adoption of restrictive measures against Taiwan exports or other unfair treatment by other nations.

Similarly, in order to enhance the concept of free trade, only under limited circumstances (e.g., compliance with international treaties or trade agreements, national security, cultural, sanitation, environmental, and ecological reasons or policy requirements) can restrictions be imposed on exports or imports.

2. Another significant aspect of the draft Trade Act is that the authority of the Board of Foreign Trade will be greatly decentralized. Administrative functions, such as the issuing of export-import licenses, administration of quotas, customs clearance, and other matters pertinent to the importation and exportation of goods can be delegated to financial institutions, trade associations, or other designated institutions.

3. In order to eliminate the illegal practice whereby manufacturers traded or obtained commissions from their government-allotted quotas instead of applying the quotas for their own manufacturing business, the draft Trade Act states that quotas cannot be traded, used as collateral, or transferred.

4. Another significant feature of the draft Trade Act is its explicit provision to protect domestic and foreign intellectual property rights, including trademark, patent and copyright, and the maintenance of fair trade, as well as good faith practices, in conducting transactions.

5. The draft Trade Act also addresses the prevention of domestic industries from injury by imported goods. Basically, the draft Trade Act gives industry associations the right to apply for remedies if certain imported goods have drastically increased in volume and threaten the survival of a domestic industry.

6. Another important feature of the draft Trade Act imposes legal responsibility on any person who obtains proprietary information from another during the ordinary course of business to keep such information confidential.

7. The suggested penalties for violation include imposition of monetary fines, revocation of trade licenses, temporary cancellation of

the violator's right to export and import, and imprisonment for up to two years.

For many years, the trading system of Taiwan has been established through administrative decree promulgated by government agencies such as the Board of Foreign Trade. The Trade Act is the first attempt to establish a trading system through legislation. Due to changing domestic and world economic conditions, the emphasis in Taiwan is no longer on encouraging exports and earning foreign exchange. Rather, the emphasis is on establishing a sound trading system that will enhance fair and liberal trade practices, protection of intellectual and proprietary rights, the principle of reciprocity between trading partners, and protection of local industries' fundamental right to survival. Most importantly, the emphasis is on incorporating the Taiwanese trading system into the world trading system, and on recognizing the rules of trade that have been adopted by the international community.

## V. CONCLUSION

1988 marked the beginning of a period of change in the R.O.C. While the manufacturing of labor-intensive and low-value-added products is gradually moving away from Taiwan, manufacturing of capital-intensive and high-value-added products is beginning to move into the country. After years of concentrated effort to encourage exports, the demands of the now-affluent people for better quality of life has sparked rapid growth of the local consumer market for both domestic and imported products. The rules of the game must be changed to accommodate environmental concerns and labor movements. As a result of an abundant foreign exchange reserve, outward investment from Taiwan will be increased dramatically in order to fulfill a wide range of business objectives.

In recognition of the changing needs of its economy, people, and social environment, the R.O.C. government is under pressure to re-evaluate its policy and laws to cater to future developments. In 1989 and beyond, we are likely to see amendments made to the legislation regarding environmental protection, labor, banking, and taxation. There will be new legislation in the areas of unfair competition, trust, investment abroad, and the establishment of multinational corporations. There also will be further liberalization and internationalization of the capital market and securities market. In the wake of these changes, only the sky will be the limit for new business opportunities. Constant review and amendment of laws and regulations will become

a necessity in order to accommodate the dynamic evolution of the economy of the R.O.C.